COMPANY LAW

Revision Kit

Acknowledgment

We gratefully acknowledge permission to quote from the past examination papers of the following bodies: **Kenya Accountants and Secretaries National Examination Board (KASNEB); Chartered Institute of Management Accountants (CIMA); Association of Chartered Certified Accountants (ACCA).**

We would also like to extend our sincere gratitude and deep appreciation to **Mr. Jacob Gakeri** for giving his time, expertise and valuable contribution, which were an integral part in the initial development of this Revision Kit. He holds the following academic honours, **LLM (1st Class)**, **LLB**, **Diploma in Law (K.S.L), CPS (K)**, **and is also an advocate of the High Courts of Kenya and a Member of the Law Society of Kenya among others**. He is a seniorlecturer at Strathmore University, School of Accountancy, Bachelor of Commerce (BCOM) and Bachelor of Information Technology (BBIT).

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Part I: Introduction

"Revision is the process by which you remind yourself of the material you have studied during your course, clarify any problem areas and bring your knowledge to a state where you can retrieve it and present it in a way that will satisfy the examiners."

The paragraph herein- above captures the essence of revision. It is implicit that revision is nothing short of "fine tuning" the knowledge acquired in the course or making it more digestible for usage in an examination.

Revision is an integral part of examination preparation. It is not a substitute for a sustained preparation earlier in the course. The syllabus for or Company Law is expansive and cannot be "hastily crammed" for purposes of the examination. A deliberate attempt must be made to study and appreciate the basic principles and concepts and their application. Revision must therefore be seen as a final stage in the study of any topic. Its utility is therefore undermined if earlier stages have not been completed.

As an integral part of the course revision must be commenced shortly after the commencement of the course. Initially this could take the form of a review of what has been covered in a week or two not a month as this may be inordinately long. Ideally, revision is necessary after every topic. Coverage of the topics must be incisive and indiscriminate.

The main purpose of this booklet is to help candidates preparing for the KASNEB examination to make the best use of the last few weeks before the examination.

The booklet consists of three parts: part one consists of an introduction, the various revision and examination techniques. Part two consist of eight sets of past examination questions and answers. The object of this part is to demonstrate to the candidate the actual information required in responding to examination questions, the detail required and the variety of questions expected in the examination. This section demonstrates beyond question that a serious candidate must familiarize himself with the entire syllabus. Every topic ought to be accorded the requisite attention.

Part three consists of three sets of examination questions and answers. The twenty-four questions illustrate to the candidate the type of questions likely to appear in future examination papers. The purpose of this part is to expose the candidate to additional questions for better coverage of the syllabus and preparation.

Revision Techniques

I dare state at the outset that I am not an expert in revision techniques. However, it is quite inorder to make a few suggestions. A candidates revision strategy should consist of two facets namely:

- Looking back to the work already covered.
- Looking forward to the examination.

Revision must not be boring. This demands application of numerous techniques at different times. At this level it is assumed that a candidate has tested a number of techniques and should adopt the most effective one(s). The basic revision techniques include:

- Highlighting key points and cases in lecture notes, textbooks and other materials used in the course.
- Using key terms, words or phrases so as to remember the essential concepts and cases in a topic.
- Reducing lecture notes and other materials to key ideas definitions and case law and committing them to memory.
- Practicing as many examination standard questions as possible. This is best accomplished by working to time under examination conditions if possible avoiding the temptation to look at the answer before completion.
- Practicing the art of writing at speed. This is something every Law candidate need.
- In the course of revision candidates are encouraged to think of situations and circumstances which exemplify concepts and ideas likely to arise in the examination. This enriches a candidates capacity to analyse problem related questions in the real examination.
- Candidates are encouraged to practice planning answers and then compare their notes with the answers provided. This is additional practice but must not substitute writing full answers.

Approach to Examinations

ANSWERING QUESTIONS

As observed elsewhere:

> *"Examinations are formidable even to the best prepared for the greatest fool may ask more than the wisest man can answer."*

- A candidate must spend the first ten minutes of the examination reading the question paper. This enables the candidate to discriminate the questions. Generally, the division of time should be proportional to the marks on offer.
- Candidates are advised to resist the temptation to spend too much time on any question. If a question has more than one part a candidate must complete each part.
- On every question the first marks are the easiest to gain and even if matters go wrong with the timing a candidate will probably gain some marks by making a start.
- A candidate is free to answer questions in any order of preference. Some candidates start with their best questions.
- It is generally agreed that the most frequent reason for failure in examinations apart from basic lack of knowledge is the candidates unwillingness to answer the question asked. Candidates often include every scrap of knowledge they have in a topic just in case it is relevant.

A candidate must stick to the question and tailor the answer to the question.

- A candidate must be wary of questions which appear to be almost identical to those practiced during revision. They probably are not!. Seriousness demands that a candidate read a question at least twice before it is responded to. Key words on the question paper must be underlined to enable one focus on the question.
- If a candidate is unable to decipher what a question is asking, assumptions may be made. Such assumptions must be made on sound principles i.e. they must be reasonable.

PRESENTATION

- It is a good idea to make a rough plan of the answer before writing commences. This may be done in the answer booklet and then crossed out neatly to guide the examiner.
- If a question is divided into separate sub-sections, each of them must be responded to separately and numbered or lettered as in the question paper.
- Although a candidates handwriting is not marked, it must be legible. This enables the examiner identify the points made.
- To distinguish concepts and institutions candidates are required to give not only the differences in definition but also in legal effect. Effort must be made to give reasons and authorities as well as illustrations even though the examiner does not expressly ask for them.
- Before responding to an essay question candidates are advised to jot down the authorities. This enables a candidate to capture ideas likely to elude him when writing commences. Essay questions must have a clear structure, a brief introduction, the main section and a conclusion. It is advisable to break up essays into paragraphs with sub-headings underlined.
- Candidates are advised to be concise. It is better to write a little about different points than a great deal about one or two points. As much details as possible must be given.

- The examiner will be looking for evidence that a candidate has understood the syllabus and can apply his knowledge in new situations. A candidate is therefore expected to give opinion and make judgments. These should be based on reasoned and logical arguments.

An ordinary examination consists of three types of questions namely:

1) Single statement and a problem.
2) Structured
3) Problem (s)

A single question may be a combination of all of them though this is a rare occurrence.

In most instances, if part (a) or one of a question is a single statement part (b) or two is a problem. The object of such a question is to test a candidates ability to recall and apply legal principles. Almost invariably the problem is based on the same subject which makes it digestible. However its is not unusual for the problem to relate to a separate subject. It is the candidates cardinal responsibility to discern the legal issues involved. Care must be taken to ascertain the legal principles correctly.

If the entire question is a problem or a set of problems, extra care must be exercised to conlextralise the principles and the judicial or statutory authority applicable. Brevity must be avoided.

1) SINGLE STATEMENT AND PROBLEM QUESTION

Such questions are generally bookwork and are based on the premise that the candidate is familiar with the topic concerned. The question must be responded to comprehensively but must be avoided if the candidate is unsure of their purport.

For example question 2 of December 2000 reads:

a) Outline the rules that govern pre-incorporation contracts cite relevant case-law to support your answer.
b) Kioko an under Secretary in the Ministry of Viwandani was entrusted with the responsibility of selling the ministry bonded motor vehicles. He invited bids from members of the public to buy two lorries. He also bid through a nominee, Mwangangi, his brother. Subsequently, Kioko sold the lorries to Mwangangi at Ksh. 80,000 each, he then formed a company by the name Kima Company Limited and instructed Mwangangi to sell the lorries to the company at Kshs. 350,000 each. A prospectus was issued to the public to subscribe for shares in Kima Company Limited. It gave Mwangangi as the vendor of the lorries and did not disclose the profit made by Kioko. Musembi, a shareholder of the company has learnt of the sale of the lorries to the company and the profit Kioko made and seeks your advise on the company"s right in respect of the same. Advise Musembi.

a) A candidate familiar with the Law relating to Pre-incorporation contracts should have no problem in responding to the question. The answer to the question consists of an introduction highlighting what a Pre-incorporation contract is and its legal status. The main part consists of the rules:

- A Pre-incorporation contract is a contract entered into by a person purporting to act on behalf of a company before its incorporation.

- Contracts of this nature are entered into by promoters.

- As a general rule a Pre-incorporation contract is unenforceable by or against the company after incorporation.

Rules

- At common law a person who purports to contract as an agent in circumstances in which he has no principal existing at the time is personally liable on the contract. This is necessary to give effect to the transaction. It was so held in Kelner V. Baxter (1866).
- Under Section 16(2) of the Companies Act a company comes into existence on the date of incorporation mentioned in the certificate of incorporation. Before that date, the company has no legal existence and cannot have agents. It was so held in Kelner V.Baxter (1866).
- At common law, a contract purportedly entered into with a non-existent person is void. It was so held in Newborne V. Sensolid (Great Britain) Ltd (1954). This is because a contract cannot be entered into by one person.
- A company cannot after incorporation purport to ratify a Pre-incorporation contract. Any purported ratification has no legal effect. It was so held in Price V. Kelsal (1957) as well as in Natal land Co. Ltd V. Pauline Colliery Syndicate. This is because the company had no capacity to enter into the transaction when the promoter did so.
- At common law the mere adoption or confirmation by directors of a contract purportedly entered into on behalf of the company before it is incorporated creates no contractual relationship between the company and the other partly. It was so held in North Sydney Investments and Another V. Higgins and Another.
- A Pre-incorporation contract is enforceable by or against the company if after incorporation the company has entered into a new contract similar to the previous agreement. It was so held in Howard V. Patent Ivory co. Ltd. The new contract may be express or implied from the acts of the company when incorporated. It was so held in Price V. Kelsal. In Mawagola Farmers and Growers Co. Ltd V. Kayanja and others. Where the appellant company entered into a similar agreement after incorporation, it was held that the Pre-incorporation Contract was enforceable.

Problem questions are intended to test a candidates ability to relate legal principles to specific situations. It also tests the candidates ability to recall judicial and statutory authority. Most of the problems are based on cases or scenarios the candidate has come across in the course of preparation for the examination. The legal issues are in most instances easily discernible. As is the case in our problem. Responding to a problem question demands an elucidation of four issues namely:

- The principle of law being examined
- The factual situation represented i.e. the legal problem at hand.
- The position in law i.e. the candidates advise or whether the transaction is valid or not.
- The legal basis of the position taken. This is the justification of the conclusion arrived at. It is the point at which case law or statutory provision is used.

b) This problem is based on breach of judiciary duties by promoters and the remedies available to the company. As judiciaries promoters are bound to avoid conflict of interest by disclosing any personal interest in contracts made before incorporation. The disclosure must be made either to an independent board of directors or to all members in the prospectus.

In this case Kioko put himself in a position of conflict of interest but did not disclose, he is therefore guilty of breach of duty to the company in formation and the company has certain remedies against Kioko.

My advise to Musembi respecting the rights of the company is that the company is entitled to:-

- Rescind the contract of sale of the lorries. As was the case in Emille Evlanger V.New Sombrero Phosphate
- Sue Kioko for the recovery of the profit made or for an account. The suit is an action for money had and received. As was the case in Gluckstein V. Barnes (1900)
- Sue Kioko in damages for breach of his judiciary duties. As the case in re Leedsand Harnley Theatres of Variety Ltd.

My advise is based on the judicial autority cited.

A second illustration is question 8 of June 2002, which reads:

a) Outline the information that is required when registering a charge.

b) In July 2001, Muungano Limited obtained an overdraft from a bank upon deposit of title deeds and execution of a Memorandum of Charge. The Memorandum was executed in due form by the company but left undated. The overdraft continued and subsequently the manager of the bank filled in the date in the Memorandum as 10th January 2002. The Memorandum was then registered with the Registrar of Companies on 31st January 2002 and the Registrars certificate to that effect was duly issued.

Discuss the validity of the charge.

a)

- Date and description of the instrument creating or evidencing the charge.
- Amount secured by the mortgage or charge.
- A short description of the property mortgaged or charged.
- Names, postal addresses and descriptions of the mortgages or persons entitled to the charge.
- Names of the chargor or mortgagor.
- Amount or rate of commission allowance or discount, if any, paid or made either directly or indirectly by the company to any person in consideration of his subscribing or agreeing to subscribe.

b) This problem is based on the effect of registration of a charge in accordance with the provisions if the Companies Act.

Under Section 99 of the Act upon registration of the particulars of a charge the registrar issues a certificate of registration which is conclusive evidence that the provisions of the Companies Act relating to the preparation and registration of charges have been complied with (inre Mechanisations Ltd)

- In this case, the Memorandum of charge was duly executed by the Company and registered thereafter and a certificate of registration issued by the registrar.
- The charge herein is valid in all respects since its registration and issuance of the certificate cured all its defects. It is therefore enforceable against the company.

- This legal position is consistent with the decision in re Nye Ltd (1974) whose facts were substantially similar to those in this case. The principle herein was also applied in National Provincial and Union Bank of England V. Charnely

2) STRUCTURED QUESTIONS

This is the most common examination technique and a candidate must be prepared for questions of this nature. Such questions may take the form of three or four distinct questions as a single questions or a single statement question with different parts. For example question 8 December 2000 reads:-

a) What are the different types of Liquidation and who may commence proceedings?
b) How does a creditor demonstrate that the company is unable to pay its debts?
c) What courses are open to a secured creditor in Liquidation?

a) Types of winding up Commencement

i) Compulsory: -
- The company
- Creditors
- Contributory
- Attorney General
- Official Receiver
- Shareholder other than contributory

ii) Members Voluntary winding up: - Members

iii) Creditors Voluntary winding up: - Members, Creditors

iv) Winding up subject to the supervision of the court: - Members, Creditors

b) Under Section 220 of the Companies Act a company is deemed insolvent or unable to pay its debts if it is proved that:

- A debt of Kenya shillings 1000 or more remain paid 3 weeks after demand thereof.
- Execution of other process issued in favour of a creditor is returned unsatisfied in whole or in part.
- Having regard to the company"s contingent and prospective liabilities, it is unable to pay its debts.

c) A secured creditor is one who holds some security for a debt due to him from the company such as a mortgage, charge or lien. Such a creditor has certain courses: He may:

- Rely on his security and not prove at all.
- Surrender his security and prove as an unsecured creditor for the whole debt.
- Realize his security and prove as an unsecured creditor for any balance due to him after deducting the amount realized.
- Value his security and prove as an unsecured creditor for any balance due after deducting the value of the security.

Syllabus

CPA PART II

OBJECTIVE

To equip the candidate with knowledge on the law relating to the formation, registration and operations of corporations.

11.0 SPECIFIC OBJECTIVES

A candidate who passes this subject should be able to:

- Appreciate the legal principles relating to the nature and registration of companies
- Describe the various classes of companies
- Define the nature and contents of the Memorandum and Articles of Association
- Appreciate the legal principles that govern the raising of capital for companies
- Understand the general principles relating to accounts, auditors and payment of dividends.

CONTENT

12.1 Nature and Classification of Registered Companies

- Definition of a company
- Procedure for registration of a company
- Certificate of Incorporation
- Effect of Registration
- Registered companies and partnerships contrasted
- Companies limited by shares
- Companies limited by guarantee
- Unlimited companies
- Public and Private companies
- Holding and subsidiary companies

12.2 Memorandum and Articles of Association and Promoters of Companies

- Clauses in the memorandum of association (name, registered office, objects, liability, share capital and other clauses)
- Alteration of the memorandum of association
- Form of articles
- Adoption and application of Table A
- Effect of the registration of the articles
- Alteration of articles
- Promoters: meaning of the term "Promoter"; position and duties of promoters; payment for promotion services; pre-incorporation contracts

12.3 Share Capital

- Meaning of "capital"
- Types of capital
- Raising of share capital
- Public offer of shares (Direct invitation, offers for sale, placings)
- Misrepresentation and omissions in listing particulars or prospectus
- Commissions and discounts
- Underwriting and brokerage
- Allotment of shares
- Commencement of business
- Issue of shares at Discount and at Premium
- Share Premium Account and issue other than for cash
- Alteration of share capital
- Maintenance and reduction of capital
- The acquisition and redemption by a company of its own shares: general rules relating to acquisitions; redemption and purchases of shares; redemption or purchase of shares out of capital
- Financial assistance by a company for purchase of its own shares: liability of the company; exceptions to the rule; legal significance to the lender

12.4 Membership Shares and Majority Rule

- Ways of becoming a member
- Who can become a member
- Register of members
- Disclosure of substantial holdings
- Classes of shares
- Share certificate
- Transfer and transmission of shares
- Mortgage of shares
- Calls and liens on shares
- Forfeiture and surrender of shares
- Share warrant
- Valuation of shares
- Majority Rule and Minority Protection: The Rule in Foss–vs–Harbottle; Protection of minority; Winding up by the court on the "just and equitable" ground; Investigations and powers to obtain information;
- Investor protection: Insider dealing (Capital Markets Authority Act Cap.485 A)
- Central Depository System

12.5 Meetings

- Kinds of general meetings
- Notices of meetings
- Proceedings at meetings
- Proxies
- Resolutions

12.6 Directors, Secretaries and Auditors

- Number and appointment of directors
- Persons who cannot become directors
- Share qualification of directors
- Register of directors and secretaries
- Particulars of directors and Secretaries
- Disclosure of director"s shareholdings
- Directors" service contracts
- Powers and duties of directors
- Vacation of office by directors
- Remuneration of directors
- Loans to directors
- Compensation to director for loss of office
- Directors and insolvency
- Transaction involving directors; the rule in Turquand"s case
- Directors" powers and shareholders" control
- Qualification: Certified Public Secretaries Act (Cap. 534)
- Appointment: Companies Act
- Powers and duties
- 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

12.7 Dividends and Debentures

- Nature of a dividend
- Profits available for dividends
- The realised profits test
- Payment of dividends
- Creation and capitalisation of Reserves
- Debentures: A company"s power to borrow money; Debenture and debenture stock; Issue of a debenture; Registered debentures; Bearer redeemable and perpetual debentures; Charges securing debentures; Registration of charges; Remedies of debenture holders

12.8 Corporate Insolvency

i) Winding up by Court

- Grounds for winding up by Court
- Petition of a winding up order
- Consequences of a winding up order
- Proceedings after a winding up order
- The liquidator as office holder: Powers and duties

ii) Voluntary winding up

- Members" voluntary winding up
- Creditors" voluntary winding up
- Consequences of voluntary winding up
- Distribution of the property of the company in voluntary winding up
- Powers and duties of the Liquidator in a voluntary winding up

- Compulsory liquidation after commencement of voluntary liquidation

iii) Contributories and creditors

- Contributories
- Creditors
- Completion of winding up by the Court

Part II: Revision Questions and Answers

QUESTIONS - PAST PAPERS

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATIONS BOARD

CPA PART II

Pilot Paper
July 2008 **Time Allowed: 3 hours.**

Answer any FIVE questions. **ALL questions carry equal marks.**

QUESTION ONE

In relation to company law:

a) Explain the meaning of the term "Promoter". (4 marks)
b) Discuss the rules that govern pre-incorporation contracts. (6 marks)
c) Describe the common law duties of a Promoter. (10 marks)
(Total: 20 marks)

QUESTION TWO

a) Hopeful, a private limited company has adopted Table A as its Articles of Association. The company now, wishes to alter the Articles of Association.

Outline the procedure to be followed to effect the change (10 marks)

b) Wafula, one of the Directors of Hopeful Co. Ltd is unsure of his duty of care and skill as a director of the company. He seeks your advice on this.
Advise him. (10 marks)
(Total: 20 marks)

QUESTION THREE

a) Explain the Statutory and Common Law Rules that govern raising and maintenance of share capital of a company. (10 marks)

b) Define the term „prospectus" and explain the circumstances under which a company may issue a prospectus. (10 marks)
(Total: 20 marks)

QUESTION FOUR

The rule in *Foss v Harbottle* establishes the principle that where a wrong is done to the company, the proper plaintiff is the company itself. However, where the wrong is done by the company directors, it may be impossible for the company to sue. In such a case, a derivate action may be the only option.

a) Explain what is meant by "derivative action". (10 marks)

b) Describe the conditions that must be satisfied before a derivative suit can be instituted (10 marks)

(Total: 20 marks)

QUESTION FIVE

a) Highlight the requirements to be met before a notice of meeting served on members can be held to be valid. (10 marks)

b) Describe the duties of an Auditor as set out under the Companies Act. (10 marks)

(Total: 20 marks)

QUESTION SIX

a) Distinguish a Fixed Charge from a Floating Charge. (6 marks)

b) The directors of Alumasi Co. Ltd borrowed Shs.20 million from Maendeleo Bank. The Bank was informed that the money was intended to be used to expand the company"s horticultural business. The bank however, did not ask for the company"s Memorandum of Association and lent the money. The money was spent for purposes not intended. These facts have come to light and Maendeleo Bank seeks your advice on whether the bank can successfully recover the money.

Advise the bank. (8 marks)

c) Outline the legal rules that govern the appointment of an Administrative Receiver by a holder of a floating charge. (6 marks)

(Total: 20 marks)

QUESTION SEVEN

a) Describe the circumstance under which a company may be wound up on the ground that it is „just and equitable" to do so. (12 marks)

b) State the legal consequences of a winding up order made against a company. (8 marks)

(Total: 20 marks)

QUESTION EIGHT

a) Detail the statutory provisions governing the investigation into the affairs of a company by the registrar. (12 marks)

b) State the powers of the inspection appointed to investigate the affairs of the company. (4 marks)

c) Explain who is responsible for the expenses incurred while carrying out investigations into the company"s affairs. (4 marks)

(Total: 20 marks)

December 2008. **Time Allowed: 3 hours**

Answer any FIVE questions. **ALL questions carry equal marks**

QUESTION ONE

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

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

b) What details would you expect them to contain and what other information might you be able to give about these details? (15 marks)

(Total: 20 marks)

QUESTION TWO

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

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

Subsequently, he sold the lorries to Mwangangi, at Sh.80,000 each. Kioko then formed Kima Company Ltd and instructed Mwangangi to sell the lorries to the company at Sh.350,000 each. A prospectus as issued to the public to subscribe for shares to Kima Company Ltd. The prospectus gave Mwangangi as the vendor of the lorries and did not disclose the profit Kioko was making. Musembi, a shareholder of the company has learnt of the sale of the lorries to the company and the profit Kioko made and seeks your advice on the company"s rights in respect of the same.

Advise Musembi. (8 marks)

(Total: 20 marks)

QUESTION THREE

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

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

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

(Total: 20 marks)

QUESTION FOUR

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

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

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

QUESTION FIVE

a) In relation to the provisions of the Companies Act (Cap.486) of the Laws of Kenya, outline general provisions relating to meeting and votes. (10 marks)
b) State the duties of an Auditor of a company. (6 marks)
c) Describe the categories of persons who do not qualify to be appointed auditors of a company. (4 marks)
(Total: 20 marks)

QUESTION SIX

a) Explain the reason why a third part dealing with the company may concern himself with the doctrine of ultra vires. (6 marks)

- The Companies Act (Cap.486) of the Laws of Kenya imposes certain statutory limitations and obligations on directors.

List four of such limitations. (4 marks)

b) Explain the circumstances under which a company may issue bonus shares. (10 marks)
(Total: 20 marks)

QUESTION SEVEN

a) Last six types of company charges that require registration as outlined in the Companies Act (Cap.486) of the Laws of Kenya. (6 marks)

b) Green Bank gave a loan of Sh.3,0000,000 to Maendeleo Company Ltd. The bank took a floating charge over all the company"s movable and immovable property. The company has defaulted on repayment of the loan. However, the administrative receiver appointed by the bank has noticed that the chattels of the company were not registered and Ujenzi Company which is Maendeleo Company"s creditors are claiming the chattels.

Advise the Official Administrative Receiver of his rights over the chattels. (8 marks)

c) Explain the remedies available to an aggrieved debenture holder. (6 marks)
(Total: 20 marks)

QUESTION EIGHT

a) What are the different types of Liquidation and who may commence proceedings? (6 marks)

b) How does a creditor demonstrate that the company is unable to pay its debts? (8 marks)

c) What courses are open to a secured creditor in liquidation? (6 marks)
(Total: 20 marks)

June 2009 **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 indiced 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 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)

December 2009 **Time Allowed: 3 hours**

Answer any FIVE questions **ALL questions carry equal marks**

QUESTION ONE

a) Identify five clauses contained in the Memorandum of Association. (5 marks)

b) To what extent and by what methods may the various clauses in the memorandum of association of a company be altered. (15 marks)

(Total: 20 marks)

QUESTION TWO

a) State and briefly discuss the conditions which must be fulfilled before a company can either issue or redeem shares which are stated to be redeemable. (10 marks)

b) State the requirements of the Companies Act which relate to the company giving financial assistance for purchase of its own shares. What are the consequences of non - compliance with these requirements? (10 marks)

(Total: 20 marks)

QUESTION THREE

Birds Limited has three directors: Peacock, Sparrow and Vulture. Explain the legal implication of each of the following situations:

a) Vulture"s son has recently come of age and vulture wishes to appoint him a director of the company. (4 marks)

b) The company is considering the purchase of a substantial quantity of goods from fly ltd., in which sparrow has a large shareholding through he is not a director peacock and vulture are unaware of sparrow"s interest in fly ltd. (4 marks)

c) Because of adverse publicity about peacock"s private life, vulture and sparrow wish to remove him as a director, since he refuses to resign. (4 marks)

d) In view of the adverse publicity, vulture and sparrow decide to exclude peacock from participation in the company"s affairs. (4 marks)

e) The directors are advised by wise & co., the company"s auditors, that there is no possibility of the company trading at a profit in the foreseeable future and no reasonable prospect of its paying its debts. (4 marks)

(Total: 20 marks)

QUESTION FOUR

Joan has inherited one million shillings from the estate of her late mother. She has decided to invest it in a small private company of which Janet and Jeffrey, her old friends are directors. However, Joan is not sure whether to lend the money to the company secured by a debenture containing a fixed and floating charge or through purchase of ordinary preference shares.

Joan now seeks your advise on the following issues:

a) What is the difference between ordinary and preference shares, and what rights accrue to the holders of each class shares? (8 marks)

b)

i) What is the return on ordinary and preference share capital? (4 marks)

ii) What are the restrictions that may be imposed on her ability to transfer any shares she may purchase in the Company? (8 marks)

(Total: 20 marks)

QUESTION FIVE

a) List four types of registers a company is required to keep and outline the contents of each register stating who can access the register. (12 marks)

b) Highlight the circumstances under which a person may cease to be a member of a company. (8 marks)

(Total: 20 marks)

QUESTION SIX

In relation to corporate insolvency,

a)

i) Explain what is meant by a contributory. (5 marks)

ii) Distinguish between fraudulent and wrongful trading. Against whom may proceedings by brought for breaches of provisions against fraudulent trading and wrongful trading? (10 marks)

b) Highlight the powers of the court on hearing a petition. (5 marks)

(Total: 20 marks)

QUESTION SEVEN

a) Describe the various kinds of resolutions that may be passed at general meetings. State the difference between them and list matters that require such resolutions to be passed before they can have effect. (14 marks)

b) In order to frustrate a threatened take-over bid, the directors of Kesho Ltd. issue to themselves and their nominees sufficient ordinary shares for cash so as to give themselves control of a majority of the shares which give the right to vote at a general meeting.

Mwananchi, a minority shareholder who had hoped to benefit by selling to the bidder, is very annoyed by the action of the directors.

Advise him as to his legal rights. (6 marks)

(Total: 20 marks)

QUESTION EIGHT

a) Dividend is payable only in cash to shareholders out of profits available for distribution. State the rules which determine the extent to which profits arising out of the disposal of fixed assets may be used to pay such dividends. (10 marks)

b) Happy co. Ltd was incorporated in January 2000 with an authorized share capital of 50,000,000 of one shilling per share which is fully issued and fully paid. The original articles of association gave the directors authority to issue the initial authorized share capital.

The directors are proposing to purchase a plot from Mr Karan for KShs.3,000,000 and to finance the purchase by a fresh issue of 2,000,000 shares at one shilling per share to

Mr. Karan. In order to develop the plot they propose to raise further capital by issuing a further 2,000,000 shares of one shilling each. The directors propose that 1,000,000 of the shares should be offered to existing shareholders and 1,000,000 to the general public. The shares to Mr Karan, the existing shareholders and to the general public are to be offered at one shilling and fifty cents each.

Explain the preliminary checks which the directors must make before proceeding with these proposals. State the steps the directors must take to give them effect. (10 marks)

(Total: 20 marks)

June 2010 **Time Allowed: 3 hours**

Answer any FIVE questions **ALL questions carry equal marks**

QUESTION ONE

a) Distinguish between a corporation sole and a corporation aggregate (4 marks)

b) Tim and Tom wish to establish a business jointly. However, they are not sure whether to establish a limited liability company or an unlimited liability company; as they know little about these types of companies.

i) Explain to them the differences between a limited company and an unlimited company. (4 marks)
ii) State the provisions of the Companies Act regarding the re-registration of unlimited company as limited. (6 marks)

c) Outline the documents that are normally kept at the registered office of a company (6 marks)

(Total: 20 marks)

QUESTION TWO

The shares of Promotion Limited, a private company are held by members of three families, that is, the family of Mr. Karanja, Mr. Mutisya and Mr. Otieno.

Mr. Karanja and Mr. Mutisya hold 90% of the company"s shares. However, they feel that, the company is in need of further capital but due to the squabbles among the families, Mr. Otieno is not willing to inject additional funds so long as Mr. Karanja still holds any shares in the company. Further, Mr. Karanja and Mr. Mutisya have reasonable cause to believe and do in fact believe that the family of Mr. Otiengo is running their own business which is competing with that of Promotion Limited. It is known as a fact that Mr. Otieno is obtaining information as a member of Promotion Limited, which he is using to the benefit of his competing business.

To resolve the problems, Mr. Karanja and Mr. Mutisya propose to alter the company"s articles of association by adding two new articles. The first article will enable the shareholders of 90% of the company"s shares to compulsorily acquire the shares of the minority shareholder. The second one will require any shareholder who carries on competing business with company"s business to transfer his shares to the nominee of the directors.

Required:

i) State the restrictions imposed both by common law and statute law upon a company"s power to alter its articles of association. (14 marks)

ii) Discuss the validity of the proposed alteration (6 marks)

(Total: 20 marks)

QUESTION THREE

a) James and Shem proposed to form a company by the name "Micromine Limited". On behalf of the proposed company, Shem entered into contracts to purchase office furniture and stationery.

Required:

i) What are the company"s rights and liabilities under such contracts after incorporation? (6 marks)
ii) What provisions for the protection of Shem are found in such contracts? (4 marks)

b) Discuss the doctrine of ultra vires and state the exceptions to the doctrine, (10 marks)

(Total: 20 marks)

QUESTION FOUR

a) "The capital of may no doubt be diminished by the expenditure upon and reasonably incidental to all the objects specified. A part of it may be lost in carrying on the business operations authorized. Of this, all persons trusting the company are aware and take the risk. But creditors have the right to rely and were intended by the legislature to have the right to rely on the capital remaining undistributed by any expenditure outside these limits or by the return of nay of it to the shareholders".

Per Lord Herchell L.J. in Trevor v Whitworth (1837) 12 App. Cap 409 at 415.

Discuss this statement outlining the circumstances and conditions under which companies may reduce their capital. (14 marks)

b) State what is meant by underwriting commission and distinguish it from brokerage (6 marks)

(Total: 20 marks)

QUESTION FIVE

a) State the circumstances under which a company would be required to maintain an index of the register of members (4 marks)

b) Kazi Bure borrowed Shs.50,000 from Tumaini Bank and deposited his XYZ Supermarket Ltd"s share certificate with a blank transfer as a security. Subsequently he bought goods from the supermarket on credit. The goods were worth Shs.15,000. The articles of association of XYZ Supermarket Ltd claimed a first and paramount lien on its members shares on debts due to the supermarket. However, before the supermarket lien arose the bank gave the supermarket notice of Kazi Bure"s share certificate having been lodged with the bank as a security for the loan. Kazi Bure is unable to pay for the goods he obtained from the supermarket and has also defaulted on the loan. XYZ Supermarket Ltd wants to exercise its lien and the bank wants to exercise its equitable right to have the shares transferred to into its name.

In this situation discuss the rights of

i) The Bank
ii) XYZ Supermarket Ltd

c) Bob and Babs jointly own shares in Powerfoam Ltd. They are seeking your advice regarding their legal position as joint holders of the shares. Advice them. (4 marks)

QUESTION SIX

a) Outline the various matters that require to be sanctioned by members through a special resolution. (10 marks)

b) In a company with a share capital:
   i) What is the members right to appoint a proxy (2 marks)
   ii) What are the rights of the proxy so appointed? (2 marks)

c) Explain the classes of persons who may petition the court for the compulsory winding up of a company. **(Total: 20 marks)**

QUESTION SEVEN

a) Discuss the rules relating to appointment and vacation of office of directors (10 marks)

b) Triple H, Undertaker Austin and Flair are directors of Mieleka Ltd a company regulated by Table A. Fair is the managing director and undertaker is the chairperson of the company. Sometime ago the directors meeting as a board decided to:

i) Lend Triple H Shs.500,000 to purchase a car for his wife Stephane for her personal use;

ii) Advance Shs.500,000 to Austin to cover his expenses on a worldwide (promotional tour on behalf of the company).

Booker T, the company secretary informs you that Stone Cold a shareholder claims that this transaction should have been approved by the members and that he intends to raise the matter during the next general meeting.

Required

i) Advise Booker T which of the transactions need approval by the members in general meeting (4 marks)

ii) What are the consequences of the necessary approval not being obtained? (6 marks)

(Total: 20 marks)

QUESTION EIGHT

a) Outline the information that is required when registering a charge. (8 marks)

b) In July 2001, Muungano Ltd obtained an overdraft from a bank upon deposit of title deeds and the execution of a memorandum of charge the memorandum was executed in due form by the company but left undated. The overdraft continued and subsequently the manager of the bank filled in the date as 10th January 2002. The memorandum was then registered with the registrar of company"s on 31stJanuary 2002and the registrars certificate to that effect was duly issued.

Discuss the validity of the charge (12 marks)

(Total: 20 marks)

NOVEMBER 2010

QUESTION ONE

(a) Explain the statement that "a company is a legal entity quite separate from the persons who constitute it."

(b) Discuss the circumstances under which a corporate veil or incorporation may be lifted.

(c) Angela is employed as a managing director of Eclipse Ltd. The main object of Eclipse Ltd. is to retail hair products. Angela"s contract of employment contains a clause which states that in the event of her leaving the employment of Eclipse Ltd, she would not solicit Eclipse Ltd"s customers for a period of three years.

Angela has resigned from her employment and together with Ellina formed another company Angellina Ltd. whose main objective is to sell hair products.

Angela has given Marie, a salesperson in Angellina Company a list of customers of Eclipse Ltd. to immediately start soliciting the customers for Angellina Company Ltd.

Eclipse Ltd. has learnt of these facts and intends to sue Angela, Ellina and Angellina Company Ltd.

Advise Eclipse Ltd.

QUESTION TWO

(a) (i) Explain the Rule in Royal British Bank V. Turquand.

(ii) Enumerate the various exceptions to the rule in (i) above.

(b) The articles of Shirika Company Ltd. provided that the directors had power to determine who should be entitled to sign contracts and documents of behalf of the company.

One director Chapu Chapu, describing himself as the Chairman and without having been so authorized, executed and gave guarantee to Chafua in the name of the company. Shirika Company have found out about the guarantee executed and have refused to honour it as demanded by Chafua.

Explain whether Shirika Company Ltd. is liable with regard to the demands by Chafua.

QUESTION THREE

(a) Explain the concept of "capital of limited company" as used in company law.

(b) Enumerate the various exceptions to the rule in (i) above.

(c) The Companies Act restricts a company from issuing shares at a discount. Identify and explain the restrictions.

QUESTION FOUR

(a) Explain the proprietary rights of a member in a company.

(b) Rita applied for 2,000 shares in Bidii Yako Company Ltd. following her application, no allotment at the time was made. Later on without her application, 2,000 shares were transferred to her and her name placed in the register of members.

Rita knowing that her name was in the register of members took no steps to have it rectified. Later on, the company collapsed. Rita was called upon to pay up on her shares and she has declined to do so arguing that she was not a member of Bidii Yako Company Ltd. She seeks your advice on the matter. Advise Rita.

QUESTION FIVE

(a) A part from the appointment of a receiver, four other events will cause a floating charge to crystallize. Describe these four events.

(b) What happens to a floating charge when it crystallizes?

(c) A person who lends to the security of a specific mortgage of a company"s property is always entitled to repayment on his loan out of the proceeds of the sale of the mortgaged property. This is done before any other creditor receives any payment. A person who takes a floating charge is not in such a secure position.

Why is the holder of a floating charge in a less favourable position?

QUESTION SIX

(a) Identify the different types of meetings that may be held by police limited companies.

(b) State the Rule in Sharp-vs-Dawes and explain the exceptions to this rule?

(c) (i)What is a special notice?

(ii) Give the circumstances under which a special notice would be required with respect to company meetings.

QUESTION SEVEN

(a) Explain the circumstances under which directors of a company will be held personally liable to acts committed on behalf of the company.

(b) Rush, Fast and Speed are directors of Modern Technology Company Ltd. The company was formed with the main object of computer training. However, due to the power rationing, the company business has fallen below the expected productivity and is threatened with closure. In order to keep afloat, the three directors approached Money Bank Ltd for an overdraft of Sh. 2 million to establish an off-licence bar and restaurant within the city centre. The credit manager asked the company to provide its copy of the memorandum of association and the company complied. Modern Technology was then given the overdraft. However, it has run into financial difficulties and is unable to repay the loan.

Can the bank successfully sue for recovery of the loan?

QUESTION EIGHT

(a) Enumerate the circumstances under which the court may order the winding up of a company on a just and equitable ground.

(b) Section 213 of the Companies Act qualifies the liability of past and present members as contributories. Explain these qualifications as provided for in the Companies Act.

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATIONS BOARD

CPA PART II

June 2011 **Time Allowed: 3 hours.**

Answer any FIVE questions. **ALL questions carry equal marks.**

QUESTION ONE

Martha is engaged in the promotion of a company. She seeks your advice on several matters relating to the promotion of a company. You are required to advise her on the following matters:

(a) The restrictions upon the choice of a corporate name with which a promoter must comply. (8 marks)

(b) The legal duties of a promoter with regard to her responsibility where she sells her own property to the company she is promoting. (6 marks)

(c) The promoter"s right to payment for her services by the company after incorporation. (6 marks)

(Total: 20 marks)

QUESTION TWO

Anna and Berita are directors of Pesa Limited and each holds forty per cent of the ordinary shares. The remainder is held by Charles.

In addition to the shares, Anna also holds debentures issued by Pesa Limited, redeemable on 8 August 2003. Anna wishes to dispose of her shares and debentures.

On the other hand, Berita and Charles do not wish Anna"s substantial interest in the company to pass to other people upon the sale of the shares and debentures.

Advise Pesa Limited on the legality of each of the courses of action listed below:

(a) Pesa Limited will raise the necessary funds and purchase the shares and debentures. (8 marks)

(b) Pesa Limited will raise funds and lend them to Charles so that he may purchase Anna"s debentures. Charles will also arrange for a private loan guaranteed by Pesa Limited so that he may purchase Anna"s shares. (8 marks)

(c) A new company, Pendo Limited, will be formed and eighty per cent of its ordinary shares will be held by Pesa Limited. Berita and Charles to hold ten per cent each. Pendo limited will borrow money to buy Anna"s shares and debentures. (4 marks)

(Total: 20 marks)

QUESTION THREE

Distinguish between the following classifications and debentures:

(a) Bearer debentures and registered debentures. (5 marks)

(b) Redeemable debentures and irredeemable debentures. (5 marks)

(c) Debentures and debenture stock (5 marks)

(d) Unsecured debentures and secured debentures (5 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Distinguish a company limited by shares from a company limited by guarantee. (4 marks)

(b) What are the contents of the memorandum of association as stated in the Companies Act? (6 marks)

(c) Outline the documents that must be delivered to the registrar of companies together with the memorandum of association. (10 marks)

(Total: 20 marks)

QUESTION FIVE

(a) (i) Citing decided cases, state and describe the characteristics of a "derivative action." (8 marks)

(ii) Explain the disadvantages to a minority shareholder in bringing a derivative action. (6 marks)

(b) Jane Wangokho is a minority shareholder of Tuzo Company Limited.

John Daudi is the managing director and majority shareholder of Tuzo Company Limited.

Jane Wangokho has discovered that John Daudi has breached his duties as a director by purchasing goods from the company at a gross undervalue. A general meeting of the company at which John Daudi attended and voted has ratified the sale.

Advise Jane Wangokho on the courses of action she may take. (6 marks)

(Total: 20 marks)

QUESTION SIX

Discuss the position of a company auditor with regard to the following:

(a) A company wishes to remove its auditor from office before the next annual general meeting. (8 marks)

(b) An auditor considers that he has been intentionally obstructed by company officers from carrying out his professional and statutory duties. (6 marks)

(c) EFG Company Limited purchased shares in PQR Company Limited on the basis of PQR Company Limited"s audited accounts. Unfortunately, EFG Company Limited has incurred losses as a result of the purchase.

EFG Company Limited considers that the auditor was negligent in carrying out his audit.

EFG Company Limited wishes to sue the auditor for the loss it has incurred. (6 marks)

(Total: 20 marks)

QUESTION SEVEN

(a) Describe the following:
- (i) The committee of creditors in liquidation. (5 marks)
- (ii) The committee of creditors in administration proceedings. (5 marks)

(b) Describe the meaning and essence of an application for early dissolution. (10 marks)

(Total: 20 marks)

QUESTION EIGHT

(a) In relation to special notice, state the following:
- (i) Objects of a special notice. (4 marks)
- (ii) The number of days required. (2 marks)
- (iii) The ordinary resolutions which require special notice. (6 marks)

(b) In relation to company meetings, explain the following:
- (i) Issues that require special resolution. (6 marks)
- (ii) Support required for a special resolution to be passed. (2 marks)

(Total: 20 marks)

DECEMBER 2011 **Time Allowed: 3 hours.**

Answer any FIVE questions. **All questions carry equal marks.**

QUESTION ONE

(a) Compare and contrast a corporation created under the Companies Act and a corporation created under an Act of Parliament. (10 marks)

(b) Mr. and Mrs. Matanguta intend to form a limited company known as M and M Hardware Limited. They approach you and seek you advice.

Advise them on the following issues:

(i) What is the meaning of a private limited company according to the Companies Act? (3 marks)

(ii) What are the advantages of forming a private company as opposed to a public company? (4 marks)

(iii) Assuming Mr. and Mrs. Matanguta wish to convert the private company into a public company, what would they be required to do? (3 marks)

(Total: 20 marks)

QUESTION TWO

(a) In what way does the decision in the case of Macaura Versus Northern Assurance Company Limited (1925) illustrate the corporate entity theory? (5 marks)

(b) (i)State the circumstances under which the objects clause of a company may be altered (5 marks)

(ii) Explain the procedure to be followed in altering the objects clause. (10 marks)

(Total: 20 marks)

QUESTION THREE

Tama Quin Ltd., a company manufacturing pharmaceutical drugs is about to make a new issue of 400,000 shares of Sh. 40 each at the current market price of Sh. 50 each.

The prospectus states: "The company has just patented the manufacture of a drug that cures malaria."

Jacob White, the managing director of the company is interviewed on television and he states that the news to be released shortly will demonstrate a great break-through in the control of malaria. He also stated that the company was the only one with modern technical knowledge of this great invention. As a result there is over-subscription of the shares.

Allan, who has not read the prospectus, applied for shares and is allotted 2000 at the price of Sh. 50 each.

Betty, who read the prospectus, is not allotted any shares but buys 3000 shares at the stock exchange at Sh. 60 per share.

Charles, who read the report of the interview in the national newspaper, bought 5000 shares at the stock exchange at Sh. 55 per share.

In the meantime, the patents are found not to be original and are revoked. The shares fall in value to Sh. 10 per share.

David who owned 10,000 shares in the company long before the new issue is disappointed as he believes the publicity has caused the shares to fall in price (value).

Advise Allan, Betty, Charles and David. **(20 marks)**

QUESTION FOUR

(a) Joe owns 2000 shares in Lotto Limited and 1000 shares in Jolles Ltd. He sells all his shares in Lotto Limited to Janet and 500 shares in Jolles Ltd. to Jeremy. All the shares in Lotto Limited are partly paid up. Six months later, Lotto limited goes into liquidation.

(i) In the absence of any express agreement, discuss the liability of Joe and Janet in relation to the company"s debts. (8 marks)

(ii) State the steps to be taken to register the transfer of shareholding from Joe and Jeremy. (4 marks)

(b) Outline the exceptional cases when a member may be held liable in excess of the limited liability which he undertook when he became a member of the company. (8 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The law governing the directors" duty of care and skill takes account of the fact thatthe director may be a part-time counselor rather than a full-time professional manager.

Discuss. (8 marks)

(b) Mwerevu is one of the directors of Kamaliza Ltd. whose articles of association are in the form of Table A. He knows that his fellow directors are interested in obtaining motor vehicles from Modern Vehicles Ltd. to increase the company"s fleet of trucks. Mwerevu purchases controlling shares in Modern Vehicles Ltd.

Modern Vehicles Ltd. then sells the trucks to Kamaliza Ltd. at Sh. 100,000 over and above the true market price. Mwerevu voted at the board meeting of Kamaliza Ltd. which decided on the purchase price, without revealing that he controlled the vendor company. When true facts are discovered, the company"s board of directorsdoes not protest against Mwerevu"s conduct.

Mpole, a minority shareholder is aggrieved.

Advise him. (12 marks)

(Total: 20 marks)

QUESTION SIX

(a) Enumerate the various types of charges that require registration as stated under the Companies Act. (8 marks)

(b) Two years ago, Smart Limited issued a series of debentures in favour of Tumaini Bank. The debentures were in the Standard Bank form described as a fixed and floating charge over all the company"s assets. There was an express term of the debenture that the company would not issue a subsequent fixed charge to rank in priority to the floating charge. Six months later, Smart Limited issued a fixed charge over its freehold property in favour of Mali Bank.

Mali Bank was unaware of the prohibition. Smart Limited has gone into liquidation and both banks are proving their debts on priority basis.

Discuss the legal position of each bank. (6 marks)

(c) The most common method of securing debentures is to execute a trust deed. Explain the meaning of a trust deed and outline its advantages. (6 marks)

(Total: 20 marks)

QUESTION SEVEN

Discuss the powers of the liquidator:

(a) With the sanction of the court. (10 marks)

(b) Without the sanction of the court. (10 marks)

(Total: 20 marks)

QUESTION EIGHT

(a) Explain the rules that govern quorum and the exceptions thereof (14 marks)

(b) In relation to proxies, write brief notes on:

(i) General proxies. (3 marks)

(ii) Special proxies. (3 marks)

(Total: 20 marks)

JUNE 2012

QUESTION ONE

(a) The principle of corporate legal personality is an important and fundamental aspect of company law.

Discuss this statement citing relevant decided cases. (6 marks)

(b) Ropoff Company Ltd., a private limited company, has been under inquiry on alleged fraudulent financial transactions. The officers of the company under suspicion have denied any association with the company.

At the inquiry it was suggested that the corporate veil be lifted and the realities of the company in question be looked into.

Explain the instances when the veil of incorporation may be lifted. (14 marks)

QUESTION TWO

a) "The rule in the case of *Ashbury Railway Carriage Vs. Riche (1875)* stated that an act has not been authorized by the objects clause of a company"s Memorandum of Association in ultra vires to the company and the members cannot ratify it."

Discuss. (8 marks)

b) Explain the various ways in which persons intending to form a company may avoid personal liability on contracts they make on behalf of the proposed company. (6 marks)

c) It has been held that the memorandum and Articles of Association of a company shall, when registered, bind the company and the members to the same extent as if the documents has been signed and sealed by each member and contained covenants an the part of each member to observe all the provisions of the memorandum and the articles.

Explain the effect of this provision on the relationship between shareholders and their company and between shareholders themselves. (6 marks)

QUESTION THREE

(a) Outline the qualified minority rights of a member which can only be enforced by the joint efforts of a membership group as defined under the Companies Act. (10 marks)

(b) The Articles of X Company Ltd provide that every member is entitled to one vote for each of the first ten shares and thereafter to one vote for each additional ten shares. Jane owns one hundred shares. She transfers ten of her shares to her nine nominees to increase her voting powering general meetings. Joseph, who is the chairman at the general meeting, refuses to accept the votes of Jane"s nominees.

Advise Jane on the validity of the Chairman"s action and her right as a member.

QUESTION FOUR

(a) Explain the category of persons to whom an auditor owes a duty of care in the preparation of his audit report.

(b) Enumerate the rights accorded to an auditor to enable him perform his duties as the auditor of a company.

(c) In Hedley Byrne V. Heller (1964) the court held that provided that it could be established that a special relationship existed between parties it was possible for a person to sue for having suffered a financial loss even though no contractual relationship existed between the parties.

Highlight the factors that should be established in order for a third party to successfully sue an auditor for professional negligence. (8 marks)

QUESTION FIVE

(a) Explain the circumstances when a dividend may become payable and enforceable as a debt against the company.

(b) Give reasons why a company may seek to control the funds from which dividends are paid.

(c) Explain the effect of the failure by the company to register a charge of a debenture.

QUESTION SIX

(a) Outline the provisions of the Companies Act, relating to civil and criminal liability in respect of non compliance with provisions relating to a prospectus on the Company and the directors.

(b) Makanga, Kamore and Gatweku are directors of Wakwetu Co. Ltd. The company is in dire need of capital to fund its expansion.

Advise them on the methods available for raising capital from the public.

(c) State the circumstances under which a Company can pay an underwriting commission.

QUESTION SEVEN

The Board of Borrowers Company Ltd. has applied for a loan from Uchumi Commercial Bank. The Bank has advised that any loan will be conditional upon the bank being granted security in the form of a combination of fixed and floating charges on the companies assets. The bank has also advised Borrowers Company Ltd. that the charges will be contained in the bank"s standard form debenture document. This contains a "negative pledge clause" and a term which enables the bank to place the company in administrative receivership in the event of default by the company.

(a) (i)In numbered paragraphs distinguish between a fixed and a floating charge. (6 marks)

(ii) What are the disadvantages of a floating charge to the bank? (4 marks)

(b) Explain the meaning of a "negative pledge" clause. (4 marks)

(c) Explain how administrative receivership differs from liquidation. (6 marks)

QUESTION EIGHT

Section 40 (1) of the Companies Act requires a prospectus to contain the matters and reports specified in Part I and II of the Third Schedule.

Explain these matters as outlined in the Third Schedule.

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATIONS BOARD

CPA PART II

December 2012 **Time Allowed: 3 hours**

Answer any FIVE questions. **All questions carry equal marks.**

QUESTION ONE

(a) "The advantages of limited liability combined with the ease with which a member of a family or a provider of capital or an adviser can be given a stake in the business without the financial risk involved in being a partner, usually turns the scale in favour of incorporation as opposed to a partnership."

Discuss. (10 marks)

(b) Mr. John Miriti recently attended a court session during which he heard a cousel asking a key witness about articles of association of a company. Mr. John Miriti does not understand the meaning of articles of association.

Explain to him:
(i) The meaning and characteristics of the articles of association. (5 marks)
(ii) The legal significance of the articles of association. (5 marks)

(Total: 20 marks)

QUESTION TWO

Economy Departmental Store Limited was incorporated in December 1970 with an authorized share capital of 5,000,000 shares of Sh. 10 each. The share capital is fully issued and fully paid. The original articles of association gave the directors authority to issue the initial authorized share capital.

The directors are proposing to purchase a small shop from Jijenge Holdings for Sh. 3,000,000 and to finance the purchase by a fresh issue of 2,000,000 shares of Sh. 10 each to Jijenge Holdings. In order to re-equip the shop they propose to raise additional capital by issuing a further 2,000,000 shares of Sh. 10 each. The directors propose that 1,000,000 of these shares should be offered to existing shareholders and 1,000,000 to the general public. All the additional shares are to be offered at Sh. 15 for each Sh. 10 par value share.

(a) What preliminary information must the directors check and what steps must they follow in order to effect these proposals? (10 marks)

(b) What are the rights of the existing shareholders in respect of the proposed additional issue of 4,000,000 share? (5 marks)

(c) What limitations are there on the uses to which the premium on the shares can be put? (5 marks)

(Total: 20 marks)

QUESTION THREE

(a) In relation to company law, explain the powers and fiduciary duties of the board of directors of a company. (10 marks)

(b) Hellen is the managing director of Artworks Ltd. and owns 60% of the shares in the company which distributes and sells works of art. Charles and Martin are the other directors holding between them 30% shares. Hellen is also a shareholder in Oilprojects Ltd., a company which produces oil paintings. In her capacity as managing director of Artworks Ltd., Hellen ordered Sh. 1 million worth of oil paintings from Oilprojects Ltd. and she was paid a commission of Sh. 500,000 by Oilprojects Ltd.

Evaluate whether Artworks Ltd. has any claim against Hellen and state the remedies open to the company. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) (i)State the rule in Foss-vs- Harbottle, making clear the purpose and the rational underlying the rule. (6 marks)

(ii) State briefly the principal exception to the rule. (4 marks)

(b) Shadrack Ruto owns 500 shares of Sh. 20 each in Alpha and Omega Ltd. and 500 shares of Sh. 10 each in the Beginning and End Ltd. Both companies are regulated by Table A – articles of association. Shadrack Ruto has agreed to sell all his shares in Alpha and Omega to Albelnego Soi and 300 shares in Beginning and End to Meshack Mamba. He has been informed that both companies use the form of transfer that is generally used by brokers, who are members of national stock exchange.

Advise Shadrack Ruto on:

(i) The information which is required on the share transfer form. (4 marks)
(ii) The procedure which should be followed to effect the transfer, and the duration it will take to issue the new share certificates. (6 months)

(Total: 20 marks)

QUESTION FIVE

Advise the directors of Tangaza Company on the following issues:

(a) The provisions of the Companies Act that relate to the calling of the annual general meeting and duties of the chairman during such a meeting. (10 marks)

(b) When a company is compelled to call an extra ordinary general meeting. (5 marks)

(c) The procedure to be followed to remove a director from office. (5 marks)

(Total: 20 marks)

QUESTION SIX

(a) State the provisions of the Companies Act relating to the qualification and appointment of the company secretary, and explain the extent to which a company secretary can contractually bind a company. (10 marks)

(b) In what circumstances can a court make a disqualification order against a director of a company? (10 marks)

(Total: 20 marks)

QUESTION SEVEN

(a) Explain the various types of securities that must be registered under the Companies Act, Section 96, as registrable charges. (10 marks)

(b) Kazi Bure Company Ltd. brews alcohol. It obtains barley from Narok Farm Produce Ltd. on terms stating that the company will not have ownership of the consignment of barley until it has paid full purchase price for the consignment. Kazi Bure Company Ltd. has an overdraft facility with Liquidity Bank but only pays Narok Farm Produce Ltd. in full for a consignment of barley when the alcohol made using the barley is sold to and paid for by the company"s wholesalers (who receive title on payment).

Kazi Bure Company Ltd. has given Liquidity Bank a floating charge over all its assets. The company has however, become insolvent and a receiver, appoint by the bank under the floating charge, has taken over the brewery.

Explain how the receiver should handle each of the following items:

(i) Some bags of barley delivered by Narok Farm Produce Ltd. (6 marks)
(ii) Semi-processed alcohol in containers made of barley and yeast. (2 marks)
(iii) A consignment of brewed alcohol with a label marked "sold to wholesalers and paid for." (2 marks)

(Total: 20 marks)

QUESTION EIGHT

(a) Outline the circumstances under which a company may be wound up by the court on just and equitable grounds. (12 marks)

(b) Highlight the types of debts which are treated as preferential in a winding up under the Companies Act. (8 marks)

(Total: 20 marks)

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATIONS BOARD

CPA PART II

JUNE 2013 **TIME ALLOWED: 3 HOURS**

Answer any FIVE questions. **ALL questions carry equal marks.**

QUESTION ONE

(a) What are the legal restrictions imposed on the choice of a name of a proposed company? (8 marks)

(b) "The doctrine of ultra vires was a nuisance to the company and a trap to unwary third parties." Explain the principles in the doctrine of ultra vires and the exceptions thereof. (12 marks)

(Total: 20 marks)

QUESTION TWO

(a) Outline the distinctions between the memorandum and articles of association. (12 marks)

(b) Explain the statutory provisions under which a company may alter its articles of association. (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) State and briefly explain the conditions which must be fulfilled before a company limited to shares can issue redeemable preference shares. (10 marks)

(b) Outline the rules governing payment of dividends. (6 marks)

(c) It is a basic principle of company law that dividends must not be paid out of funds raised by issue of shares or debentures.

Highlight the exceptions to this principle. (4 marks)

(Total: 20 marks)

QUESTION FOUR

A CPA Part II candidate taking the paper has requested you for advice on the issues listed below. Advise him.

(a) A company has established an employee share scheme and a number of employees including two directors wish to borrow money from the company to enable them purchase shares in the company. (6 marks)

(b) The same group of employees and the two directors have requested additional loans from the company to enable them buy additional shares in the company. (6 marks)

(c) The company is proposing to offer shareholders the option of receiving shares in the company in lieu of dividend. (4 marks)

(d) The company is proposing to co-opt John Omwami to the Board of Directors and the board is proposing to lend him Sh. 100,000 to purchase qualification shares. (4 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Explain the ways in which a person would:
   i. Become a member of a registered company. (5 marks)
   ii. Cease to be a member of a registered company. (5 marks)

(b) Henry, a sole trader carrying on a business in the printing industry has asked Tumaini Bank Ltd. to advance him Sh. 500,000 as an additional working capital. The bank is prepared to advance the money on condition that Henry offers a security. Henry has a share certificate for 5,000 shares issued by Bright Star Company Limited. Henry wants to know whether he can use the shares whose value is Sh. 650,000 as a security for the loan. He further seeks to know whether he would still receive dividends even after he has charged the shares to the bank. (10 marks)

Advise Henry. **(Total: 20 marks)**

QUESTION SIX

(a) Compare the position of directors with that of auditors in respect to the standard duty of skill and care expected of them. (10 marks)

(b) Explain the rules that govern the appointment and removal of an auditor of a company. (10 marks)

(Total: 20 marks)

QUESTION SEVEN

(a) Highlight the contents of a statutory report. (10 marks)

(b) Outline the purposes for which a special resolution is required. (10 marks)

(Total: 20 marks)

QUESTION EIGHT

(a) A court of law has a right to compulsorily wind up a company.

Explain the grounds for a compulsory winding up of a company by the court. (10 marks)

(b) Summarise the procedure to be followed in winding up a company by the high court. (10 marks)

(Total: 20 marks)

CPA PART II

December 2013 **Time Allowed: 3 hours**

Answer any FIVE questions

QUESTION ONE

(a) (i) A basic fundamental rule of company law is that a company may not purchase its own shares. Explain the exceptions to this rule. (8 marks)

(ii) Explain the advantages of a company purchasing its own shares. (6 marks)

(b) Outline the circumstances under which a company may give financial assistance for purchase of, or subscription for its shares. (6 marks)

(**Total: 20 marks**)

QUESTION TWO

Citing relevant examples, state and explain the rule in Foss v Harbottle (1843) and the exceptions therefore. (**20 marks)**

QUESTION THREE

With reference to company law, discuss the proposition that a company has separate legal separate legal personality from its members and the exceptions thereof. (**20 marks)**

QUESITON FOUR

(a) Define the term "promoter." (4 marks)

(b) Mr and Mrs Karanja, who intended to form a limited liability company known as Central Construction Company Ltd, approached Jijenge Bank for a loan to purchase office furniture and stationery. A loan of Sh.1 million was given by the bank. Subsequently, the company was incorporated. However, the business did not flourish and the company was unable to pay the loan as and when the installments fell due. When the bank sent a demand notice to the company, Matata, a shareholder who opposed the demand notice, said that he company was not liable to repay the loan. Mr and Mrs Karanja, now want to alter the objects clause in the memorandum of association to include a clause authorizing the company to effect the payment but Matata is still opposed to the proposal.

Discuss the legal position of the bank and the validity of the proposed alteration. (16 marks)

(**Total: 20 marks**)

QUESTION FIVE

(a) What are the directors" rights with regard to receiving remuneration and compensation for loss of office? (6 marks)

(b) Outline the procedure that a company must follow if it wishes to offer a director a service contract for more than five years. (4 marks)

(c) Although the directors of a company are its agents, they are also held as trustees of the company"s money and property. However, their position as trustees of the companydiffers from that of ordinary trustees.

Discuss. (10 marks)
(**Total: 20 marks**)

QUESTION SIX

(a) Outline the resolutions which may be passed for voluntary winding up a company. (6 marks)

(b) State the persons who may petition for the winding up of a company by the court. (4 marks)

(c) Explain the consequences of a voluntary winding up a company limited by shares. (10 marks)
(**Total: 20 marks**)

QUESTION SEVEN

(a) Advise the Board of Directors of Excellent Home Care Agencies Ltd. on the following matters:

i) The length of notice to be given before an annual general meeting can be held. (4 marks)

ii) The ordinary business transacted at such meetings. (4 marks)

(b) As you are leaving a meeting of the board of directors, you meet Mr Shida, a shareholder, who is aggrieved that since the time the company was incorporated three years ago, no annual general meeting has ever been held by the company. He seeks your advice.

Advise him. (12 marks)
(**Total: 20 marks**)

QUESTION EIGHT

(a) Explain the similarities and differences between shares and debentures. (14 marks)

(b) Wheels Limited issued a debenture to East Bank years ago. The debenture was in the standard bank form described as a fixed and floating charge over all the assets of the company. However, due to inadvertence, the charge was not dated nor registered within time. The company is now in liquidation and the loan is in arrears. The bank seeks your legal advice as to whether it can rely on the charge to prove its claim in the winding up proceedings of the company.

Advise the bank. (6 marks) (**Total: 20 marks**)

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATIONS BOARD

CPA PART II

June 2014 **Time Allowed: 3 hours**

Answer any FIVE questions **ALL questions carry equal marks**

QUESTION ONE

The law requires that certain statutory books must be kept in the registered offices of the company.

Explain the contents and matters relating to inspection of the following statutory books:

(a) Register of members. (5 marks)
(b) Register of directors and secretaries. (5 marks)
(c) Register of directors" interests. (5 marks)
(d) Register of charges. (5 marks)

(Total: 20 marks)

QUESTION TWO

Discuss the ways in which the traditional role of an auditor has been affected by recent demands by regulatory authorities and shareholders. **(20 marks)**

QUESTION THREE

(a) Explain the preliminaries incidental to promotion of a company. (8 marks)
(b) Explain the ways in which promoters can be remunerated. (6 marks)
(c) Outline the reasons that may lead to suspension of promoters by a company. (6 marks)

(Total: 20 marks)

QUESTION FOUR

In pursuit of good corporate governance practices by directors, enumerate the best practices relating to directors which would promote and protect the shareholders rights. **(20 marks)**

QUESTION FIVE

Abel and Boaz have been carrying out business as a partnership. They have both been employed on full time basis in the business and have shared profits and losses equally. Abel wished to bring his son David into the business and Boaz accepts the proposal.

They wish to convert the partnership into a private limited company, ABD Company Ltd., in which Abel and Boaz will each hold 40 percent of the shares and David will hold 20 per cent. All the three shareholders will be directors of the new private company.

(a) Advise the three shareholders of ABD Company Ltd. on the documents which they are required to submit to the registrar of companies for approval in connection with the formation of the private company. (8 marks)

(b) After ABD Company Ltd. was formed, there arose a disagreement between Boaz and David regarding the day-to-day management of the business. Abel and David decided to remove Boaz from the board of directors.

Explain the procedure that Abel and David should follow to effect the removal of Boaz as a director of the company. (6 marks)

(c) Discuss whether Boaz has grounds for petitioning for the compulsory winding up of the company. (6 marks)

(Total: 20 marks)

QUESTION SIX

Explain to a new shareholder of a central depository account the circumstances in which a central depository securities account may be suspended. **(20 marks)**

QUESTION SEVEN

(a) With regard to investor protection, explain the meaning of inside information. (8 marks)

(b) In relation to allotment of shares in a company, discuss the legal position in each of the following situations:

(i) Sarah applied for 4,000 shares in a public company known as ABC Ltd. She was allotted only 2,000 shares. She intends to sue the company.

Advise Sarah. (6 marks)

(ii) Meshack was recently appointed an accountant of Economy Departmental Store, a public limited company. The company intends to issue shares to the public. Meshack seeks your advice on whether there are any restrictions imposed by the Companies Act upon allotment of such shares.

Advise Meshack. (6 marks)

(Total: 20 marks)

QUESTION EIGHT

(a) Enumerate the sequence of events to be followed by a shareholder who intends to transfer his shares to another person. (12 marks)

(b) Mwinzi, a holder of shares in Hewa Airways Company Limited deposited his share certificate with a broker, Otieno. Otieno forged Mwinzi"s signature on the share certificate and transferred the shares to Kuria. When the share certificate and the transfer document were presented to the company for registration, the secretary wrote to Mwinzi advising him of the transfer. Mwinzi did not reply to this letter and Kuria was registered as the new shareholder. Kuria then transferred the shares to Wafula who was registered as the shareholder and a new certificate was issued.

Explain the effect of the forgery. (8 marks)

(Total: 20 marks)

ANSWERS - PAST PAPERS

SUGGESTED SOLUTIONS TO THE PAST PAPER QUESTIONS

JULY 2008

QUESTION ONE

a)

- Under Section 45 (5) of the Companies Act, Promoter means "Promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement but does not include a person by reason of his acting in a professional capacity on behalf of the persons engaged in procuring the formation of the company".
- In Twycross v Grant, it was observed that "a promoter I apprehend is one who undertakes to form a company with reference to a given project and set it going and who takes the necessary steps to accomplish that purpose".
- It has been observed that the term Promoter is not a term of law but of business usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence.
- Ordinarily a Promoter is a person who has taken some part in the formation of a company or in procuring persons to join it as soon as it is technically formed.
- The role a Promoter plays may be active or passive.
- An advocate or accountant engaged by those interested in forming a company becomes a Promoter if he agrees to become or provide a director.
- It therefore follows that the question as to who a promoter is one of fact and varies from case to case.

b)

- This is a contract entered into by persons purporting to act on behalf of the company before its incorporation (sec.16 (2) of the Companies Act.)
- A company comes into existence on the date of incorporation mentioned in the certificate of incorporation.
- Before the date of incorporation, the company does not exist and has no capacity to contract.
  Kelner V Baxter
- The company is generally not liable on such contracts.
- A person who purports to contract as agent for a non-existent Principal is personally liable on the contract. Kelner v Baxter (1866).
- A contract purportedly entered into by or with a non-existent person is void. Newborne v Sensolid (GB) Ltd.
- The company cannot ratify a pre-incorporation contract after its incorporation. Price v Kelsal (1957)
- Natal Land Co. Ltd v Pauline Collery Syndicate
- Nor can directors adopt or confirm a pre-incorporation contract after the company"s incorporation.
- North Sydney Investments and others V Higgins and others

- A pre-incorporation contract is enforceable by or against a company if after incorporation the company has entered into a new contract similar to the previous agreement.
- Mawogola Farmers and Growers Co. Ltd v Kayanja and others (1971)

c)

- Act bona fide for the benefit of the company information.
- Proper accounting.
- Disclose any personal interest.
- Determine and settle the name of the company.
- Prepare or cause preparation of the constitutive and other documents.
- Register or cause registration of the company.
- Secure the services of directors.
- Ensure that the company has an independent board of directors.
- Prepare the requisite prospectus if any.
- Acquire assets for use by the company.
- Enter into business contracts on behalf of the company.
- Meet all the preliminary expenses of company formation.

QUESTION

TWO a)

- Under Section 13 (1) of the Companies Act, a company may by special resolution alter the provision of its articles.
- The altered article is as valid as if originally embodied in the articles and is alterable by special resolution.
- An extra ordinary general meeting of the company must be convened.
- Members must by special resolution authorize the alteration.
- A copy of the resolution must be delivered to the registrar for registration within 30 days of its passing.
- The alteration take effect on registration.

b) Directors" common law duties fall in to two broad categories namely:

- Duty of care, skill and diligence
- Duty of loyalty and good faith

Directors owe their company a duty to exercise some care, skill and diligence falling, which they are liable in damages. The rules governing directors duty of care, skill and diligence were formulated by Romer J. in Re: City Equitable Fire Insurance Co. Ltd.

- A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected of a person of his knowledge and experience. In re Brazilian Rubber Plantations and Estates Ltd. He is not bound to bring any special qualifications to his office.
- A director is not bound to give the affairs of the company continuous attention. His duties are of an intermittent nature to be performed at periodical board meetings and meetings of committees of the board upon which he happens to be placed. He is however not bound to attend all such meetings, though, he ought to attend whenever in the circumstances he is reasonably able to do so. In The Marquis of Butes Case
- In the absence of suspicion, a director is justified in trusting that officers of the company perform their duties honestly. He is entitled to rely on information provided by trusted or tried servants of the company. Dovey v Cory.

QUESTION THREE

a) It is a fundamental principle of company law, that share capital be maintained. Company law has evolved principles and provisions to ensure that companies raise and maintain their capital for example:

- A public company may not commence business before the minimum subscription is raised.
- Consideration for shares must be in money or money"s worth.
- A public company may not allot shares for non-cash consideration.
- Issuing of shares at a discount is in principal prohibited. Section 59 of the Act.
- If shares are issued at a premium, a share premium account must be created. Section 58 of the Act.
- Reduction of capital by a company must strictly comply with the provisions of the Companies Act.
- Preference shares should only be redeemed by reserves or proceeds of a special issue for that purpose.
- Dividend must not be paid out of capital. Article 16 of Table A.
- The par value of shares must be maintained.
- A company must not purchase its shares.
- A company must not finance the purchase or acquisition of its shares. Trevor V.Whitworth. This rule is embodied in Section 56 (1) of the Companies Act.

(b) Under Section 2 (1) of the Companies Act "prospectus" means:

- "Any prospectus, notice, circular advertisement or other invitation offering to the public for subscription or purchase any shares or debentures of a company."
- Any invitation intended to avail shares or debentures to the public qualifies as a prospectus.
- A prospectus does not offer securities but invites offers from prospective investors.
- "Public" is not restricted to the public at large, it includes a section thereof.
- Its contents are prescribed by law and a copy thereof must be delivered to the registrar for registration.

- A newly formed company may issue a prospectus inviting subscription for its shares.
- An existing company may issue it when floating new share to the public.
- When a private company goes public, pursuant to Sec.32 (1) of the Act, it may issue prospectus or statement in lieu.

QUESTION FOUR

a)

- This is a suit brought by a person in the name of and on behalf of the company to remedy a wrong done to the company. It is available only for the enforcement of duties owed to the company and is unavailable to enforce the right of an individual shareholders e.g. actions against directors or officers for breach of their duties to the corporation for an injunction to preclude a threatened injury to the company.
- This action is representative in character.

b) Conditions necessary for a derivative action to be instituted include:

- The wrong complained of must involve fraud on the minority, for example:
  - Expropriation of corporate assets.

- Breach of duty by directors.
- Unfair use of voting power.

- The wrong doers must be in control of the company. Their control may be legal or factual.
- The company must be made a defendant in the action so as to benefit from any court order arising.
- The plaintiff shareholder should sue in a representative capacity on behalf of himself and all other members other than the real defendants.
- The right to bring a derivative action is conferred upon individual members of the company as a matter of grace.
- The plaintiff remains dominus litis until judgement. However, he can discontinue or settle it out of court at his pleasure.

QUESTION

FIVE a)

- The notice must be issued with the requisite authority of the board, court, members or registrar.
- The requisite number of days must be given.
- It must specify the business of the meeting with clarity.
- Must specify all resolution proposed and passed, as a special and notice of their intention to be passed as such must be given.
- Must specify the date, time and place of the meeting.

b)

- Acquaint himself with his duties under the Companies Act and the articles of the company whose books and accounts he is called upon to examine.
- Examine the books, accounts, vouchers and other documents of the company
- Make a report for submission to members in general meeting.
- Act honestly i.e. not certify as true what he does believe to be true.
- Exercise reasonable care, skill and caution of a competent careful and cautious auditor.
- Satisfy himself that the companies security exist and are in safe custody.
- Provide professional advise if called upon to do so.
- Approach his task with an inquiring mind and not with suspicion of dishonesty.

QUESTION SIX

a) Fixed Charge

This is a legal or specific charge. It is a charge securing a debenture on a fixed asset. In *Illingworth v Houldsworth*it was observed that a fixed charge is specific. The security iscertain or capable of being ascertained.

Floating Charge

This is a charge securing a debenture by the assets of a going concern. In *Illingworth vHouldsworth*, it was observed that a floating charge is ambulatory and shifting in itsnature. In re Yorkshire wool Combers Association, Romer J. set out the characteristics of a floating charge:

- It is a charge on a class of assets of the company both present and future.
- The class of assets must be one that keep on changing from time to time in the ordinary course of business of the company.
- The charge remains dormant until crystallization.

b)

- This is a case of abuse of power by directors i.e. excesses of directors.
- In this case, directors borrowed for a purpose other than that for which it was intended.
- This borrowing is intra vires, the company and is enforceable, since the bank was unaware of the misuse of the power to borrow.
- My advise to the Maendeleo Bank is that it can successfully recover the amount borrowed as it is not party to the abuse of power. My advise is based on the decision in re: David Payne & Co. where a company with a general power to borrow, borrowed from the plaintiff bank, but used the amount for an ultra vires purpose. The lending party was unaware of the abuse of power and it was held that the borrowing was enforceable.

c)

i) Under Section 35 (1) of the Companies Act, where a receiver or manager of the whole or substantially the whole of the property of the company is appointed on behalf of the holders of any debentures of the company secured by a floating charge, then subject to the provisions of this section and of section 352.

- The receiver shall forthwith send notice to the company of his appointment; and
- There shall, within fourteen days after receipt of the notice, or such longer period as may be allowed by the court or by the receiver, be made out and submitted to the receiver in accordance with section 352 a statement in the prescribed form as to the affairs of the company; and
- The receiver shall within two months after receipt of the said statement send
- To the registrar and to the court, a copy of the statement and of any comments he sees fit to make thereon and in the case of the registrar also a summary of the statement and of his comments (if any) thereon; and
- To the company, a copy of any such comments as aforesaid or, if he does not see fit to make any comment, a notice to that effect; and
- To any trustees for the debenture holders on whose behalf he was appointed and, so far as he is aware of their addresses, to all such debenture holders, a copy of the said summary.

ii) Under Section 351 (2) of the Companies Act, the receiver shall within two months, or such longer period as the court may allow after the expiration of the period of twelve months from the date of his appointment and of every subsequent period of twelve months, and within two months or such longer period as the court may allow after he ceases to act as receiver or manager of the property of the company, send to the registrar, to any trustees for the debenture holders of the company on whose behalf he was appointed, to the company and (so far as he is aware of their addresses) to all such debenture holders an abstract in the prescribed form showing his receipts and payments during that period of twelve months or, where he ceases to acts as aforesaid, during the period from the end of the period to which the last preceding abstract related up to the date of his so ceasing, and the aggregate amounts of his receipts and of his payments during all preceding periods since his appointment.

QUESTION SEVEN

Under Section 219 (f) of the Companies Act, "a company may be wound up by the court, if the court is of the opinion that it is just and equitable, that the company should be wound up." Companies have been wound up on this ground in the following circumstances:

a)

- **Fraudulent or illegal purpose**
  - Inte Thomas Edward Brinsmead & Sons Ltd

- **Failure of the substratum**
  - Inre German Date Coffee.
  - Inre Baku Consolidated Oil Fields.
  - Inre Amalgamated Syndicate.
- **Loss of confidence in the management**
  - Loch v John Blackwood
- **Expulsion or exclusion from management**
  - Inre Westbourne Galleries Ltd
  - Inre Lundie Brothers Ltd
- **The company is „a bubble"**
  - Inre London and County Coal Ltd
- **Oppression of Minority**
- **Deadlock in management and membership**
  - Inre Yenidje Tobacco Ltd
  - Inre Modern Retreading Ltd

b)

- All floating charges created by the company crystallize and become fixed.
- The company ceases to carry on business except such as may be required for the beneficial winding up of the company.
- Any disposition of the company"s property including choses in action, anytransfers of shares or alteration in the status of members of the company is void.
- Any attachment, distress or execution put in force against the estate or effects of the company is void.
- Actions or legal proceedings by or against the company are automatically stated.
- By virtue of his office, the official receiver becomes the provisional liquidator.
- Director"s powers becomefunctus officioi.e. not exercisable.
- Employees of the company are ipso facto dismissed. However, those who continue to render services and receive wages are deemed to have entered into a new contract of service with the liquidator.

QUESTION EIGHT

a) The registrar of companies is empowered to investigate the affairs of a company by self or by an inspector in certain circumstances. The registrar is empowered to investigate the affairs of a company where:

- He has reasonable cause to believe that the provisions of the companies act are not being complied with.
- A document submitted to him does not disclose a full and fair statement of the matters it relates to.
- He has good reason to investigate the ownership of any shares in or debentures of a company by demanding information from persons whom he has reasonable cause to believe are or have been interested in the shares or debentures or has acted as an advocate or agent in relation to the shares or debentures.
- There is good reason to investigate 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
- Control the company or materially influence the policy of the company.

b)

- To investigate the holding or subsidiary company if the same is necessary of the investigation.
- To administer oath.
- To examine persons on oath.
- To compel officers or agents of the company to produce books or documents of the company.
- To apply to the court to have persons whom he has no power to examine to be examined in court for purposes of the investigation.

c) Under Section 171 (1) of the Companies Act, the expenses of and incidental to an investigation by an inspector appointed by the court are defrayed by the registrar in the first instance. However, the following persons are liable to repay the registrar:

- Any person who is convicted on a prosecution instituted by the attorney general on the basis of the report.
- Any person who is ordered to pay damages or restore any property in proceedings instituted on the basis of the report.
- Any body corporate in whose name proceedings are instituted.
- Any body corporate dealt with by the report.
- The applicants for the investigation.

DECEMBER 2008

QUESTION ONE

a) Memorandum of Association

- This is one of the constitutive documents. It is the external constitution of the company. It provides for the relationship between the company and third parties.
- It is a mandatory document – every company must have it.
- Its contents are prescribed by Section 5 and 6 of the Companies Act e.g. name, object, capital.

Articles of Association

- This is one of the constitutive documents. It provides for the internal constitution. It contains the rules for the internal management of the company"s affairs. It regulates the relations between the company and itsmembers.

Main difference between the two

- The Memorandum of Association provides for the relationship between the company and the outside world while the Articles of Association provides for the rules of internal management of the company"s affairs.

b) Details in the memorandum of association

Contains the following clause:

- **Name clause –**name of the company with limited as the last word thereof.
- **Object clause –**the purposes for which the co is incorporated.
- **Registered office clause –**this is the domicil of the company.
- **Capital clause –**this is the authorised or nominal capital.
- **Liability clause –**states that the company is limited by shares or guarantee.
- **Association clause/declaration clause –**states the desire of members to beincorporated.
- **Particulars of subscribers and signature**
- **Date -** the memorandum must be dated.

Details in the articles of association

Assuming the company adopts the model article in Table A of the first schedule to the Companies Act, the Articles of Association must contain inter alia.

- Transfer and transmission of shares.
- Calls
- Meetings generally.
- Declaration and payment of dividend.
- Powers of directors
- Office of the Managing Director
- Bonus issues
- Winding up
- Voting
- Lien on shares

QUESTION TWO

a) A pre-incorporation contract is a contract entered into before a company is incorporated.

Rules governing pre-incorporation contracts

- A pre-incorporation contract does not bind the company. Kelner v Baxter

- A company cannot ratify a pre-incorporation contract Natal Land Co. v Pauline Colliery Syndicate
  Price v Kelsal

- A promoter is personally liable on a pre-incorporation contract Kelner v Baxter

  R V Kyslant

  - The company may be bound by a pre-incorporation contract if it enters into a new contract similar to the previous agreement.
    Mawagola Farmers Co. v Kayanja and others

  - Before incorporation the company lacks contractual capacity and cannot have agents

b) Kioko was a promoter of the company and he stood in a fiduciary position towards the company he was promoting. Therefore he was bound to disclose any secret profits made in the course of the promotion which he did not.

Therefore my advice to Musembi as to the company"s rights are:

- The company can rescind the contract.
- To recover the secret profit made by Kioko.
- To sue for damages for breach of fiduciary duties.

My advice is based on the decisions in Erlanger v New Sombrero Phosphate Co., GlucksteinV Barnes

QUESTION THREE

a) Ways of raising capital
   - Offer of shares through the issue of a prospectus, offer for sale, placing etc.
   - Borrowing.
   - Bonus issues.
   - Issues on take-overs.

b) Issue of shares at a discount
   - The shares must belong to a class already issued by the company.
   - One year must have elapsed from the date the company was entitled to commence business.
   - It must be authorised by a resolution of members in general meeting
   - The resolution must fix the maximum rate of discount at which the shares are to be issued.
   - The issue must be approved by the court.
   - The issue must be made within one month from the date of approval by the court or such extended time as the court may permit.
   - The issue must be disclosed in the prospectus of the company.

c) Terms implied in a contract of sale of shares between a seller and purchaser.

   - That the buyer will pay the price of the shares.

- That the seller has the right to sell.
- That the purchaser shall indemnity the seller against any calls made after the date of the contract.
- The seller will give to the purchaser a genuine share certificate required to enable the purchaser to be registered as member.
- The seller will not do anything preventing the buyer from having the transfer registered or delay the process.
- The seller will compensate the buyer for any calls or liability which may arise in respect of the shares sold.

QUESTION FOUR

a) Contents of the Register of Members
- Name and address of every shareholder.
- Number of shares or stocks held.
- Date of entry of the name.
- Date of removal of the name.
- Amount paid on each share.
- Postal address of every member.

b) My advice to Njoroge is that he should apply to the High Court for an order of rectification of the register to include his name. My advice is based on the Provisions of the Companies Act.

c) The principle has the following consequences:
- A company cannot purchase its own shares.
- A company must not give financial assistance for the purchase of its own shares.
- Dividends must not be paid except out of distributable profits.
- Where a public company suffers a serious loss of capital a meeting of the company must be called to discuss the issue.
- Shares must not be issued at a discount.
- Reduction of capital must strictly comply with the provisions of the Companies Act.

QUESTION FIVE

a) The Companies Act, recognises the following meetings :
- Statutory Meeting.
- Annual General Meeting.
- Extra Ordinary General Meeting.
- Class Meetings.
- Directors meetings
- Creditors meeting.

Generally, the following constitutes the requisites of a meeting:

- Notice of the meeting.
- Proper authority to convene the meeting.
- Quorum for the meeting.
- Chairman of the meeting.
- Taking of minutes of the meeting.

- Voting in a company meeting can either be on a poll or by show of hands. By show of hands – one member has one vote. By Poll depends on the number of shares a member holds. Under Table A one share is one vote.
- The results of the voting are declared by the Chairman.
- Members are free to appoint a proxy who can only vote by a poll.

b) Duties of an auditor

- To acquaint himself with his duties under the Companies Act and the Articles of Association of the Company who books he is called upon to audit *Inre ThomasGerald & Sons Ltd.*
- To examine the accounts, books, vouchers, etc. Inre Republic of BoliviaExploration Syndicate Ltd.
- To make a report for submission to members in general meeting.
- To be honest Fomento V. Selsdon Fountain Pen Ltd.
- To exercise care, skill and caution. Inre Kingston Cotton Mills Ltd.
- To satisfy himself that the company"s securities exist are in safe custody. Inre CityEquitable Fire Insurance Co Ltd.
- To provide professional advice if called upon to do so Inre London and GeneralBank Ltd
- Approach his task with an inquiring mind.

c) Categories of persons disqualified to be auditors:

- A body corporate.
- An officer or servant of the company.
- A person who is a partner or in employment of an officer or servant of the company.
- A person disqualified for appointment as an auditor of a holding or subsidiary company.
- Common law disqualification e.g. undischarged bankrupts, persons of unsound mind.

QUESTION SIX

a) A third party may concern himself with the doctrine of ultra vires when dealing with the company as any such contracts will be considered void and unenforceable.

- It is imperative that third parties examine the contents of the memorandum of association.
- Third parties must be aware of the contents of the memorandum.
- Any transaction outside the objects clause will be ultra vires the company.
- Such a contract is void and cannot be ratified and nothing can be done to render it intra vires.

b) Statutory Limitations

- A director cannot guarantee a loan.
- In a public company a director outside the age limit for appointment is not qualified for appointment as director unless a resolution upon a special notice has been passed.
- In a public company, a director must take and pay for his qualification shares, if any.
- A director must not be compensated for loss of office unless particulars are disclosed to the members who must approve of it.
- Prohibitions of tax free payments to directors.
- Disclosure of interests in contracts made on behalf of the company.

c) Circumstances in which a company may issue bonus shares:

- There must be authority in the articles.
- It must be authorised by an ordinary resolution of members in general meeting.
- It must be recommended by the board and approved by the general meeting.
- Bonus issues can be financed by reserves or by share premium account.
- Its nominal share capital must be sufficient.
- A return of allotment must be delivered to the Registrar within one month of allotment.
- Must be issued in the proportion prescribed by the articles.

QUESTION SEVEN

a) Types of charges requiring registration under the Companies Act

- Floating charges.
- Fixed charges.
- Charge on book debts.
- Charge on unpaid calls.
- Charge on an uncalled capital.
- Chattels mortgage.
- Charge on copyrights and patent goodwill etc.
- Charge on a ship or any part thereof.

b)

- This problem is based on registration of charges. Under the provisions of the Companies Act, a floating charge is registrable. In this case, the charge was duly registered and a certificate issued.
- Although the chattels were not registered they constitute the security and the administrative receiver is entitled to the same. This is because the registration of the charge cured this defect and the charge is deemed to be valid. As was the case in Ve C. L. Nye Ltd

c) Remedies available to an aggrieved debenture holder:

- Appointment of receiver.
- Petition for winding up.
- Sue for the debt.
- Foreclosure.
- Exercise the statutory power of sale.

QUESTION EIGHT

a) Types of winding-up

i) Compulsory winding up or winding up by the court.
ii) Winding up subject to the supervision of the court.
iii) Voluntary winding up.

Who may commence proceedings?
Compulsory winding up

- The company
- Creditors
- Contributories
- The attorney general
- The official receiver
- Members other than contributories.

Winding up under the supervision of the court

- The creditors
- The official receiver
- Members

Voluntary winding-up

- Shareholders
- Creditors

b) How the creditor can prove insolvency:

- That a debt of KSh.1,000 or more remain unpaid three weeks after demand
- Execution or other process has been returned unsatisfied wholly or in part.
- That taking into account the prospective and contingent liabilities the court is satisfied that the company is unable to pay its debts.

c) Course of action open to a secured creditor in liquidation

- Value the security and prove the balance, if any.
- Sell the security and prove the balance, if any.
- Surrender the security and prove the entire debt.
- Rely on the security and not prove at all.

JUNE 2009

QUESTION

ONE 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. i.e. rule in TurquandsCase

- 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 if it has actual knowledge of their existence in the documents. It was so held in RamaCorporation 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. Alexander Ward &Co. Ltd v Samyang Navigation.

- 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:

- To avoid the formalities of forfeiture
- Fully paid up shares may be accepted in return for shares of the same nominal value.

QUESTION TWO

a) The remedies available to a subscriber include:

- **Compensation** for any loss or damage occasioned by the untrue statementsi.e. Sec 45 of the Act.
- **Damages** for loss or liability arising. This remedy is available to the investorin the false statements were negligently or fraudulently misrepresented.
- **Rescission of contract**: The innocent party has the right to rescind thecontract if the false statements were innocently, fraudulently or negligently made. The right is exercisable at the earliest possible instance.
- **Damages** against the company for breach of contract.
- **Indemnity**: This remedy which entails monetary compensation is available ifthe false statements were innocently made. However, it is only available where the innocent misrepresentation occasion direct financial loss.

b) Under Section 63 (1) of the Companies Act, the capital of accompany 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

i)

- To alter the company"s capital in the aforementioned ways, the following conditions are necessary:
- The articles of the company must authorise the alteration.
- The alterations 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, thepower to reduce a company"s capital must be embodied in the articles.
- **Special Resolution**: Under Section 68 (1) of the Act, a reduction of capitalmust 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:
  - Extinguishing or reducing liability of unpaid capital.

- Cancellation of any paid up capital which is lost or unrepresented by available assets.
- 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, anapplication 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 and 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 courtis satisfied that all creditors have consented and/or their claims have been discharged, determined or secure, 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, uponproduction of a certified copy of the court order and the mincite 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 with 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. The 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 THREE

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/ 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.

National Dwellings Society v Sykes
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 or in the event of disorder.
- 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 five members present in person or by proxy.
- A member or members representing not less than $1/10^{th}$ of the issued shares, present in person or by proxy.
- A member or members representing not less than $1/10^{th}$ of the total voting rights present in person or by proxy.

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 of 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.
- Special Resolution

QUESTION FOUR

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.

b) 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. If directors are of the opinion that:

- It would be impracticable.
- It would occasion delay or expense..
- It would be misleading
- It would be harmful to the business of the company or any subsidiary.
- It would be of no real value to members.

- 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 Section32 (1) of the Companies Act, a copy of a statement ***in lieu***, if any, must be delivered to the registrar 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 1 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 facilitated 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

FIVE a)

- Capacity to appoint receiver or manager in the event of default.
- It charges both existing and future assets of the company.
- Upon crystallization, the chargee becomes entitled to sell the security.
- Until crystallization value of security remain uncertain.
- Other interests e.g. landlord"s distress for rent have priority in the satisfaction of claims.
- A fixed charge created subsequent to a floating charge has 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 rules is now embodied in Section 56 (1) of the Companies Act. However, there are several exceptions to this rule.

- If the lending of money is part of 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 SIX

a) In the words of Lord Denning in Littlewood Stores Ltd v Inland RevenueCommissioner

"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". Courts have lifted the veil in the following circumstances:

- **Agency or trustee or nominee**
  In Re: F.G. Films Ltd
  Firestone Tyre and Rubber Co. v Llewellin
  Smith Stone and Knight v Burmingham Corporation

- **Determination or ascertainment of residence**
  Deebers Consolidated Mines Ltd v Howe

- **Ratification of corporate acts**
  In Re: Duomatic Ltd
  Re: Express Engineering Co. Ltd

- **Group Enterprises**
  Harold Holdsworth v Caddies

- **Fraud or improper conduct**
  In Re: Buggle Press LtdJones
  v Lipman and another
  Gilford Motor Co. Ltd v Horne and another

- **Determination of Character**
  Daimler Ltd v Continental Tyre and Rubber Co.

b)

- Every person who was a promoter of the company at the time of issue.
- Every person who was a director of the company at the time of issue.
- 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)

- ***Ultra Vires*** literally means beyond the powers. It is a rule of capacity whichdelimits the contractual capacity of a company.

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

- 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 Carraige and Iron Co. v Riche and Attorney General v Great Easter Railway Co.

- An ***ultra vires*** transaction is void since the company had no capacity to enter into it. Such a transaction is generally unenforceable. It cannot rendered ***intra vires*** by estoppel acquiescence, lapse of time, delay or ratification. It was sold held in the Rolled Steel Products (Holdings) Ltd v British Steel Corporation and Others (1986).

- Once ***ultra vires*** always ***ultra vires***. It was sold held in Brady v Brady (1987).

- 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 the purpose to which their investment can be applied by the company.
  - It protects persons who deal with the company"s who appreciate its contractual capacity.

QUESTION SEVEN

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.

i) 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 distribution its assets

QUESTION EIGHT a)

- The conduct complained of most at the lowest involve some fraud.
- The fraudsters or wrong doers must be in control of the company in law or in fact.
- 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 HooperTelegraph Wires where the majority shareholders purported to benefit at the expense of the minority.

DECEMBER 2009

QUESTION ONE

a) The various clauses of the memorandum of association are set forth in Sections 5 and 6 of the Companies Act and are:

- **Name Clause**: Contains the name of the company with limited as the last word ofthe name where the company"s liability is limited by shares or guarantee.
- **Registered Office Clause**: This is the domicil clause which states that theregistered office of the company will be situated in Kenya.
- **Objects Clause**: Sets out the purposes for which the company is incorporated.
- **Liability Clause**: states that the liability of the company is limited by shares orguarantee. If limited by guarantee it must state that each member has undertaken to contribute to the assets of the company is wound up during the currency of his membership or within one year of cessation of membership.
- **Capital Clause**: States the capital with which the company proposes to beregistered with and thereof.
- **Association or declaration Clause**: states the desire of the subscribers to beformed into a body corporate.
- **Particulars of the Subscribers**:This clause specifies:
  - Name and postal address of every subscriber.
  - Number of shares held which must be not less than one.
  - Signature of the subscriber held which must be attested to by at least one witness.
- **Date**: Under section 6 (1) of the Companies Act the memorandum must be dated.
- Various clauses of the memorandum are alterable as follows:
- **The Name Clause** is alterable by special resolution and written consent of theregistrar pursuant to Section 20 (1) of the Companies Act. The registrar must be notified of the change within 14 days thereof.
- **The Objects Clause** is alterable by special resolution pursuant to Section 8 (1) ofthe Act. The resolution is registerable within 30 days thereof.
- **The Liability Clause** is alterable pursuant to Section 18 (1) of the Act where anunlimited company may be registered as limited.
- **The Capital Clause** is alterable pursuant to Section 63 (1), 65 (1) and 68 (1) of theCompanies Act. Whereas reduction of capital must be authorized by a special resolution. Other forms of alteration e.g. increase of capital, consolidation of shares or diminution of capital require an ordinary resolution.
- **Particulars of Subscribers** change when company membership changes by transferor transmission of shares.

Company law prescribe the extent to which a company may alter the various clauses of the memorandum e.g.

i) A company may change its name to the extent that:
- It is not in the opinion of the registrar undesirable.
- It is not too similar to that of an existing company.
- It does not mislead the public.
- It does not suggest any patronage of the president government department or local authority.
- It does not suggest a criminal or immoral intent or purpose.
- It contains the word limited as the last word where liability is limited by shares or guarantee.
- It does not contain the term "center" or "co-operative" or any abbreviation thereof.
- It does not contain the terms "bank", "hotel" or "insurance" unless the company carries on such business.

ii) A company may change its objects clause so far as may be necessary to enable it:
- Carry on its business more economically or more efficiently.
- Attain its purpose by new or improved means.
- Enlarge or change the local area of its operation.
- Sell or dispose of the whole or any part of its undertaking.
- Restrict or abandon any of the objects specified in the objects clause.
- Amalgamate with any other company or body of persons.

iii) A company may alter the capital clause of its memorandum to:
- Reduce its capital pursuant to section 68 (1) of the act.
- Increase its capital pursuant to sections 63 (1) and 65 of the act.
- Convert shares to stock.
- Reconvert any stock to shares.
- Consolidate shares.
- Sub-divide shares.
- Diminish capital.

QUESTION TWO

a) A company may issue redeemable preference shares pursuant to the following conditions:
- The issue must be authorized by the articles.
- The company"s capital must be dividend into different classes of shares.
- The issue must be disclosed in the company"s prospectus or statement in lieu.
- The registrar must be notified of the issue.

A company may redeem any redeemable preference shares pursuant to the following conditions:
- The redemption must be authorized by the articles.
- The shares must be fully paid.
- The share must be redeemed profit or proceeds of a special issue for that purpose.
- Any premium payable must be provided out of the profit of the company or the share premium account.
- If the shares are redeemed otherwise than out of the proceeds of a special issue, the capital redemption reserve fund must be created.
- The registrar must be notified of the redemption within 30 days thereof.

b) Under Section 56 (1) of the Companies Act, it is generally unlawful for a company whether directly or indirectly and whether by means of a loan, guarantee or the provision of security to give any financial for the subscription or purchase of its shares or those of its holding subsidiary.

- This section exemplifies the rule in Trevor v Whitworth. However, a company may lawfully finance the purchaser or acquisition of its shares in the following circumstances:
- Where lending of money is part of the ordinary business of the company and the same is lent in the ordinary course of business.
- Where the company enforces a scheme to advance loans to trustees to enable them to purchase its fully paid shares for the benefit of its employees including salaried directors.
- Where 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 shares by way of beneficial ownership.

Non-compliance with this section renders the company and every officer in default liable to a fine not exceeding KShs.20, 000.

QUESTION THREE

Birds Limited has three directors: Peacock, Sparrow and Vulture. Explain the legal implication of each of the following situations:

a)

- Appointment of directors is a power vested in the general meeting by the articles and directors have no power to appoint other directors let alone their own sons.
- The appointment of a director is effected by the passage of an ordinary resolution in a general meeting.
- Vultures wish to appoint his son a director is untenable since he has no power to do so.

b)

- Since directors stand in a fiduciary position in relation to the company whose board they form, they are bound to avoid conflict of interest.
- In this case sparrow is bound to disclose the nature of his interest at board meeting failing which the contract is voidable at the option of the company. as was the case in Aberdeen Railway Co. v Blaikie Brothers. additionally, it is a criminal offence for which sparrow is liable to a fine not exceeding kshs.2,000.

c)

- Removal of a director from office is a power vested in the general meeting by the companies act.
- Directors cannot remove one of their number from the office of director.
- In the case sparrow and vulture cannot remove peacock from directorship since they have no power to do so.

d)

- Being a director of the company, peacock has the right to take part in the affairs of the company.
- Vulture and sparrow cannot legally exclude peacock from participating in the affairs of the company.
- Peacock has the right to sue the other directors for an order to restrain them from excluding him from the affairs of the company.
- Additionally Peacock may petition for the winding up of the company on the ground that it is just and equitable to do so. As was the case in Re: Lundie BrothersLtd.

e)

- Based on the advice of the auditor, the company is insolvent and should cease to carry on business.
- The company may therefore be wound up compulsorily or voluntarily by creditors.

QUESTION FOUR

a) Ordinary Shares

- An ordinary share gives the holder the right to participate in the company"s surplus profit and capital.
- There is no limit to the level of dividend payable; this is dependent of the level of profit.
- Dividend is payable after preference dividend.
- In winding up the holder is entitled to capital.
- The shares counter unrestricted voting rights.
- Holders participate in surplus dividend.

Preference Shares

- Their essential characteristic is that they carry a prior right to dividend.
- Holders are entitled to a fixed rate of return.
- They carry a prior right to return of capital.
- The shares do not generally confer voting rights.
- Unless otherwise provided by the articles the shares are deemed to be cumulative i.e. unpaid dividend is payable when a profit is made.
- If the shares are issued as participating they participate in surplus profit and capital.

b)

i)

- Income return and capital growth are both determined by the company"s financial performance.
- If the company continuously or consistently under performs, capital is seriously at risk.
- Since the income return is determined by dividend payment, the ordinary shareholder is always at risk, if no dividend is declared.
- Preferential dividend is cumulative and has priority in the return of capital in winding up.

ii)

- As a general rule shares are transferable in accordance with Section 75 of the Companies Act subject to the restrictions prescribed by the articles.
- The articles association of private companies generally restrict the right of members to transfer shares.
- Directors are empowered to refuse registration of a transfer.
- However, the power of directors to do so must be exercised properly and if exercise improperly may precipitate a court action for validation of the transfer and rectification of the register.
- The director must exercise the power bonafide in the interest of the company. Such good faith is presumed unless the contrary is shown (in Re: Smith andFawcett)
- It must also be exercised within a reasonable time of receipt of the transfer (in Re: Zinotty Properties Ltd)
- There must be a positive act of refusal on the part of the directors. If action is ineffective. However there is no obligation to give reasons for the refusal unless otherwise provided by the article (in Re: Bede SS Co. Ltd

- As a general rule articles of private companies contain pre-emption clauses i.e. that any shares to be transferred be offered to existing members in the first instance (Curtis v Curtis & Co.)
- Under Section 77 of the Companies Act a transfer of shares can only be effected by the delivery to the company of an executed proper instrument of transfer.

QUESTION FIVE

a) Types of Registers

- **Register of Members**

  Under Section 112 (1) of the Act every company must keep a register of members. Its contents include:
  - Name of the shareholders
  - Postal addresses.
  - Number of shares or stocks held.
  - Date of entry of the name n the register.

  The register of members is accessible to:
  - Members of the company without charge.
  - Others subject to payment of the prescribed charge.

- **Register of Directors and Secretaries**

  Under Section 201 (1) of the Act every company, must keep a register of its directors and secretaries at its registered office.

  a) The register contains:
  - Christian and surname of every director.
  - His postal address.
  - His nationality.
  - Business occupation.
  - Other directorships.
  - In the case of a company its name, registered office and postal address.

  The register is accessible to:
  - Members of the company without charge.
  - Others on payment of the prescribed charge.
  - Directors and secretaries of the company.

- **Register of Charges**

  Under Section 105 (1) of the Act every limited company must keep a register of charges at its registered office.

  The register contains:
  - Particulars of all fixed and floating charges created by the company.
  - Description of the property charged.
  - Amount of charge.
  - Names of the persons entitled thereto.

  The register is accessible to:
  - Creditors of the company without charge.
  - Members of the company without charge.
  - Others on payment of the prescribed charge.

- **Register of debenture-holders**

  Under Section 88 (1) of the Act, if a company issues a series of debentures, it must keep a register of holders of such debentures at its registered office.
  The register contains:
  - Particulars of the debentures.
  - Names of the persons entitled thereto
  - Description of the security.

  The register is accessible to:
  - Holder of any debenture without charge.
  - Holder of shares in the company without charge.
  - Others on payment of the prescribed charge.

- **Register of directors Shareholding, etc**

  Under Section 196 (1) of the Act every company must keep a register showing as respects each director of the company, the number, description and amount of shares or debentures of the company or any other body corporate being the company"s subsidiary or holding company.

  The register contains:
  - Number, description and amount of shares or debentures held.
  - Nature and extent of the director"s interest in the shares or debentures.

  The register is accessible to:
  - Any member of the company.
  - Holders of debentures of the company.
  - Any person acting on behalf of the registrar.

b) A person may cease to be a member of a company on the following circumstances:

- Transfer of shares
- Death
- Bankruptcy
- Forfeiture of shares
- Sale by the company in exercise of lieu.
- Valid surrender of shares
- Rescission of contract.
- Repudiation by an infant.
- Winding up or liquidation.
- Redemption of redeemable preference shares.
- Disclaimer by trustee in bankruptcy.

QUESTION SIX

a) i)

Under Section 214 of the Companies Act "contributory" means "every person liable to contribute to the assets of a company in the event of its being wound up."

- The liability of a contributory creates a debt from him to the company.
- These are persons who owe the company in respect of shares held.
- A contributory may be a present or past member of the company.

ii) Under Section 323 (1) (a) of the Act, if in the course of winding up a company, it appears that any business of the company has been carried on,

- With intent to defraud its creditors or creditors of any other person or
- For any fraudulent purpose.

the court may, on application of the official receiver or liquidator or creditor or contributory of the company, declare that any person who was knowingly party to the carrying on of the company"s business as such personally responsible without any limitation of liability, for any debts or other liabilities of the company as the curt may direct.

- All persons who are knowingly parties to the carrying on of the company"s business are liable to an imprisonment for a term not exceeding 2 years or a fine not exceeding Kshs.10,000 or both.
- If the person(s) is a creditor to the company, the court may order that he ranks behind all other creditors in the satisfaction of claims.
- If the person(s) is a creditor to the company, his claim against the company is offset against the amount due from him to the liquidator.

b) Under Section 222 of the Companies Act, on hearing a winding up petition the court may:
   - Dismiss it.
   - Adjourn the hearing conditionally or unconditionally.
   - Make an interim order.
   - Make such other or further order as it may deem fit.

   However, the court cannot refuse to make a winding up order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets or that the company has no assets.

QUESTION SEVEN

a) Company meetings make decisions by passing resolutions. Kenyan company law recognizes three types of resolutions namely:
   - Ordinary resolution
   - Resolution requiring special notice.
   - Special resolution.

- **Ordinary Resolution**: The Companies Act does not define it.
  - This is a resolution that requires simple majority to pass.
  - It need not be set out in the notice of the meeting and is generally not registerable. Business of the company requiring an ordinary resolution include:
    - Adoption of accounts
    - Declaration of dividend
    - Appointment of auditors
    - Election of directors
    - Increase of capital

- **Special Resolution**
  - This is a resolution created by Section 141 of the Companies Act.
  - It must be supported by a qualified majority of not less than 75% of all members present and voting in person and proxy.
  - Must be set out in the notice of the meeting.
  - Notice of intention to pass it as a special resolution must be given.
  - Generally passed by meetings convened by a 21-day notice.
  - A copy thereof must be delivered to the registrar for registration within 30 days thereof.

Business of the company that require such a resolution include:

- Alteration of the articles, Sec 13 (1)
- Change of name, Sec 20 (1)
- Alteration of the objects clause, Sec 8 (1)
- Reduction of capital, sec 68 (1)
- Creation of reserve capital, sec 62

- **Resolution requiring special notice**
  - This is a resolution created by Section 142 of the Companies Act.
  - Under Section 142 of the Act, a 28 day notice of intention to move, it must be given to the company and the company must give a similar notice to its members failing which a 21 day notice suffices provided it is published in some newspaper circulating in Kenya or as prescribed by the articles.
  - It must be supported by a simple majority of members.

  Business of the company requiring such a resolution include:
  - Removal of a director or auditor from office.
  - Reappointment of a director who has attained the age of 70.

b)

- This problem is based on abuse of power by directors.
- By issuing shares to themselves and nominees, the directors are exercising the power to issue shares for a purpose other than that for which the power is conferred. As was the case in Piercy v Mills and Punt v Symons.
- The directors are therefore guilty of breach of duty to the company.
- Since directors owe their duty to the company as opposed to individual shareholders (Percival V. Wright) Mwananchi has no action against them.
- My advise to him is to instigate the convention of an extra ordinary general meeting of the company to resolve the matter. The meeting may resolve that the company sue the directors for breach of duty or ratify the transaction, whereupon it becomes a valid act of the company. As was the case in Bamford and Another v Bamfordand Others.

QUESTION EIGHT a)

- The profits which may be distributed as dividend are accumulated realized profits so far as not previously utilized by distribution or capitalization, less accumulated realized losses so far as not previously written off in a reduction or re-organization.
- Profits are generally ascertained by reference to audited accounts prepared on a proper basis.
- If a fixed asset has a limited useful economic life, provision must be made for depreciation calculated to write off the value of that asset over the period of its useful economic life.
- In so far as depreciation relates to the historical cost of the asset it must be treated as a realized loss and debited against profit, in determining the amount of distributable profit remaining. But if the asset has been revalued, any increase depreciation provision related to the increase inv value of the asset may be treated as profit.
- If on a general revaluation of all fixed assets it appears that there is a diminution in value, any provision related to it need not be treated as realized loss.
- If a company shows development expenditure as an asset in its accounts it must usually be treated as realized loss.
- A public company may only make a distribution of its net assets are at the time, not less that the aggregate of its called up of its called up share capital and

undistributable reserves the dividend which it may pay is limited to such amount as will leave its net assets at not less than that aggregate amount.

- If fixed assets taken as a whole show a value below their aggregate book value there is an unrealised loss and the company must retain out of profit otherwise available for distribution an amount sufficient to make good the deficiency.
- If the value of the assets exceeds book value, the surplus since it is unrealised cannot be added to the total of realized profit and it is not distributable as dividend.
- It should be taken as revaluation reserve.
- It is a well-established principle that in determining the net worth of company all assets and not just selected items must be considered and the figures aggregated.

b)

- Since authorized or registered capital of Happy Company Ltd. is fully issued the company must increase the same.
- The directors must satisfy themselves that the company"s articles authorize such increase pursuant to Section 65 (1) of the Act.
- The increase of capital must be authorized by an ordinary resolution of members in general meeting.
- Directors must therefore convene a general meeting to secure the resolution.
- A copy of the resolution must be delivered to the registrar for registration within 30 days of its passing so as to register the increase.
- For the purpose of allocating or issuing shares directors must satisfy themselves they have the power to do so.
- Directors are generally authorized to allot shares, otherwise the same must be authorized by an ordinary resolution of members in general meeting.
- The allotment in this case must be authorized by an ordinary resolution of members in general meeting and copy thereof must be delivered to the registrar for registration.
- In order to disapply pre-emption rights, so that some shares can be issued to members of the public and not to existing members the same, must be authorized by a special resolution of members in general meeting.
- In order to issue shares to Mr. Karan in return for the plot, the directors require an independent valuation of the plot since consideration is non-cash.
- The report must be made or procured by a person qualified for appointment as auditor of the company and must be submitted to the company within 6 months before allotment.

JUNE 2010

QUESTION ONE

a)

- **Corporation sole:** This is legally constituted office distinct from the holder and canonly be held by one person at a time after which he is succeeded by another. The office is a body corporate with perpetual succession, capacity to contract, sue or be sued and own property e.g. Office of the Permanent Secretary to the Treasury, Office of the Public Trustee.
- **Corporation aggregate:** This is a legal entity formed by two or more persons for alawful purpose and whose membership consists of at least two persons. It has independent legal existence, capacity to contract, sue or be sued and perpetual succession e.g. private and public companies.

b)

- **Limited Company:** This is a registered company whose liability is limited byshares or guarantee. It means that member"s liability to contribute to the assets of the company is limited either:
  i) To the amount outstanding on their shares, if any, or
  ii) To the amount they undertook to contribute if the company was wound up during the currency of their membership or within one year of cessation of membership beyond which they are not liable.

- **Unlimited Company:** This is a registered company whose liability is unlimited.Under section 4 (2) (c) of the Companies Act members are liable for the debts of the company without any limitation. Creditors may sue members for the debts of the company if the company is unable to pay. Private assets of members may be attached by creditors to the company.

Under the provisions of the Companies Act a company registered as unlimited may be re-registered as limited upon application. Such registration does not affect the rights or liabilities of the company in respect of any debt or obligation incurred or any contract entered into by, to with or on behalf of the company before the registration.

- Upon registration the registrar shall close the former registration of the company and may dispense with the delivery to him of copies of any document copies of which he was furnished on the occasion of the original registration of the company.
- However, the registration shall take place in the same manner and shall have effect as if it were the first registration of the company under the provisions of the Act.

c) Documents ordinarily kept at a company"s registered office include:

- Copies of the memorandum and articles of association of the company.
- Register of members.
- Copies of charges
- Register of charges.
- Minute book of general meetings.
- Register of directors and secretaries.
- Register of directors interests in the company.
- Register of debenture holders.

QUESTION TWO

Under Section 13 (1) of the Companies Act a registered company has statutory power to alter add to its articles. Under Sec 13 (2) such alteration or addition is as valid as if originally contained in the articles and is alterable. It was so held in Walker v London Tramways Co.Ltd

i) However, this power is subject to both statutory and common law restrictions.

- **Statutory Restrictions**
  - Under Section 13 (1) of the Act an alteration of the articles must be authorized by a special resolution of members in general meeting.
  - The alteration must not be inconsistent with any written law including the Companies Act.
  - It must not exceed the conditions contained in the Memorandum of Association of the company.
  - It must not increase the liability of members ore require them to take up more shares without written consent.
  - It must not amend the provisions of Section 30 of the Companies Act if the company is to remain private.
  - It must not be inconsistent with a court order made pursuant to Section 211 of the Companies Act for purposes of minority protection in cases of oppression.
  - It must not be contrary to the rights of dissentient shareholders affected by a variation of class rights pursuant to Section 74(1) of the Act, to apply to the court for the variation to be cancelled.

- **Common law or judicial restriction**
  - The alteration must be bonafide for the benefit of the company as a whole i.e. regard must be had to existing and future shareholders of the company. As was the case in Sidebottom v Kershaw Leese & Co.. where the articles was altered to enable the company get rid of competitors from among its members. However, in Brown v British Abrassive Wheel where the articles were altered to enable the majority acquire the shares of the minority it was held that the alteration was not bonafide.

ii) This problem is based on the restrictions subject to which a company must alter its articles. Under the provisions the Companies Act a company has statutory power to alter its articles and it is on this basis that Karanja and Mutisya propose to alter the articles.

- Firstly, the alteration to enable holders of 90% of the company shares to compulsorily acquire the shares of the minority shareholder is not bona fide and cannot withstand judicial scrutiny. It is therefore invalid. This position is consistent with the decision inBrown v British Abrassive Wheel Co. Ltd whose facts were substantially similar.
- Secondly the alteration to require competing shareholders to transfer their shares to nominees of the directors is bona fide and valid since it is beneficial to get the company get rid of competitors from among its members. This position is consistent with the decision in Sidebottom v Kershaw Leese & Co whose facts were substantially similar.

QUESTION THREE

a) (i)

- A company comes into existence on the date of incorporation. Before such date it does not exist and hence has no capacity to contract and cannot have agents. It was so held in Kelner v Baxter (1866).
- Whereas a company may benefit from contracts entered into before its incorporation it cannot, as a general rule be held liable on them. Such a contract cannot be ratified. It was so held in Natal Land Co. v Pauline CollierySyndicate as well as in Price v Kelsal, nor can directors of the company purport to adopt or affirm the contract after the company"s incorporation. It was so held in North Sydney Investments and another v Higgins and another. Such contracts can only be entered by or against the company if the company after incorporation enters into a new contract similar to the previous agreement. It was so held in Howard v Patent Ivory Co. Ltd
- In this case "Micromine Limited" has no enforceable rights on the contracts and cannot sue or be sued on them hence it is free from liability.

(ii)

The contract may expressly provide that any amount or sum spent by Shem s recoverable from the company when incorporated. Problem however arises since the company is not privy to the contract and Shem cannot contract as the agent of the company. The articles of the company generally provide for the recovery of such expenses e.g. Article 80 of Table A. However such an Article is unenforceable by virtue of section 22 (1) of the Companies Act. Arguably therefore no provision in the contract can adequately protect Shem.

b)

Ultra Vires literally means beyond the powers. This is a rule of capacity of registered companies now embodied in the provisions of the Companies Act Cap

The provisions are emphatic that the memorandum of association of the company must state its objects. The objects clause of a company determines what is intra and ultra vires. It therefore delimits the doctrine of ultra vires. The doctrine of ultra vires was first incorporated into the statute books Iron Co. vs Riche where the Court of Appeal was emphatic that a company could only engage in transactions set forth in its objects clause other transactions being ultra vires the company.

The capacity of registered companies was expanded by the court Attorney Generalvs Great Eastern Railway Co (1880) where the court held that in addition to the express objects a company had capacity to engage in transactions reasonably incidental to or consequential upon these objects. These are transactions reasonably incidental to the attainment or pursuit of the express objects.

At Common Law a company"s capacity is restricted to, transactions et forth in the objects and those that are reasonably incidental to the attainment or pursuit of such objects. The doctrine of ultra vires was developed to serve a double purpose. Cotman vs Brougham (1918)

To protect investors who learn from it where their money will be invested.

To protect third parties who deal with the company by appreciating the company"s capacity.

The doctrine of ultra vires has been modified so much that companies enjoy almost unrestricted capacity. Companies can engage in virtually any transaction.

Judicial Contribution

Courts ultra vires have been ready and willing to imply powers e.g. a transaction reasonably incidental to the attainment or pursuit of the express objects is intra vires the company.

Legislative intervention

Before 1890, a registered company could not alter it"s objects clause. In 1890, the English parliament amended the Companies Act to confer upon companies" power to alter their objects clause. The power is now contained in Section 8 (1) of the Companies Act and the company may within the confines of Section 8 (1) enhance it"s capacity.

Drafting techniques

These are techniques that have rendered the doctrine of ultra vires virtually useless e.g.:

- Inflated objects clauses, which entails the listing down of every conceivable object in the clause.
- Use of independent object clauses Cotman V. Brougham(1918)
- Use of subjective as was the case in Bell Houses Limited v City Wall PropertiesLtd(1966)

QUESTION

FOUR a)

- The issued capital of the company whether paid up or not must be maintained.
- It is in principal regarded as a permanent fund or a fund of last resort available to all creditors in the event of default by the company.
- The capital of a registered company must remain certain. It acts as a guarantee that creditors will be paid. Creditors are entitled to insist that no part of the company"s capital is wasted or returned to members.
- Creditors and other persons who deal with companies are aware that the companies have an amount of capital and are entitled that to insist no part thereof is returned to members without due compliance with law.
- It is therefore a fundamental principle that of company law that capital be maintained.
- Company Law has evolved both statutory provisions and prepositions of common law to facilitate the raising and maintenance of capital. One of these provisions is that the company should only reduce capital in accordance with the provisions of the Companies Act. These provisions of the companies act prescribe the circumstances and conditions under which a company may reduce capital.

i) Authority of the Articles

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

ii) Special Resolutions

Under Section 68(1) of the Act reduction of capital of capital by a company must be authorized by a special, resolution of members in general meeting. This resolution is referred to as "resolution for reducing share capital". The reduction of capital may take the form of:

Reducing or extinguishing liability on any unpaid up capital.

Cancellation of any paid up capital, which is lost or unrepresented by available assets.

Paying off any paid up capital, which is in excess of the wants of the company.

iii) Application to court for confirmation

Under Section 69(1) of the Act after the special resolution is passed an application must be made to the High Court for confirmation of the reduction. The essence

of the application is for the court to satisfy itself that the reduction does not unfairly prejudice the position of any class of members or creditors. In particular the court must settle a list of all creditors and must satisfy itself that any creditor entitled to object to the reduction has either objected or consented to the same. In the case of an objection the court must be satisfied that the creditors claim or debt has been discharged, determined or secured. If the court is so satisfied it may confirm the reduction.

iv) Confirmation of the reduction

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

v) Registration of the reduction

Under Section 71 (1) of the Act upon production of a certified court order approving the reduction and the minute of the same the registrar registers the reduction and issues a certificate of registration, which is conclusive evidence that the requirements of the act relating to reduction of capital have been complied with. A reduction of capital by a company take effect when registered and notice of registration must be published in accordance with the courts direction

Underwriting Commission

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

Brokerage

This is an amount paid by the company to a person or persons who agrees to place the company"s shares i.e. exhibits the company"s prospectus in their premises or send copies to their clients, but without incurring any liability on the shares.
It is an amount only payable to brokers.
It must be disclosed in the company"s prospectus.

QUESTION FIVE

a) Under the provisions of the Companies Act every company with more than fifty members must have an index of the names of the members unless the register is in the form of an index.

- It may be in the form of a card.
- The index must contain a sufficient indication to facilitate access to a members account.
- Changes on the register must be incorporated in the indeed within 14 days.
- The index must be kept at the same place as the register of members.

b)

i) Bank

- In law if a third party advances money on the security of shares and the third party gives notice of his security to the company before the company"s lien arises the third party will have priority.

In Bradford Banking Co. v Briggs and Co. (1886) a shareholder created an equitable mortgage of his shares by depositing the share certificate with a bank as security for an overdraft and the bank gave notice of the notice of the deposit to the company. The shareholder subsequently became indebted to the company whereupon a lien arose in favour of the company t was held that the bank had priority as the company"s lien arose after notice of the equitable mortgage.

- The bank is entitled to enforce the lien on the shares since its lien has priority over that of the company. This position is consistent with the holding in Bradford Banking Co. v Briggs and Co. (1886)

ii) XYZ Supermarket Ltd

XYZ Supermarket Ltd cannot enforce its lien since the banks lien has priority.

c) Bob and Babs have similar rights in relation to the shares e.g. dividend payable thereon. They are jointly and severally liable to make good any calls on the shares. In the case of voting in general meetings the members decide who among them is to vote, failing which the member whose name appears on the register first votes.

QUESTION SIX

a)

i)

- Voluntary change of name, Sec.21
- Alteration of the objects clause, sec.8(1)
- Alteration of the articles, sec.13(1)
- Creation of reserve capital, sec.62
- Conversion of private to public company, sec.32(1)
- Compulsory winding up sec.219(a)
- Reduction of capital, sec.68 (1)
- Payment of interest out of capital, sec.67 (1)

b)

- At common law a shareholder is entitled to attend a general meeting of a company in person or by proxy.
- Under section 136 (1) of the Companies Act a member of a company entitled to attend and vote at a meeting of the company is entitled to appoint another person whether a member or not as his proxy to attend and vote instead of him.
- The appointment is effected by completion and submission to the company of the proxy form.

i)

- To attend the general meeting instead of the member.
- To join other members and/or proxies to demand voting by poll.
- To vote by poll.
- To speak at the meeting in the case of a private company meeting.

Under Section 221 of the Companies Act a petition for the compulsory winding up of a company may be presented to the court by any of the following person(s)

- The company
- Members or shareholders other than contributories.
- Creditors of the company.
- Contributories.

- Attorney General
- Official receiver

QUESTION SEVEN

a)

Appointment

- The names of the first directors are determined in writing by the subscribers or a majority of them failing which the signatories to the memorandum are the first directors.
- Directors are elected by members in general meeting by an ordinary resolution.
- to qualify for appointment as a director one must:
  - Be between the age of 21-70
  - Be of sound mind.
  - Not be an undischarged bankrupt or insolvent.
  - Not have been disqualified by the court.
- A person appointed director must sign and deliver to the registrar for registration a written memorandum.
- If the articles require a director to hold any share qualification a person must take them up within two months of appointment or such shorter time as the articles may prescribe.
- Under section 184 (1) in the case of a public company meeting a motion for the appointment of two or more persons as directors by a single resolution must not be made unless a resolution to that effect has been agreed to by the meeting without any vote against it.

Vacation

The office of director must be vacated if the director:

- Is disqualified by the court pursuant to section 189 of the Act.
- Fails to acquire share qualification.
- Is declared bankrupt or makes an arrangement or composition with his creditors generally.
- Becomes of unsound mind.
- Resigns his office by notice in writing to the company.
- Attains the age of 70 unless re-appointed.
- Is removed by an ordinary resolution of members in general meeting absents himself from directors meeting held in over six months without permission of the other directors.
- Dies
- If the company goes into liquidation.

b)

- The transaction to advance Shs.500,000 to Austin to cover his expenses on worldwide promotional tour on behalf of the company required prior approval by members in general meeting pursuant to the proviso to Sec.191(1) of the Act which permits a company to provide funds to a director to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an office of the company.
- Under Sec.191 (3) of the Act if the requisite approval is not given by the company in general meeting the directors authorizing the making of the loan are jointly and severally liable to indemnify the company against any loss arising there from.

QUESTION EIGHT

a) Under Section 97 (1) of the Companies Act, it is the duty of the company to deliver to registrar for registration the particulars of every charge created by the company. These particulars include:

- Date and description of the instrument creating or evidencing the charge;
- Amount secured by the mortgage of charge;
- A short description of the property mortgaged or charged;
- Names, postal addresses and descriptions of the mortgages or persons entitled to the charge;
- Names of the chargor or mortgagor;
- Amount or rate % of the commission allowance or discount if any paid or made either directly or indirectly by the company to any person in consideration of his subscribing or agreeing to subscribe whether absolutely or conditionally or procuring or agreeing to procure subscriptions whether absolutely or conditionally.

b)

- This problem is based on the effect of registration of a charge pursuant to the provisions of the Companies Act. Under Section 99 of the Companies Act upon registration of particulars of a charge the registrar issues a certificate of registration, which is conclusive evidence that the provisions of the Act have been complied with. This section has been interpreted to mean that the certificate of registration is conclusive evidence that the provisions of the Act relating to the preparation and registration of charges have been complied with (in reMechanizations Ltd).

- In this case since the memorandum of charge was duly executed by the company and registered thereafter and a certificate of registration issued by the registrar, the charge is valid in all respects and is therefore enforceable since its defects were cured by its registration.

- This position is consistent with the decision In re C.L. Nye Ltd where a bank lent money to C.L. Nye Ltd and obtained a charge on the company"s land as security.

  The charge contract was undated and the bank solicitor forgot to register it with the Registrar of Companies. Several months later the bank sought to realize its security. The solicitor inserted that day"s date on the charge contract delivered it to the registrar for registration and obtained a certificate. The company"s liquidator argued that he could ignore the charge because it was not registered within the requisite time. However, it was held that the certificate was conclusive evidence that the provisions of the Act relating to registration had been complied with i.e. it was registered within the requisite time hence the charge was valid.

  This position was also upheld in National Provincial and Union Bank of Englandv Charnley.

NOVEMBER 2010

QUESTION ONE

(a)

- It is a trite principal of law that when a company is incorporated or registered it becomes a legal person distinct and separate from its members.
- It becomes a body corporate.
- It acquires an independent legal existence with rights and subject to obligations.
- This is the rule in Salomon V. Salomon and Co. Ltd (1897) where Lord MacNaghlen was emphatic that "…..The company is at law a different person altogether from the subscribers to the memorandum."
- The principle of legal or corporate personality of a company is now contained in Sec 16(2) of the Companies Act.
- That the company is a legal entity separate from its members is illustrated by the following arguments.
  - **Limited Liability**: Liability of members for its debts and other liabilities is limitedby shares or guarantee. This principle is contained in Section 4 (2) (a) and (b) of the Companies Act.
  - **Sue or be sued**: a company has capacity to enforce its rights and may be sued on itsobligations. It was so held in Foss V. Harbottle (1843).
  - **Perpetual Succession**: the life of a company lies in the intendment of law. This isbecause it is a creation of law.
  - **Owning of Property**: a registered company has capacity to own property (Sec 16 (2) "power to hold land." The property of a company is vested in it. It was so held in Macaura V. Northern Assuarance Co. (1925)
  - **Capacity to contract**: a registered company has capacity to enter into contractualrelationships. It has capacity to hire and fire. It was so held in Lee V. Lee Air Farming Co. Ltd. (1961).
  - **Common Sea**: Under Sec 16 (2) of the Companies Act, a registered company has acommon seal to authenticate its transactions.

(b) These are qualifications or modifications to the rule in Salomon"s case often referred to as "piercing the corporate shell." The veil of incorporation may be lifted by the courts or at common law and by the legislature.

- **Statutory or Parliamentary exceptions**
  - Reduction of number of members
  - Non-publication or misdescription of the company"s name
  - Group accounts
  - Investigation of company affairs
  - Investigation of company membership
  - Take over bids
  - Fraudulent trading

- **Judicial or Common Law exceptions**
  - Agency or nominee or trustee
  - Group enterprises
  - Ratification of corporate acts
  - Determination of residence
  - Determination of character
  - Fraud or improper conduct.

(c)

- This problem is based on lifting of the veil of incorporation by courts of law to prevent a person from using a company to evade an existing legal obligation.

- It is evident that Angela entered into a contract in restraint of trade not to solicit the customers of Eclipse Ltd within 3 years of leaving employment.
- By forming a company which is soliciting the customers Angela is in breach of her contractual obligations and Eclipse Ltd has an action against her and Angellina Co. Ltd.
- My advise to Eclipse Ltd is to institute civil proceedings against Angela and Angellina Co. Ltd for an injuction to restrain them from soliciting its customers. The fact that Angellina Co. Ltd was not privy to the original contract not withstanding since Angela is using the company to evade an existing legal obligation.
- My advise is based on the decision in Gilford Motor Co. Ltd V. Horne and Another whose facts were substantially similar to those of the instant case.

QUESTION TWO

(a) (i)

- The rule in Royal British Bank V. Turquand often referred to as the "indoor management rule" is to the effect that a 3rd party dealing with a company in good faith is entitled to assume that it is acting within its constitutional powers.
- He is not bound to satisfy himself that all rules of internal management have been complied with.
- He is entitled to assume that what appears regular is indeed regular (Mahony V. EastHoly Food Mining Co.)
- He is entitled to assume that officers of the company who purport to exercise certain powers ordinarily exercised by those sort of officers, are the officers concerned. (Freemans case).
- This rule protects 3rd parties against the company in cases of internal irregularities.
- It is based on the principles of equity and is intended to give business efficacy.

(ii)

- Public documents of the company.
- Knowledge of the irregularity or lack of authority.
- Suspicion i.e. 3rd part is put on inquiry.
- Excess of power by the officer dealt with
- Insiders e.g. directors in certain circumstances.
- Forged documents.

(b)

- This problem is based on the rule in Turquands Case.
- The articles of Shirika Company Limited are emphatic that directors have the power to determine who should sign contracts and other documents of the company.
- Evidence shows that Chapu Chapu one of the directors purporting to be the chairman executed a quaranted to Chafua and Shirika Ltd has after discovery of the state of affairs refused to honour the quaratnee. Question is whether Shirika Company Limited is liable.
- Shirika Company Ltd is liable for the following reasons:
  - Chapu Chapu, a director represented himself as Chairman and purported to do what a chairman ordinarily does.
  - The company is estopped from denying the representation.
  - Chafua was not obliged to satisfy himself that Chapu Chapu was the elected chairman.
  - This position is consistent with the decision in Freeman and Lockyer V. BackhurstPark Properties Ltd. whose facts were substantially similar.

QUESTION THREE

(a)

- "Capital of Limited Company" means share capital.
- In simple legal parlance, capital means the various types of categories of capital which a company may have for example.
  - Registered or authorized capital.
  - Allotted or subscribed capital.
  - Called up capital.
  - Paid up capital.
  - Uncalled up capital
  - Unpaid up capital
  - Reserve capital.

(b)

Shares	Stock
• These are units of capital. • Are issued directly by the company. • They need not be fully paid. • Are always numbered • Fractions thereof are not transferable.	• This is a set of shares put together in a bundle i.e. lumpsum holding. • Cannot be issued directly. • The shares in question must be fully paid. • Are not numbered. • Fractions thereof are transferable.

(c)

- A company issues shares at a discount if the cash consideration which is receives for them is less than the nominal amount of the issued shares. Issue of shares at a discount is a principal prohibited. However, under Section 59 of the Companies Act shares may be issued at a discount subject to the following restrictions:
  - The shares must belong to a class already issued by the company.
  - The issue must be authorized by a resolution of the general meeting.
  - The resolution of the general meeting must specify the maximum rate of discount at which the shares are to be issued.
  - The issue must be sanctioned by the court.
  - The shares must be issued within one month of sanction by the court of such other time as the court may allow.
  - At least one year must have elapsed from the date the company was entitled to commence business.
  - Particulars of the discount must be disclosed in the company prospectus.

QUESTION FOUR

(a)

- Proprietary rights of members fall two categories namely primary and secondary.
- **Primary rights** include:
  - Right to vote in company"s general meetings.
  - Right to capital in the event of winding up.
  - Right to dividend if the same has been declared and become payable.
- **Secondary rights** include
  - Right to received notices of all general meetings of the company.

- Right to receive copies of the memorandum and articles.
- Right to receive copies of the balance sheet laid before the company in general meeting.
- Right to inspect the various registers maintained by the company.
- Right to obtain copies of registers.
- Right to petition for the alternative remedy.
- Right to petition of the winding up of the company.

(b)

- This problem is based on the membership and the liability of members in the event of winding up.
- Ritas application for 2000 shares in Bidii Yako Co. Ltd was not accepted within a reasonable time and hence lapsed.
- However, subsequently, Bidii Yako Co. Ltd transferred shares to her and inserted her name in the register of members a fact rita was aware of but failed to rectify the situation.
- Rita is for all intents and purposes a member of Bidii Yako Co. Ltd an is therefore liable to pay the amount outstanding on her shares.
- Rita is a member by estoppel and cannot deny her apparent membership.
- She is liable as a contributory.
- My advise to her is to pay up the amount due on the 2000 shares.
- My advise is based on the fact that she is a member of the company and the provisions of Companies Act on the liability of contributories.

QUESTION FIVE

(a)

- Failure to pay the principal or interest when due and payable provided the charges takes some step to realize the security.
- Commencement of recovery proceedings against the company.
- Commencement of winding up the company.
- Cessation to carry on business by the company.
- Occurrence of an event which under the terms of the debenture causes crystallization.
- It is a company has a number of floating charge, the crystallization of one causes the crystallization of the others.

(b)

- When a floating charge crystallizes it fastens on the assets within its reach and grasp (Illingworth V. Holdsworth) and becomes a fixed charge.
- It entitles the chargee to sell the security, if any.

(c)

- The value of security remain uncertain since the company continues to carry on business in the ordinary manner.
- A fixed charge created subsequent to the floating charge has priority in the satisfaction of claims.
- Other interests for example landlords distress for rent has priority in the satisfaction of claims.
- Other interests for example landlords distress for rent has 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.

QUESTION SIX

(a)

- Statutory meeting
- Annual general meeting
- Extra ordinary general meeting
- Class meeting
- Creditors meeting
- Directors meeting

(b)

- This case is authority for the proposition that one person cannot constitute a meeting.
- However, in law one person can constitute a meeting. These are exceptions to the rule in Sharp V. Dawes (1876)
- Directors meeting in the case of a private company with a single director.
- Class meeting in the case of a company with different classes of shares.
- Creditors meeting if only one creditor has proved his debt.
- Adjourned meeting.
- Annual general meeting convened by or in accordance with the registrars directions.
- Meeting convened pursuant to a court order.

(c) (i)

- This is notice whose intention to move it must be given to the company at least 28 days before the date of the meeting.

(ii)

- Removal of an auditor from office
- Removal of a director from office
- Re-appointment of a director who has attained the age of 70.

QUESTION SEVEN

(a)

- Has bound himself personally
- Has acted on behalf of an illusory company
- Has signed a negotiable instrument in which the company"s name is not published or is misdescribed.
- Breach of warranty of authority.
- Has acted fraudulently.
- Has engaged the company in an ultra vires transaction
- Has assumed a direct duty of care to 3rd parties.

(b)

- This problem is based on abuse of power by directors otherwise called excesses of directors or "better still" transactions ultra viresthe directors.
- In this case directors of Modern Technology Co. Ltd borrowed from Money Bank Ltd for a purpose other than that for which the company was incorporated and the credit manager of the bank had a copy of the company"s memorandum of association hence by the doctrine of constructive notice, he was deemed to know that he company was borrowing for a wrong purpose.
- The borrowing in this case intra vires the company but ultra vires the directors.
- The borrowing is voidable at the option of the company.

- Money Bank Co. Ltd cannot recover the loan on account that:
  - It is deemed to know the contents of the company"s public documents.
  - It"s the creditor manager had a copy of the company"s memorandum of association but failed to satisfy himself that the company was borrowing for its purposes.
  - It is a party to the abuse of the power to borrow and cannot therefore recover the loan.
- This position is consistent with the decision in re Introduction Ltd (1968) where a company formed to entertain and accommodate visitors in the UK borrowed from the plaintiff bank to promote Pig breeding which was not an objects clause. It was held that since the bank had a copy of the company"s memorandum and hence aware of the abuse of power, it was privy thereto and could not enforce the borrowing.

QUESTION EIGHT

(a)

- Under Section 219 (f) of the Companies Act, a company may be bound up by the court if the court is of the opinion that it is just an equitable that the company should be wound up.
- Courts of law have wound up companies on this ground in certain circumstances:
  - Fraudulent or illegal purpose.
  - Failure of substratum
  - Loss of confidence in management.
  - The company is a "bubble" or "sham."
  - Oppression of the minority.
  - Expulsion or exclusion from management.
  - Deadlock in management and membership.

(b)

- A member cannot be held liable to contribute after one year of cessation of membership.
- A member can only be held liable to contribute if it appears to the court that existing members are unable to satisfy the contributions required.
- A member can only be called upon to contribute the amount outstanding on his shares.
- A member can only be called upon to contribute to the assets of the company the amount he undertook to contribute in the event of winding up.

JUNE 2011

QUESTION ONE

(a)

- The name chosen must have "Limited" or "Ltd" as the last word thereof for companies limited by shares or guarantee.
- The name must be undesirable in the opinion of the registrar.
- It must not be too similar to that of an existing company.
- It must not contain the term co-operative, its equivalent or any abbreviation thereof.
- It must not suggest any patronage of the president, government ministry, department or local authority.
- It must not suggest a criminal or moral intent or purpose.
- It must not contain the term "bank," "insurance" or hotel unless the company proposes to carry on such business.
- It must not mislead the public in any way.
- It must not contain the term "national" or "international". However, the latter may be used in certain circumstances.

(b)

- As a fiduciary Martha is bound to:
    - Actbonafidefor the benefit of the company in formation.
    - Disclose her personal interest in the contract to an independent board of directors or in the prospectus. She must disclose any secret profit made failing which she is liable to account the same to the company.
- Render proper accounts on the application of monies or assets coming to her hands during the promotion exercise.

(c)

A promoter is not entitled to any remuneration for incorporating a company. This is because there is no contractual relationship between the promoter and the company. In any event the company did not contract for her services. However a promoter may be rewarded in other ways, for example; being offered deferred shares, freedom to sell assets to the company at an over valuation, being appointed director or liberty to sell over-valued assets to the company in return for fully paid shares.

QUESTION TWO

(a)

- Pesa Limited cannot raise funds to purchase Anna"s shares as if in contrary to the rule in Trevor V. Whitworth.
- The rule in Trevor V. Whitworth is emphatic that a company must not purchase its shares or finance their purchase. However, there are certain circumstances in which a company may purchase its share e.g. redemption of redeemable preference shares.
- Pesa Limited is free to redeem redeemable debentures out of reserves or the share premium account. The debenture must be redeemed in accordance with its provisions.

(b)

- It is unlawful for a company to finance the purchase or subscription of its shares. In this case, the lending of money to Charles is unlawful and the purported guarantee by Pesa Ltd is unlawful as well. This case does not fall within the exceptions prescribed by the provisions prescribed by the proviso to section 56 of the Act in which a company may finance the purchase of its shares.

(c)

- The purported course of action cannot stand judicial scrutiny as Pesa Ltd is still purchasing its own shares indirectly which is contrary to the law. The new company will be nothing but a sham to enable Pesa Ltd purchases it share.

QUESTION THREE

(a)

Bearer debenture

- This is a debenture payable to the holder or bearer.
- It is a negotiable instrument transferable by mere delivery and free from equities.
- A bonafide transferee acquires a good title.
- Bearer can sue the company in his own name.

Registered debenture

- This is a debenture issued to a registered holder i.e. registered by the company.
- It is payable to the registered person.
- The company has particulars of a specific person.
- It is transferable by the execution of an instrument of transfer.

(b)

Redeemable debentures

- These are debentures which are redeemable within a specified duration.
- The redemption must be effected in accordance with its provision i.e. payment of principal and interest.

Irredeemable debentures:

These are debentures that are only redeemable in the event of winding up or some serious default by the company.

Debentures

It is a document evidencing indebtedness which is secured or unsecured.

This is acknowledgement of indebtedness it is evidenced that a company is indebted Edmunds V. Blaing Co. Debenture includes:

Debenture Stock:

- It is transferable in whole.
- This is a loan fund created by a company. It is divisible among a class of lenders each of whom is given a debenture stock certificate specifying the part a creditor is entitled to.
- It is the indebtedness itself and the certificate evidences the stockholders interest.
- Debenture stock can be divided and transferred in fractions.
- It is created by a trust deed.

Unsecured debentures

These are debentures that are naked i.e. They have no charge or security to secure the amount borrowed. The creditor can only sue the debtor in the event of default.

Secured debenture

- This is a debenture which contain a charge over the assets of the company.
- May be secured by a fixed or floating charge or both.

QUESTION FOUR

(a)

Under section 4 (2) (a) of the Companies Act, a company limited by shares means that a member thereof can only be called upon to contribute to the assets of the company the amount if any outstanding on his shares beyond which he is not liable.

Under section 4 (2) (b) of the Companies Act, company limited by guarantee means that a member can only be called upon to contribute to the assets of the company the amount he undertook to contribute, if the company was wound up during his membership or within 1 year of cessation of membership, beyond which he is not liable.

(b)

Under the provisions of the Companies Act Cap 486, the contents of the memorandum of association are:

- **Name of the Company** with "Limited" or "Ltd" as the last word thereof forcompanies limited by shares or guarantee.
- **Registered office clause**: the registered office of the company will be situate in Kenya.
- **Objects of the company**: purposes for which the company is incorporated.
- **Liability clause**: the liability of members is limited or unlimited and if limited, whetherby shares or guarantee.
- **Capital clause**: the capital with which the company proposes to be registered and thedivisions thereof.
- **Association of declaration clause**: the desires of the subscribers to be incorporated.
- **Particulars of subscribers**: Name, postal address and occupation of subscribers.Number of shares taken.
- **Date:** under section 6 (1) of the Companies Act, a memorandum must be dated.

(c)

- **Articles of association**: it is the internal constitution of the company. Contains therules of internal management. Regulates the relations between the company and its members.
- **Declaration of compliance**: this is a sworn statement made by a director or thesecretary to the effect that the subscribers have complied with the provisions of the Act and are desirous of being formed to a company.
- **Statement of nominal capital**: this document is a requirement of the Stamp Duty Act.It specifies the capital with which the company proposes to be registered.
- **List of directors**: this list identifies the persons who have agreed to become directorstheir date of birth occupation etc.
- **Consent to act as director**: this is a document to the effect that the signatory haspersonally agreed to become a director of the company.
- **Notice of location of registered office**: this is a document which specifies the physicaland postal address of the company i.e. the city or town in which the registered office is situate, plot number and building.

QUESTION FIVE

(a)

- This is an action instituted by a member in his name on behalf of the company to remedy a wrong done to the company.
- It is representative in character.
- Involves the violation of corporate rights. Prudential Assurance Co. Ltd V. NewmanIndustries Ltd.
- Right to institute a derivative action in a matter of grace.
- It is controlled by the plaintiff.

- There must be a dispute between a member (s) of the company and those in control of its affairs.
- The company must be joined as a co-defendant to enable it enforce its rights EstamcoLtd. V. Greater London Council, Spokes V. The Grosvenor and Another.

(b)

- Can only be instituted in circumstances in which there is fraud on the minority.
- The minority must discharge the heavy burden of proof i.e. the company is entitled to the remedy sought and that the company cannot itself sue.
- The minority shareholder has no legal right to bring a derivative action.
- The minority must not have participated in the wrongful act complained of
- Legal costs are only recoverable if the action is successful.
- The case may be struck off at the instance of the defendant.

(c)

- This problem is based on breach of duty by directors. In this case it is apparent that Daudi is guilty of breach of duty to the company. His conduct is fraudulent in character and the company is entitled to damages since the general meeting of the company has ratified the abuse of power Jane Wangokho and other aggrieved members have the right to institute a derivative action against Daudi for the misfeasance. The action is representative in character. My advise is based on the exceptions to the rule in Foss V.Harbottle which facilitate a derivative action against fraudsters if the company cannot itself institute proceedings.

QUESTION SIX

(a)

- Special notice of the intended resolution must be given to the company.
- The company must send a copy thereof to the auditor.
- The auditor is entitled to make written representations as his defence.
- An extra-ordinary general meeting must be summoned. A special notice of the intended resolution must be sent to all members. If the auditor has made representations members must be notified and copies must be enclosed unless received too late.
- If copies are not enclosed due to lateness or default by the company the auditor is entitled to have them read out at the meeting.
- An auditor can only be removed from office if a general meeting passes an ordinary resolution to that effect.

(b)

Since an auditor has the statutory right of access to all the company"s books, accounts etc and is entitled to demand explanation from officers of the company the obstruction by the company officers is antithetical to his duty and is entitled to:

i) Demand that the officers forthwith desist from interfering with his duties failing which he instigates their investigation with a view to prosecution.

ii) Write a protest note to the company.

iii) Make a report on the information availed to him and set out the circumstances in which it was made highlighting the problems encountered.

(c)

- This problem is based on the question whether an auditor owes legal duty of care to a third party. As a general rule, an auditor does not owe 3rd parties any legal duty of care when making his report. However, a 3rd party who suffers loss or damage by relying on an auditors report may recover from the auditor if it is established that:

i) There was a special relationship between the auditor and the 3rd party and therefore the auditor owed that party a legal duty of care. (Hedley Byrne and Co. Ltd V. Heller and Partners Ltd.

ii) The loss suffered was of a financial nature.

- It must be evident that the auditor knew or reasonably ought to have known that the 3rd party would rely on the report. In this case it is not evident that there was any special relationship between the auditor and EFG Company Ltd. The company is unlikely to succeed against the auditor.

QUESTION SEVEN

THIS QUESTION IS BASED ON ENGLISH LAW. IT IS NOT IN THE SYLLABUS: NO SOLUTION PROVIDED.

QUESTION EIGHT

(a) (i)

- This is a 28 day notice to the company of an intention to move a particular resolution at the next meeting.
- It is not a notice by the company.
- It is required by law in certain circumstances.

(ii) 28 days

(iii)

- The removal of a director from office.
- Removal of an auditor from office.
- Re-appointment of a director who has attained the age of 70.

(b) (i) Matters or issues that require special resolution include:

- Alteration of the objects clause
- Alteration of the articles.
- Voluntary change of name
- Reduction of capital
- Conversion of private company to public.
- Voluntary winding up.
- Creation of reserve capital.

(ii)

It must be supported by not less than ¾ or 75% of all members present and voting in person or by proxy.

DECEMBER 2011

QUESTION ONE

(a)

Registered Companies	Statutory Corporations
• This is a company incorporated pursuant to the provisions of the Companies Act. • Owes its existence to registration. • It is a legal person distinct and separate from its members. • A private company consists of 2 – 50 excluding passed and current employees who are members. A public company must have a minimum of 7 members. • May be public or private. • Managed by directors elected by members. • Canonly engage in transactions set forth by the objects clause and those that are reasonably incidental to the attainment or pursuit of such objects.	• This is a corporation created by an Act of parliament e.g. Kenya Wildlife Services or Agricultural Finance Corporation, Capital Markets Authority. • It is a legal person in its own right. • Owes its existence to an Act of Parliament. • The statute gives it a name and prescribes its objects. • It is "owned" by the government. • Can only engage in transaction set forth by the statute and those reasonably incidental thereto. Other transactions are ultra vires and therefore void. • Management is prescribed by the statute.

(b) (i)

Under section 30 (1) of the Companies Act, a private company means a company whose articles of association:

- Limit the number of members to 50 excluding current and former employees who are members.
- Restrict the right to transfer its shares.
- Prohibit any invitation to the public to subscribe for its shares or debentures.

(ii)

- Original members are able to control membership.
- Members retain control as shares are not freely transferable.
- It is entitled to commence business at anytime after incorporation.
- It is subject to less formalities e.g. need not publish accounts or hold the statutory meeting.

(iii)

- Mr. and Mrs. Matanguta must comply with the provisions of the Companies Act. The company must hold an extra ordinary general meeting to pass a special resolution to amend or alter the provisions of section 30 (1) of the Act.
- The company ceases to be private on the date of the resolution and must within 14 days thereof deliver to the registrar for registration either.
    - A prospectus containing the particulars of Part I and II of 3rdschedule or
    - A statement in lieu of prospectus containing the particulars of Part I and IIof the 2nd schedule.

QUESTION TWO

(a)

- This case is authority for the proposition that a company being a legal person has capacity to own property. The property of a registered company is vested in it and the company has an insurable interest in such property.
- In this case it was held that since the timber belonged to the company the company alone had an insurable interest in it and the plaintiff was not entitled to indemnity.
- The principle enunciated in this case is embodied in section 16 (2) of the Companies Act.

(b) (i) Under the provisions of the Companies Act a company may alter the objects clause o its memorandum so far as may be necessary to enable it:

- Carry on its business more economically and more efficiently.
- Attain its main purpose by new or improved means.
- Sell or dispose off the whole or any part of its undertaking.
- Amalgamate with any other company or body of persons.
- Carry on sum business which under existing circumstances may conveniently or advantageously be combined with the business of the company.
- Enlarge or change the local area of its operations.
- Restrict or abandon any of the objects specified in the memorandum.

(ii)

- An extra ordinary general meeting must be summoned. The notice of the meeting must notify the members of the intended resolution and the resolution must be framed in the notice in the manner in which it will be passed.
- The general meeting must pass a special resolution authorizing the change or alteration of the objects clause. i.e. must inter alia be supported by at least 75% of the members present and voting in person by proxy.
- A copy of the resolution must be delivered to the registrar for registration within 30 days of its passing where upon the alteration becomes legally effective.
- However, a proposed alteration of the objects clause may be objected to by members or creditors applying to the court for its cancellation. In such a case, the court may order the alteration to be cancelled or dismiss the application.

QUESTION THREE

- This problem is based on civil liability in respect of prospectuses.
- In this case, the prospectus of Tamaquin Ltd contained a false statement in that the patent had not been registered. However, for the company or its officers to be held liable it must be proven that the statement:
    - Was false in material particular
    - Was more than mere sales talk or puff
    - Was one of fact not opinion
    - Was in fact made by the company or its officers
    - Was intended to be acted upon by the investors e.g. Allan or Betty.
    - Influenced the party"s decision to apply for the shares.
- It is important to note that the issue was over-subscribed which means that the prospectus became exhausted and persons who bought the shares at the stock exchange cannot purport to hold the company liable on the basis of the prospectus.
- My advise to Allan is that he has no action against the company or its officers in that he did not rely on the prospectus to purchase the shares.
- Betty has no action against the company or its officers as she bought the shares at the stock exchange by which time the prospectus had become exhausted. My advise is

consistent with the decision in Peek V. Guvney where it was held that the plaintiff could not base his action on the prospectus as it had been exhausted.

- Charles cannot sue the company or its officer in that he did not read the prospectus and the report of the interview is not a prospectus. My advise is based on the decision in Peek V. Guvney.
- David has no actionable claim against the company or its officers in that the company is not liable to investors when the value of its shares fall due to speculators. In this case it is evident that the drop in the value of the company"s shares is not based on any of the fundamentals.

QUESTION FOUR

(a) (i)

- This problem is based on the liability of members for debts of the company. In this case Joe sold all his shares to lotto ltd to Janet and the shares are partly paid up.
- By the time Lotto Ltd went into liquidation Joe is not a member of the company.
- Since Janet"s name is on the register of members of Lotto Ltd, she is a contributory andis liable to make good the amount outstanding on the shares. This amount is a debt due to the company from her.
- Joe is not liable for the debts of the company as he is not a member. However, since Janet is bound to indemnify him in respect of the liability on the shares, Joe is liable to repay Janet the amount paid to the liquidator. This argument is based on the fact that in a contract of sale of shares, it is implied that the transferee will indemnify the transferor in respect of all calls and other liabilities arising on the shares after the transfer.

(ii)

- Joe and Jeremy must execute the proper instrument of transfer.
- Joe must present the executed instrument of transfer and the share certificate to Joles Ltd for certification. The share certificate is retained by Joles Ltd for cancellation.
- Jeremy must present the certified instrument of transfer for stamping i.e. payment of stamp duty.
- Jeremy must present the stamped instrument of transfer to Joles Ltd for registration.
- On registration of the transfer, the share certificate is cancelled and two others issued, one in the name of Joe for the 500 shares retained and the other in the name of Jeremy for the 500 shares acquired.

(b)

- **Reduction of number of members**

  Under section 33 of the Companies Act, if at any time, the number of members of a company falls below the statutory minimum and the company continues to carry on business for more than 6 months while the number is so reduced all persons who are members after the 6 months and who are aware that the company has less than 2 or 7 members are personally liable for all the debts of the company incurred after the 6 months and may be sued for them.

- **Non-publication or misdescription of the company"s name**

  Under section 109 (4) of the companies Act a member who is an officer of the company may be held liable to make good any liability arising if he signed or authorized the signing of a negotiable instrument on which the company"s name is not published or is misdescribed.

- **Fraudulent trading**

  Under section 323 (1) of the Companies Act if in the course of winding up it appears that any business of the company has been carried on:
  - For any fraudulent purpose or

- With intent to defraud its creditors or creditors of any other person,

- The court may on the application of a creditor, contributory, liquidator or official receiver declare all persons who were knowingly parties to the carrying on of the company"s business as such personally liable without limitation for all or any of thedebts of the company.
- This section renders members who are officers of the company personally liable for debts and other liabilities of the company. As was the case in Re: William LeitchBrothers Ltd.

QUESTION FIVE

(a)

- A director owes his company a duty of care, skill and diligence. The principles governing this duty were enunciated by Romer J in re: City Equitable Fire Insurance Co.Ltd (1925) and to a large extent the law takes into account the fact a director may be a part-time counselor rather than a full-time Professioner Manager. This is principally because of the tax nature of the standards expected of a director.
- **Primo**, a director need not exhibit in the performance of his duties a greater degree ofskill than may reasonably be expected from a person of his knowledge and experience. This principle is exemplified by the decision in re: Brazillian Rubber Plantations andEstates Ltd.
- **Secudo**: a director is not bound to give continuous attention to the affairs of hiscompany. His duties are of an intermittent nature to be performed at periodical board meeting and meeting of committees of the board upon which he happens to be placed. He is not however bound to attend all such meetings thought he ought to attend whenever in the circumstances he is reasonably able to do so. In The Marquis of Butes case where the president of the company had attended only one board meeting in 38 years. It was held that he was not liable for the wrongs committed by other directors at board meeting as he was not bound to attend them.
- Thirdly, in the absence of suspicion a director is entitled to assume that officer of the company performed their duties honestly. He is entitled to rely on information provided by trusted servants of the company as was the case in Dovey V. Cory.
- These three principles demonstrate vividly that a director is not deemed to be a professional Manager hence his standard of care, skill and diligence is that of a person of his knowledge and experience. He is not bound to bring any qualifications to his office. He is not bound to give his company"s affairs continuous attention and is entitled to trust that officer of the company performed their duties honestly.

(b)

- As fiduciaries directors are bound to avoid conflict of interest by disclosing any personal interest in contracts made by the company.
- In this case, it is clear that Mwerevu, a director of Kamaliza Ltd, had a personal interest in the contract made with Modern Vehicle, Ltd, a fact he did not disclose to the board as required by law. The vehicles are acquired at an exhorbitant price and Mwerevu voted in its favour. The tragedy is that when the facts come to light, the board acquiesces with Mwerevu"s conduct.

  Firstly, Mwerevu has committed a criminal offence for which he is liable to prosecution and second he has acted fraudulently and thereby breached his fiduciary duty to the company. Since the duty is owed to the company Mpole cannot sue to remedy the wrong.

  My advise to Mpole is to have an extra ordinary general meeting of the company summoned to consider the matter. The meeting may resolve that the director be sued in damages for breach of duty or ratifies the abuse of power. However, since the

mwerevu"s conduct amounts to frauded on the minority conduct amounts to fraud onthe minority if members ratify the transaction, Mpole may initiate a derivative action against the directors for the contract to be rescinded. This advise is based on the exceptions to the rule in Foss V. Harbottle (1843).

- I would also advice Mpole to instigate the arrest of Mwerevu by the police for prosecution for the offence of non-disclosure of personal interest in contracts made by the company for which he is liable to a fine not exceeding Kshs. 2000.

QUESTION SIX

(a)

- Fixed charge
- Floating charge
- Chattels mortgage
- Charge on unpaid calls.
- Charge on patent, trade mark etc
- Charge on a ship or part thereof.
- Charge on unpaid capital
- Charge on book debts.

(b)

- This problem is based on priority of charges created by the company. It is clear that the first charge in favour of Tumaini Bank had a negative pledge clause which prohibited Smart Ltd from creating a charge in priority thereof. But Smart Ltd created a fixed charge thereafter in favour of Mali Bank which claims ignorance of the prohibition.
- Tumaini Bank"s charge has priority in that it was created first and had a negative pledge clause and covers all the assets of the company.
- Mali Banks fixed charge ranks second in that it was created after Tumaini Banks Charge. The contention that the bank was unaware of the prohibition is untenable as the bank as a 3rdparty is deemed to know the contents of the company"s public documents. This is because charges are registrable with the registrar of companies. Arguably, therefore the doctrine of constructive notice renders the banks argument unsustainable.

(c)

- This is a document issued by a company as security whenever series of debentures or debenture stock are issued.
- It is an acknowledgment that the company is indebted to trustees on behalf of the creditors.
- It confers upon the trustees a legal mortgage over all the company"s assets.
- It embodies an undertaking by the company to honour its obligations to all creditors.
- It describes the nature of the security given, methods of redemption, circumstances in which the security may be realized meetings of creditors, powers of trustees etc.
- Facilitates protection of the company"s assets or security for the benefit of all creditors.
- Trustees acquire a legal charge over all assets of the company.
- Trustees have the right to take possession of the security.
- Trustees are entitled to sell the security in the event of default.

QUESTION SEVEN

(a)

Under section 241 (1) of the Companies Act, a liquidator is entitled to exercise the following powers with sanction of court or committee of inspection:

(ι) Bring or defend actions or other legal proceedings in the name of and on behalf of the company.

(ιι) Carry on the business of the company so far as may be necessary for beneficial winding up.

(ιιι) Pay any classes of creditors in full.

(ιϖ) Make any compromise or arrangement with creditors.

(ϖ) To compromise all calls and liabilities to calls and other debts and liabilities.

(ϖι) Appoint an advocate to assist him in the performance of his duties.

(b)

Under section 241 (2) of the Companies Act, the following powers are exercisable by the liquidator without sanction of the court or committee of inspection.

- Sell movable and immovable property and things in action of the company.
- Do all acts and execute all deeds, receipts and other documents in the name of and on behalf of the company.
- Prove, rank and claim in the bankruptcy or insolvency of any contributory for any balance.
- Draw, accept, make and endorse any bill of exchange or promissory note in the name of and on behalf of the company.
- Raise money on the security of the assets of the company.
- Appoint an agent to do any business which is unable to do.
- To take out letter of administration to any deceased contributory in his official name.
- Do all such other things as may be necessary for winding up the affairs of the company and distributing its assets.

QUESTION EIGHT

(a)

- Quorum is the minimum number of persons who must be present fro a company meeting to transact business.
- The number is prescribed by the articles failing which the provisions of the Companies Act apply where two members present in person form a quorum for a private company meeting while three members present in person constitute quorum for a public company meeting.
- It is the duty of the chairman of the meeting to satisfy himself that a quorum of members in present within 15 minutes of the appointed time.
- Persons not entitled to attend are not counted in the ascertainment of quorum.
- If a quorum of members is not present, a meeting summoned by directors stands adjourned to the following week, same day time and place unless the directors otherwise resolve. In all other cases the meeting stands dissolved.
- Quorum is only essential at the commencement of the meeting.
- A meeting with no quorum is a legal nullity.

However, one person constitutes quorum in certain circumstances for example:

- **Directors meeting**: in the case of a private company.
- **Class meeting**: shares of a particular class are held by one member.
- **Creditors meeting**: in the course of winding up.
- **Adjourned meeting**:
- **Annual general meeting convened by or at the instance of the registrar of companies**: sec 131 (3) of the Companies Act.
- **Meeting convened pursuant to a court order**: section 135 (1) of the Companies Act.

(b)

(i) **General Proxies**

- This is an ordinary proxy.
- It is a proxy form which enables a member appoint another person to attend a general meeting on his behalf such a proxy can vote as he wishes on the matters before the meeting.

(ii) Special Proxies

- This is a two-way proxy.
- This is a proxy form which enable a member of a company to direct the proxy whether to vote for or against a particular resolution before the meeting. If there are no instructions, the proxy is free to vote as he wishes.
- Under English law, this form is used in the case of quoted companies.

JUNE 2012

QUESTION ONE

(a)

In the words of Lord MacNaghten in *Salomon V. Salomon and Co. Ltd.*(1897). "The companyis at law a different person altogether from the subscribers to the memorandum……."

This is the *ratio decidendi* in *Salomon's case* and constitutes one of the fundamental principles of company law.

In simple legal parlance the principle of legal personality of the company is to the effect that when a company is incorporated it becomes a legal person, distinct and separate from its members and managers. It becomes a body corporate or a juristic person. It acquires an independent legal existence with rights and subject to duties with certain capacities and subject to incapacities.

The principle of corporate legal personality is now exemplified by the words that "From the date of incorporation mentioned in the certificate of incorporation, the subscribers to the memorandum together with such other persons as may from time to time become members of the company shall be a body corporate……"

The most fundamental attribute of incorporation from which all other consequences flow is that on incorporation a company becomes a body corporate – a different legal entity. This principle manifests itself through the principle of:

i) **Limited liability**: Sec 4 (2) (a) and (b) of the Companies Act.
ii) **Perpetual succession**: Sec 16(2) of the companies Act.
iii) **Sue or be sued:** Foss V. Harbottle (1843)
iv) **Owning of property**: section 16(2) of the ActMacaura V. Northern Assurance Co.(1925)
v) **Capacity to contract:** Lee V. Lee"s Air Farming Co. Ltd(1961)
vi) **Common Seal:** section 16 (2) of the Act.

A critical analysis of the Judicial and statutory authority demonstrates that the principle of corporate legal personality is incontrovertibly an important and fundamental aspect of company law.

(b)

This problem is based on the concept of piercing the corporate shell or simply put lifting the veil of incorporation or modifying the rule in Salomon"s case. Both parliament and courts of law have recognized circumstances in which the veil of incorporation may be lifted and regard had to the individual members of the company and its subsidiaries are treated as one of regard it had to the economic realities of the group. These circumstances are exceptions to the rule in Salomon"s case.

- Legislative or parliamentary or statutory exceptions
    - Reduction in number of members: section 33 of the Companies Act.
    - Non-publication or misdescription of the Companies name: section 109 (4) of the Act.
      Group accounts: section 150-152 of the Companies Act.
    - Investigation of companies affairs: section 167 of the Act.
    - Investigation of company membership: section 173 of the Act.
    - Fraudulent trading: section 323 (1) (a) of the Act.
- Common law or judicial exceptions
    - **Agency trustee or nominee:**
        - Inre F. G. Films Ltd.
        - Smith Stone and Knight V. Birmingham Corporation
        - Firestone Tyre and Rubber Co V. Llewellin
    - **Group enterprises:**
      Harold Holdsworth and Co V. Caddies

- **Determination of residence:**
  Debeers Consolidated Mines Ltd V. Howe
- **Ratification Corporate acts**
  Inre Express Engineering
  Bamford and Another V. Bamford and Others
- **Determination of Character:**
  Daimler Ltd V. Continental Tyre and Robber Co. Ltd.
- **Fraud and Improper Conduct**
  Gilford Motor Co V. Horne & Another Inre Buggle Press Ltd.
  Jones V. Lipman and Another

QUESTION TWO

(a)

- This case is authorized for the proposition that a registered company"s capacity is restricted to the transactions set forth in the objects clause of the memorandum other transactions are ultra vires and therefore null and void.
- In this case the transaction in question i.e. purchase of concession and construction of railways was not authorized by the objects and was therefore declared ultra vires.
- This case interpreted the doctrine of ultra vires very restrictively thereby limiting corporate capacity.
- However, in Attorney General V. Great Eastern Railway Co. it was held that a transaction reasonably incidental to the attainment or pursuit of the objects of the company was Ultra Viresthe company. In the words of Lord Selbourne "whatever may be regarded as fairly incidental to or consequential upon"
- The second aspect of ruling relates to ratification of an ultra vires transaction. In Ashburys case although members in general meeting purported to ratify the transaction it was held that the ratification had no legal effect since the transaction was void. This ruling is correct in that a void transaction is incapable of ratification. This principle was upheld in Rolled Steel Products (Holdings) Ltd V. British Steel Corporation and Others(1986) where Slade L. J. was emphatic that an ultra vires transaction cannot be rendered intra vires by ratification, delay acquiescence estoppel or lapse of time.

(b)

- As a general rule a pre incorporation contract against the company did not exist and cannot ratify the transaction when incorporated, nor can directors of the company adopt or conform the contract (see Kelner V. Baxter) (Price V. Kelsal) (North SydneyInvestments and General Tramways V. Higgins & Another) (Natal Land Company V.Pauline Colliery Syndicate)
- However a person can escape liability on per incorporation contracts by:
  - The company entering into a new contract to the same effect as the previous one (Mawagolas case).
  - Entering into a contract which expressly provides that the promoters liability shall cease when the company is formed.
  - Entering into an agreement which expressly provides that it becomes legally binding upon the company when incorporated.

(c)

- This provision is to the effect that when the Articles are registered there comes into being a contract between the company on one hand and shareholders on the other to observe the provisions of the articles.
- Either party is free to sue the other for non compliance with the provisions of the articles. Welton V. Sattery.
- Hickman V. Kent or Romney Mash Sheep Breeders Association

- The company and its members have rights and subject to obligations.
- Rights conferred by the contract are only enforceable by members qua members ElleyV. Positive Government Life Assurance Co., Beattie V. Beattie.
- The contract is unenforceable by an outsider.
- The contract is subject to the memorandum and provisions of the Companies Act.
- The terms of the contract keep on changing from time to time as and when the company alters the Articles.
- Courts have observes in Obiter that a second contract is created between each member and every other i.e. members inter se.
- The decision in Wood V. Odessa Water Works and Quin and Axtens Ltd. V. Salmon are cited for this argument.

QUESTION THREE

(a)

Under the provisions of the Companies Act the following rights are only enforceable by joint effort:

I) Under section 8 (1) of the Companies Act, a company may by special resolution alter the objects clause of the memorandum. However the proposed alteration may be objected to by either.

Holders of not less than 15% in nominal value of the Company"s issued share capital.

Holders of not less than 15% of any class of shares of the Company.

Holders of not less than 15% of the Company"s debenture entitling them to object.

Not less than 15% of the Company"s members.

II) Under section 74 (1) of the Company"s Act, proposed variation of class rights may be objected to by holders of not less than 15% of that class of shares who did not consent or vote in favour, by an application to court within 30 days of the resolution or consent.

III) Under section 140 (1) of the Companies Act holders of not less than 1/20 of the total voting rights of all members or not less than 100 members of the Company may requisition notices of any resolution which may properly be moved at the next general meeting. They are also entitled to requisition the Company to circulate to members any statement of not more than 100 words with respect to the matter referred to any proposed resolution or business to be dealt with at a meeting.

IV) Under section 132 (1) of the Companies Act holders of not less than 1/10 of the paid up capital of the Company or the total voting rights of all members may requisition an extra ordinary general meeting by depositing a requisition with the Company at its registered office and if the directors do not within 21 days thereof convene a meeting, the requisionists or not less than ½ of them may convene a meeting. Such a meeting may be held within three months of the requisition.

V) Under section 137 (1) of the Companies Act, a poll can only be effectively demanded by:

- Not less than five members present in person or by proxy.
- A member or members representing not less than 1/10 of the total voting rights of all members having the right to vote.
- A member or members representing not less than 1/10 of the paid up capital.

VI) Under section 165 (1) of the Companies Act a Company"s affairs may be investigated by an inspector or inspectors appointed by the court at the instigation of either.

Not less than 200 members or members holding not less than 1/10 of the issued shares.

Not less than 1/5 of the number of persons in the company"s register of members.

(b)

- This problem is based on the right of a member to vote in Company general meetings. It is a trite principle of law that the right to vote is one of the proprietary rights of a member. It is one of the so-called individual membership rights of a member exercisable by a member irrespective of the wishes of the majority and if the right is violated the member has a personal action for redress.
- In this case the articles of X Company are very clear on voting and the Chairman has declined to accept the votes of Jane nominees in violation of Jane"s right to vote in a general meeting. Jane has a course of action to compel the Chairman to adept the votes of her nominees.
- My advise to Jane is to institute legal proceedings against the chairman to "compel him" to accept the votes, as was observed by Sir George Jessel MR in Pender V. Lushington.
- My advise is based on the decision in Pender V. Lushington whose facts were substantially similar to those of this case.

QUESTION FOUR

(a)

In preparing his audit report the auditor owes a duty of care to:

- **The company**: since an auditor is a professional engaged by the company to rendercertain services he owes the Company a legal duty of care in preparing his report.
- **Third parties**: an auditor owes a legal duty of care to third parties whom he knew orreasonably ought to have known would rely upon his audit report. To that effect such parties are his "neighbours" and the auditor may be
- Held liable for loss or liability arising by reason of reliance on his audit report.
- The auditor"s legal duty of care is founded on the premise that there is a special relationship between him and the company as well as such third parties.

(b)

- Right to examine the company"s books, vouchers and other relevant documents.
- Right to access to the Company"s books vouchers, accounts etc.
- Right to demand an explanation from officers of the company.
- Right to seek professional advise whenever necessary.
- Right to attend all general meetings of the Company.
- Right to be heard in general meeting on any matter concerning him as an auditor.
- Right to all notices and other communication to members.
- Right to rely on information provided by trusted servants of the company (in absence of suspicion)
- Right to remuneration for services rendered.
- Right to indemnity for any loss or liability arising in the course of discharging his obligations as auditor.

(c)

For a third party to successfully sue an auditor in damages for professional negligence it must be established that:

- The auditor was engaged on the premise that he professed to have certain skills.
- The auditor was at all material times aware that his report would be relied upon i.e. he knew or reasonably ought to have known.
- The third party suffered loss of financial nature

QUESTION FIVE

(a)

- Under Article 114 of Table A directors recommend dividend and members declare the same in general meeting.
- Under Article 115 directors may form time-to-time pay member such intern dividend as is justified by profits of the Company.
- Under article 116, no dividend shall be paid otherwise than out of profits.
- Dividend is payable after payment of debts and other liabilities incurred during the year dividend is only enforceable after its formal declaration.

(b)

A company may seek to control the funds from which dividend is payable for various reasons:

- Facilitate maintenance of capital.
- Liability of members is generally limited.
- Maintain a certain level of reserves.

(c)

- The charge is void as against the liquidator.
- The amount secured becomes payable immediately.
- It is a criminal offence for which the company and every officer in default are liable to a fine no exceeding Kshs. 1,000.

QUESTION SIX

(a)

Civil Liability

Under section 45 (1) of the Companies Act a third party who suffers loss or damage by reason of subscribing for shares or debentures of a Company on the faith of prospectus containing any untrue statement is entitled to compensation for the loss or damage by any of the following persons:

- Every person who was a director of the Company at the time of issue.
- Every person who had authorized himself to be named as a director in the prospectus and was so named.
- Every person who had agreed to become a director of the Company either immediately or after an interval of time.
- Every person who was a promoter of the Company.
- Every person who authorized the issue of the prospectus.

However, sections 45 (2) and (3) of the Companies Act prescribe specific defences to directors and experts sued under section 45 (1).

Criminal liability

- Under section 40(3) of the Act it is a criminal offence to issue any form of application for shares or debentures of a company without a prospectus which complies the provisions of the Companies Act. A person guilt of contravening such provision is liable to a fine not exceeding Kshs. 10,000.
- Under section 42 (2) of the Act it is a criminal offence to issue a prospectus containing a statement purporting to have been made by an expert without such expert"s written consent. The company and every person knowingly a party to the issue liable to a fine not exceeding Kshs. 10,000.
- Under section 43 (5) of the Act it is a criminal offence to issue a prospectus before a copy thereof has been delivered to the registrar for registration. The company and

every person who is knowingly a party to the issue are liable to a fine not exceeding Kshs. 100 for every day until a copy thereof is delivered.

- Under section 43(5) of the Act is a criminal offence to deliver to the registrar for registration a copy of a prospectus without the necessary annextures. The company and every person who is knowingly a party to the issue are liable to a fine not exceeding Kshs. 100 for every day until a copy with the necessary annextures is delivered.
- Under section 46 (1) of the Act, it is a criminal offence to authorize the issue of a prospectus containing any untrue statement. A person guilty of contravening this section is liable to a fine not exceeding Kshs. 10,000 or imprisonment for a term not exceeding 2 years or both. However the accused escapes responsibility by providing either that:
    - The false statement was immaterial.
    - He has reasonable grounds to believe and did believe up to the time ofissue that the statement was untrue.

(b)

A company may raise capital from the public in three ways. This process is often referred to as "floatation" or "flotation" and securities are availed to the public for subscription. These approaches are:

- Direct invitation to the public (public or prospectus issue)
- Offer for sale
- Placing

Direct invitation

By this method, the company prepares and issues a prospectus inviting the public to subscribe for its securities. The prospectus must comply with the requirements of the Companies Act and application forms must be enclosed. The company is responsible for the administrative tasks of the issue and bears the risk if the issue is unsuccessful. To spread such risk the company may arrange for the issue to be underwritten by an underwriter who undertakes to take up all or a specified number of securities if not taken up by the public in return for a commission. The prospectus ordinarily identifies the underwriter, if any. Members of the public and corporations make offers for the securities by completing and submitting to the Company an application form.

Offer for sale

By this method the company desirous of raising capital allots all the securities to an issuing house which in turn prepares and issues a prospectus inviting the public to subscribe for the securities. The securities are offered at a premium and the issuing house may arrange for the issue to be underwritten so as to spread risk. Once an application for securities is made the issuing house renounces its allotment in favour of the applicant. This approach has two advantages:

- It relieves the company the administrative tasks of the issue.
- The company receives the entire consideration on the issue.

Placing

By this method the company arranges with an issuing house to purchase all the securities on offer or take them up and then "place" them with its clients privately.

There is no direct or indirect invitation to the public. This approach ensures that the securities are taken up by selected persons or institutions.

If the issuing house does not purchase the securities it acts as an agent for the company and is paid brokerage for the services rendered.

(c)

Underwriting commission is a payment made by a company to a broker issuing house or a bank in consideration for its undertaking to take up all or specified number of shares not

taken up by the public. The commission is payable whether or not the shares are taken up by the public and may be in the form of shares and money.

- The payment is an integral part of an underwriting agreement.
- The provisions of the Companies Act enable Companies to pay a commission to any person in a consideration of his
    - Subscribing for its shares.
    - Agreeing to subscribe
    - Procuring a subscription
    - Agreeing to procure subscription

The payment of such commission may be absolute or conditional provided:

- It is authorized by the articles
- It does not exceed 10% of the price at which the shares are issued or the amount or rate authorized by the articles whichever is less.
- It is disclosed in the prospectus in the case of shares offered to the public.

QUESTION SEVEN

(a) (i)

The *locus classicus* distinction between the fixed and floating charge was enunciated by the Lord MacNaghten in Illingworth V. Holdsworth.

Fixed charge:

- This is a legal or specific charge.
- It is a charge securing a debenture on a specific asset or an asset capable of being ascertained or defined.
- The security is identifiable and its value is ascertainable.

Floating charge:

- This is an equitable charge
- In the words of the Learned Judge it is "ambulatory and shifting in its nature."
- It is a charge securing a debenture on the assets of a going concern but which remain dormant until crystallization.
- It secures a debenture on a class of assets of the company both present and future the assets must belong to class which keep on changing from time to time in the ordinary course of business of the Company.
- The value of the security remain uncertain as the Company is free to dispose off and acquire new stock.

(ii)

- A fixed charge created after a floating charge has priority in the satisfaction of claims.
- Other interests for example landlords distress for rent have priority over floating charges.
- Under section 312 of the Companies Act, a floating charge created within 6 months before the commencement of winding up is deemed to be fraudulent preference and is void.
- Under section 314 of the Companies Act, a floating charge created within 12 months before the commencement of winding up is invalid unless it provided that the Company was solvent immediately after its creation.

(b)

This is a clause or paragraph in a debenture to the effect that the Company shall not create a charge in priority to the current one. It ensures that the charge retains priority in the satisfaction of claims.

(c)
Although administrative receivership and winding up are similar in certain many respects, they differ in that:

- Whereas a receiver takes possession of the property of the company over which he is appointed and realizes is for the benefit of the holder(s) a liquidator is appointed to wind up the Company and terminate its existence.
- An administrative receiver may be appointed to enforce a charge given by a debenture or trust deed under a power contained in the debenture or the trust deed or by the court. A liquidator may be appointed by the court, members or creditors or both.
- A receiver may be appointed when the Company is being wound up.
- Administrative receivership permits the appointment of a receiver and manager to carry on the business of the Company for the purposes of selling it as a going concern.
- A receiver appointed under a power in a debenture or a trust deed, the debenture usually provides that he is the agent of the Company.
- A receiver appointed by the Court is personally liable on the contracts made by him in the course of receivership while a liquidator is not.
- The terms of appointment may require a receiver to render accounts to debenture holders.

QUESTION EIGHT

Section 40 (1) of the Companies Act provides that
"Every prospectus issued by or on behalf of a Company or by or on behalf of any person who is or has been engaged or interested in the formation of the Company, shall state the matters specified in Part I of the Third Schedule and set out the reports specified in Part II of that Schedule….."

Part I of the schedule contains the following matters

- Number of founders, management or deferred shares if any.
- Share qualification of directors if any
- Names, postal addresses and occupation of directors and proposed directors
- Minimum subscription.
- Time of opening of the subscription lists.
- Amount payable on application and allotment.
- Particulars of options on shares and debentures
- Particulars of shares and debentures payable otherwise than for cash.
- Particulars of persons who have sold assets to the company
- Amount paid to such persons for assets including any amount payable for purposes of goodwill
- Commission paid by the company.
- Preliminary expenses or an estimate thereof.
- Amount if any paid to promoters
- Particulars of material contracts entered into by the company in the ordinary course of business
- Names and postal address of auditors if any
- Directors interest, if any in the promotion of the company or its property.
- Voting and class rights
- Length of time the company has carried on the business if less than 3 years.

Part II of the schedule sets out the following reports

- An auditors report with respect to
- Profit or losses in each of the last 5 years.
- Rate of dividend in each of the last 5 years.

- Assets and liabilities as at the last date of accounts
- And similar information on the Company"s subsidiaries if any
- In the proceeds of the issue or any part thereof is to be applied directly or indirectly in the purchase of any business, a report by named accountants on the profit or losses of the business in each of the last 5 years.
- Assets and liabilities of the business as at the last date of accounts.
- If the proceeds of the issue or any part thereof is to be applied directly or indirectly in the acquisition of share in a subsidiary, a report by named accountants on the profit or loss of the Company in each of the last 5 years.
- Assets and liabilities as at the last date of accounts.

And similar information on the subsidiaries of the Company if any

DECEMBER 2012

QUESTION ONE

(a)

This question is based on the advantages of partnerships and limited liability companies and explicitly suggests that the scale generally turns in favour of incorporation by reason of the advantage of limited liability and the wide spectrum of membership.

Generally, incorporation brings with it certain basic advantages unavailable to unincorporated associations for example partnerships.

The most fundamental attribute of incorporation from which all other advantages flow, is that, the company becomes a legal person distinct and separate e from its members. It acquires an independent legal existence. It becomes a body corporate with rights and subject to obligations. This is the rule in *Salomon V. Salomon and Co. Ltd. 1897.*

The salient advantages of incorporation include:

- Limited Liability: section 4 (2) (a) and (b) provides inter alia that liability of members may be limited by shares or guarantee. In *Salomons Case*, Salomon was not liable to contribute to the assets of the company as his shares were fully paid.
- Sue or be Sued: members cannot generally be sued for the wrongs of the company and are not obliged to sue on its behalf. (*Foss V. Harbottle (1843*).
- Owing of property: under section 16 (2) of the Act a company has capacity to hold land and other property. (*Macaura V. Northern Assurance Co. Ltd 1925*).
- Capacity to contract: registered companies have capacity to enter into contractual relationships e.g. can hire and fire. They have capacity to invest to enhance profitability.
- Perpetual Succession: The fact that a company has capacity to exit in perpetuity encourages investment on a long term basis.
- Wide Capital base: by reason of the wide spectrum of membership.
- Transferability of shares: shares in public and private companies and transferable membership keep on changing from time to time.
- Qualified or specialized management: companies are managed by directors elected by members in general meeting.
- Borrowing by floating charge: companies are free to use their movable assets as collateral. This interalia enhances their borrowing capacity.

Partnerships, on the other hand enjoy certain advantages for example,

- Sharing of losses: this reduces the amount borne by a single partner thereby lessening the burden.
- Shared management: partners shares ideas on various matter affecting the firm.
- Easy to form: there are no legal formalities to be complied with and expenses if any are minimal.
- Flexibility: partners are free to change the nature of the firms business at any time.

The foregoing demonstrates that whereas limited liability companies enjoy certain advantages.

Partnerships too have certain advantages and hence the balance may tilt on either side. However, it is undeniable that the advantages of incorporation outweigh those of partnerships by far.

(b)

(i) Section 2 (1) of the Companies Act provides that article means articles of association of a company as originally framed or as altered by special resolution including so far as they apply to the company, the regulation of Table A.

- Articles are one of the constitutive documents in company formation.
- All companies must have a set of regulations as their articles.
- It is the internal Constitution of the Company.
- It contains the rules of internal management.
- It regulates the relations between the company and its members.
- A company limited by shares may adopt Table A as its articles of association.
- It is alterable by a special resolution of members in general meeting.
- Must be signed by every subscriber to the memorandum.

(ii)

- The articles are a contract between each member and the company. It was so held in *Welton V. Saffery*.
- It binds both the company and its members. Each party must observe its provisions. *Hickman V. Kent*.
- It is a contract between the company and members only.
- It confers rights and imposes duties on the parties.
- The rights it confers can only be enjoyed by members in their capacity as members *Beattie V. Beattie.*
- The articles cannot bind a third party.

QUESTION TWO

(a) This problem is based on raising of capital by companies and acquisition of assets in this case directors:

- Must in the first instance ensure that the company has the necessary power to increase its capital.
- Such power is embodied in the articles and requires an ordinary resolution of members in general meeting.
- If the power exists they must convene an extra ordinary general meeting to pass the requisite resolution to authorize the increase.
- Notice of the increase of capital must be submitted to the registrar in a prescribed form. The notice must set out the particulars of the new shares.
- A copy of the ordinary resolution and the memorandum of association as amended must accompany the notice.
- Must check and confirm if they are empowered to allot shares.
- This power is conferred by the articles or an ordinary resolution of members in general meeting. If the authority required is conditional or insufficient a special resolution is necessary to authorize the increase of authorized share capital. A copy of the resolution must be delivered to the registrar for registration.
- To dispense with pre-emption rights to issue shares to the public shareholders must pass a special resolution. Notice of the meeting to pass the resolution must be given.
- Must obtain an independent valuation of the business of Jijenge Holdings. The report must be made by a qualified person to an auditor of the company and submitted to the company within 6 months of allotment.

(b)

- Allotment of shares for cash requires that they must in the first instance be offered to existing members in proportion to their current holding.
- The shares may be offered on the same terms or more favourable than to non-members.
- These pre-emption rights do not apply to equity security for non cash consideration.
- Existing shareholders are entitled to a written offer of the shares.
- In the event of contravention of their rights they are entitled to compensation for the resulting loss, damage, costs and expenses.
- These rights exist unless dispensed with by the afore-mentioned special resolution.

(c)

- Reduction of the share premium account is subject to the same rules as they relate to the reduction of capital.
- If a company issues shares at a premium for cash or otherwise it must create the share premium account which consists of the aggregate amount of those premiums.
- It cannot be distributed as dividend.
- It can only be applied to:
  - Write off the preliminary expenses of the company
  - Write off the expenses of or commission paid or discount allowed on any issue of shares or debentures of the company
  - Pay up unissued shares of the company to be issued to members as fully paid bonus shares
  - Provide for the premium payable on redemption of any redemptable preference shares or debentures of the company.

Otherwise the share premium account is treated as part of the paid up share capital of the company.

QUESTION THREE

(a)

- Directors are deemed to be agents when they contract on behalf of the company and are therefore in a position to bind the company with 3rd parties the company is liable as principal.
- This is the power to bind the company.
- The board is empowered to operate the company bank account.
- To hold company property in trust.
- Recommend dividend
- Recommend bonus shares.
- Pay an interim dividend from time to time.
- Summon general meetings.
- As fiduciaries directors duties include:
  - Acting bonafide in what they consider to be in the best interest of the company.
  - Exercise unfettered discretion.
  - Exercise all powers for the particular purposes for which they are conferred.
  - Avoid conflict of interest by
  - Disclosure of personal interest in contracts made by the company.
  - Disclose any secret profit to be made or account the same to the company.

- Avoid being involved in the management of competing companies.

(b)

- This problem is based on the fiduciary duties of directors which principally hinge on bonafide and avoiding conflict of interest.
- A fiduciary must not benefit by virtue of his position without the other party's consent.
- Any secret profit made by a fiduciary without disclosure must be accounted to the company and this rule applies.
- Even in the absence of bad faith on the part of the director. It was so held in *Regal (Hastings) Ltd. V. Gulliver.*
- A director can retain the profit made only if the company passes a resolution in general meeting to that effect *Cooks V. Deeks* as long as it does not involve fraud on the minority.
- In this case Hellen, the managing director made a secret profit in her position as a fiduciary and is therefore liable to account to Artworks Ltd. As was the case in *Boston Deep Sea Fishing V. Ansell* whose facts were substantially similar where a director was held liable to account.
- The remedies open to the company include:
  - Damages: for breach of her fiduciary duties.
  - Account: for the secret profit.
  - Rescission of contract.
  - The company may seek a declaration that Hellen holds the amount of Kshs. 500,000 in trust for it.

QUESTION FOUR

(a) (i)

- The rule in *Foss V. Harbottle* is the majority rule. It describes a policy of courts not to interfere with internal affairs of companies acting within their powers.
- It was enunciated in *Foss V. Harbottle (1843)*
- The rule is constituted by three principles namely
  - Proper plaintiff
  - Internal management
  - Irregularity principle

  Edwards V. Halliwell
- The rule in *Foss V. Harbottle*
  - Prevents multiplicity of actions.
  - Promotes democracy in the management of company affairs.
  - Discourages frivolous and incompetent actions
  - Re-asserts the rule in *Salomon V. Salomon and Co. Ltd.*

(ii)

- **Ultra vires or illegal acts**.
- **Special or qualified majorities** *Cotter V. National Union of Seamen*.
- **Infringement of individual membership rights** *Pender V. Lushington*.
- **Fraud on the minority**:*Prudential Assurance Co. Ltd V. Newman Industries Ltd*.
- **Oppression of minority**: Section 211 of the companies act.
- **Other exceptions**: in the interest of Justice*Pavlidesv Jensen*.

(b) (i)

- Number of shares in question.
- Name of the company
- Name, postal address and occupation of the transferred.

(ii)

- Transferor and transferee execute the instrument of transfer.
- The executed instrument of transfer is presented for stamping.
- The stamped instrument of transfer is delivered to the company for registration.
- The transfer is registered and a share certificate issued in favour of the transferee.
- Unless the registration of a transfer is refused by the company, it must be registered at the earliest possible opportunity and a share certificate must be ready for delivery within 60 days of presentation of the transfer for registration. This entails cancellation of the transferors share certificate and entry of the transferees name on the register of members and issue of a new share certificate in the transferee name.

My advise to the directors of Tangaza Company is as follows:

QUESTION FIVE

(a)

- Under section 131 (1) of the Companies Act every company much in each year hold a general meeting as its annual general meeting.
- The notice convening the meeting must so specify.
- The first annual general meeting must be held within 18 months of incorporation and thereafter 15 months must not elapse from the date of one annual general meeting to that of the next.
- If the first annual general meeting is held, no other meeting need be held by the company within two years of incorporation.
- If a company fails to hold an annual general meeting as required, any member may petition the registrar to call or direct the convention of an annual general meeting. A meeting so convened is duly constituted by one member present in person or by proxy.
- Such a meeting is deemed to be the annual general meeting of the previous year unless the meeting otherwise resolves. Such a resolution is registrable within 14 days.
- It is ordinarily summoned by a 21 day notice.
- The annual general meeting considers ordinary business e.g. declaration of dividend, election of directors appointment of auditors etc.
- Failure to hold the annual general meeting renders the company and every officer in default liable to a fine not exceeding Kshs. 2,000.
- Call the meeting to order.
- Satisfy himself that the meeting is duly constituted.
- Satisfy himself that a quorum of members is present.
- Inform himself the business of the meeting.
- Conduct voting.
- Frame motions for discussion.
- Make decisions on points of order.
- Determine who to speak and for how long.
- Maintain order in the conduct of those present.
- Close discussion on any issue after reasonable debate.
- Ensure that the sense of the meeting is maintained.

(b)

- Under the provisions of section 132 (1) of the Companies Act, a company may be compelled to call an extra-ordinary general meeting at the instigation of its members.

- Holders of not less than $\frac{1}{10}$th of the paid up capital of the company or total voting rights of all members may request for a meeting by depositing a requisition with the company at its registered office.
- The requisition must state the purpose of the meeting and must be signed by all the requisitionists.
- If it consists of a number of documents, each must be signed by at least one of the requisitionist.
- Directors must convene an extra ordinary general meeting of the company within 21 days of deposit of the requisition failing which the requisitionists or not less than one half of them may convene the meeting.
- A meeting convened by requisitionist under this section must:
  - Be held within three months of deposit of the requisition.
  - Be summoned in a manner similar to a meeting convened by the board.

(c)

- Under section 185 (1) of the Companies Act a company may by ordinary resolution remove a director from office.
- A special notice of the intended resolution must be given to the company.
- Upon receipt of the company must send a copy thereof to the director concerned.
- The director is entitled to make representations not exceeding reasonable length as his defence any may request the company to notify its members that he has made them.
- The company must convene an extra ordinary general meeting and copies of the notice of the intended resolution must be sent to all members.
- Members must be notified that the director has made representations, if any, and copies must be enclosed unless received too late by the company.
- If the directors representations are received too late by the company or are not enclosed due to default by the company the director is entitled to have them read out at the meeting.
- However copies of the directors representations need not be sent to members or be read out at the meeting if on application by the company or other aggrieved party, the court is satisfied that the director is abusing his right to be heard to secure needless publicity for defamatory matter.
- The removal of a director from office take effect when the meeting by ordinary resolution so resolves.
- **This section does not apply to directors of private companies appointed before 1/1/1962.**

QUESTION SIX

(a)

- Under section 178 (1) of the Companies Act, every company must have a secretary. However, if the office is vacant its functions may be discharged by an assistant or deputy secretary or a delegate of the board.
- The company secretary is appointed by the board for such duration and on such other terms and conditions as the board may deem fit.
- The board is empowered to remove the appointee from office.
- To qualify for appointment one must be:
  - An advocate of the high court or
  - Hold the Certified Public Secretary of Kenya Certificate or
  - Possess such other qualifications which qualify him for appointment.

However, the following persons are disqualified from acting as company secretary.

- The sole director of the company
- A company whose sole director is a company.

- The company secretary is an officer of the company with extensive duties and responsibilities. He is the chief administrative officer of the company with wide powers to bind the company. As explained in Panorama Developments Ltd V. Fidelis Furnishing Fabrics Ltd, a company secretary is entitled to sign contracts with the administrative side of the company.
- He has implied authority to bind the company.
- The company is generally liable for wrongs committed by the secretary in the course of his employment unless he has acted fraudulently. However, he may incur personal liability on contracts entered into on behalf of the company if sufficient care is not taken for example signing a negotiable instrument on behalf of the company.
- He is liable to the company in damages occassioned by his negligence.
- Misfeasance proceedings may be instituted against him.

(b)

- If the director has failed to acquire the share qualification as prescribed by the articles of association of the company.
- It the director has not attained the age of 21.
- If the director is insolvent or has been declared bankrupt.
- If the director has become of unsound mind.
- If the director has absented himself from directors meetings held on over 6 months.
- If the court is satisfied that the director:
    - Has been convicted of any offence in connection with the promotion formation or management of a company.
    - In the course of winding up a company it appears that he has been guilty of any offence for which he is liable (whether convicted or not) or
    - He has been guilty of fraud in relation to the company or breach of duty to the company.

QUESTION SEVEN

1) Under the provisions of the Companies Act, the following charges are registrable
   Fixed charge
   Floating charge
   Charge on unpaid share capital
   Charge on book debt
   Charge on unpaid calls
   Chattels mortgage
   Charge on a ship or part thereof.
   Charge on a patent, trade mark, copyright etc.

2) (i)

α) The bags of barley delivered by Narok Farm Produce Ltd are beyond the reach of the receiver due to the "retention of title" clause in the contract of sale between Kazi Bure Co. Ltd and Narok Farm Produce Co. Ltd. Simply put the bags belong to Narok Farm Produce. This is because the retention of title clause operates for the benefit of the supplier of the stock under the provisions of the Sale of Goods Act.

- Parties to a contract of sale of goods are free to stipulate the time when title passes to the buyer. (*Aluminium Industrial Vaasen V. Romalpa Aluminium Ltd.)*

(ii)

- As for the semi-processed alcohol in containers, the barley is not identifiable and Narok Farm Produce Co. Ltd. cannot reclaim it. The receiver is entitled to treat it as part of the assets of Kazi Bure Co. Ltd.
- This is because it is impossible to reclaim goods if they are mixed with others from another supplier making it impossible to identify them. A right to trace the goods in the finished produce is fraught with challenges.

(iii)

- The consignment of brewed alcohol with the label does not belong to the company as it has already been sold and title has already passed to the company"s wholesalers. It is therefore beyond the reach and grasp of the receiver.

QUESTION EIGHT

(a) Under section 219 (f) of the Companies Act, a company may be wound up by the court if the court is of the opinion that it is just and equitable that the company should be wound up.

Courts of law have ordered the winding up of companies on this ground in various circumstance namely:

- **Fraudulent or illegal purpose**

  Re Thomas Edward Brinsmead and Sons Ltd.

- **Failure of substratum**

  Re German Date Coffee

- **Loss of confidence in management**

  Loch V. John Blackwood

- **Expulsion or exclusion from management**

  Re Westbourne Gallaries Ltd

- **"Bubble" companies**

  Re London and County Coal

- **Oppression of minority**
- **Deadlock in management and membership**

  Re Yenidje Tobacco Ltd.

(b)

- All taxes and local rates due from the company in arrears for not more than one year.
- All government rents in areas for not more than one year in arrear.
- All wages or salary of any clerk or servant other than a director in respect of services rendered to the company during the four months before the commencement of winding up.
- Any amount payable in respect of any compensation or liability for compensation under the Workmen"s Compensation Act accruing before the date of commencement of winding up.

Any amount due in respect of contributions payable during the 12 months before the commencement of winding up, by the company as the employer of any person under the NSSF

JUNE 2013

QUESTION ONE

(a)

- Must not be too similar to that of an existing company.
- Must not in the opinion of the registrar be undesirable.
- Must not mislead the public in any manner.
- Must not suggest any patronage of the government, president, department or ministry.
- Must not support a criminal or immoral intent or purpose.
- Must contain the word Limited or Ltd as the last word thereof.
- Must not contain the term co-operative or its equivalent or any abbreviation thereof.
- Must not generally contain the terms "national" or "international."
- Must not contain the terms "bank," "insurance" or "hotel" unless the company proposes to carry on such business.
- Must not contain the surname of a person who is not named or proposed directory of the company.
- Must not contain the registered trademark of any person without his written consent.

(b)

- Ultra vires: literally means beyond the powers.
- This is a rule of capacity respecting registered companies.
- This rule means that a company"s contractual capacity is restricted to transactions set forth in the objects clause of the memorandum and those that are reasonably incidental to the attainment or pursuit of such objects.
- A transaction is deemed ultra vires if it is beyond the capacity of a company.
- Such a transaction is null and void and unenforceable.
- This doctrine was explained in Ashbury Railway Carriage and Iron Co. V. Riche (1875) and Attorney General V. Great Eastern Railway Co. (1880).
- Since this doctrine restricts the company"s capacity to contract it is arguably a nuisance to the company. In addition this doctrine may be pleaded by either the company or the third party. Bell houses Ltd V. City wall properties Ltd (1966).
- It is a trap to unwary third parties in that a 3rd party who is unaware of the company"s capacity cannot enforce a transaction which is ultra vires the company.
- However, such a party may where circumstances permit sue the company for tracing or enforce subrogative rights.
- The party may also have a personal action against the directors of the company.
- However, this doctrine has been watered down and companies enjoy almost unrestricted capacity and the probability of a transaction being ultra vires the company is tremendously reduced for example:
    - Inflating the objects clause.
    - Use of subjective clauses.
    - Use of independent objects clauses.
    - Companies have capacity to alter the objects clause.
    - Willingness of courts to imply powers where non is expressly provided for.

In my view, the doctrine is no longer a nuisance to the company.

QUESTION TWO

(a)

Memorandum of Association	Articles of association
– This is the company"s charter of external constitution.	– This is the internal constitution of the company.
– It regulates the relations between the company and third parties.	– It regulates the relations between the company and its members.
– Its contents are prescribed by the provisions of the Companies Act.	– Its contents are agreed upon by members.
– It is the principal or primary document.	– It is subordinate to the memorandum.
– Contents include name, domicil, objects capital, association date, particulars of subscribers.	– Contents include borrowing dividend, voting, meetings, Lien on shares, forfeiture of shares, capital company secretary.

(b)

- Under the provisions of the Companies Act, a company may by special resolution alter or add to its articles.
- Any alteration or addition to the articles is as valid as if originally contained in the articles and may be altered by special resolution.
- Any alteration to the articles must not increase the liability of members or require them to take up more shares without written consent.
- The alteration must not exceed the conditions contained in the memorandum of association of the company.

QUESTION THREE

(a)

- The issue must be authorized by the articles of association of the company.
- The company"s capital must have been divided into different classes of capital some ofwhich must be irredeemable.
- Consent of the Capital Markets Authority is necessary in the case of companies quoted at the Nairobi Stock Exchange.
- Notice of the issue must be given to the registrar of companies.

(b)

- A company must not pay dividend otherwise than out of profit.
- Directors recommend dividend in board meeting.
- Dividend is declared by members in general meeting by ordinary resolution.
- Directors may from time to time pay to members such interim dividend as may be justified by the profits of the company.
- Once dividend is declared it becomes a debt due from company to the member.
- Members cannot in general meeting declare dividend in excess of the rate recommended by directors.
- A company must not pay dividend if it renders it incapable of paying debts as and when they fall due.
- A company is not legally obliged to make provision for depreciation before paying dividend.
- Losses of circulating assets of the current accounting period must be made good before dividend is declared.

- Losses of circulating assets of the previous accounting periods need not be made good before dividend is declared.
- Profits realized on the sale of a fixed asset may be treated as profit available for dividend.

(c)

- To this basic principle is the exception that where shares are issued at a premium, proceeds of the share premium account may be used by the company to finance a capitalization issue which must be fully paid.

QUESTION FOUR

(a)

- This problem is based on the provisions of section 56 (1) of the companies Act which prohibit a company from financing the purchase of its shares. However, if it has an employee share scheme in place, it is lawful for the company to advance loans to trustees to enable them subscribe for fully paid shares of the company for the benefit o its employees including salaried directors.
- In this case the proposed transaction is lawful.
- If the company"s scheme is to advance loans to all bonafideemployees of the companyto enable them subscribe for fully paid shares of the company to hold by way of beneficial ownership the two directors are excluded.

(b)

- In the absence of an employee share scheme, neither the directors nor the members are entitled to the additional loans to purchase additional shares.
- This is because the scenario before us is not captured by any of the exceptions to section 56 (1) of the Companies Act.

(c)

- This is referred to as script dividend and may be resorted to in the distribution of the final dividend by a company.
- It is perfectly in order for a company to do so if authorized by its articles.

(d)

- Any person who qualifies for appointment as a director may be appointed by members if they so resolve by ordinary resolution.
- If the articles of a company require a person to take up qualification shares, for appointment as director, the same must be taken within 2 months of appointment or such shorter time as the articles may prescribe failing which the person ceases to be a director.
- In this case, the board of directors of the company is proposing to lend John Omwami Kshs. 100,000 to enable him purchase the shares.
- It is apparent that this is contrary to the provisions of the Companies Act as the lending at hand is not covered by the exceptions outlined by section 191 (1) of the companies Act.
- The proposed transaction is unlawful.

QUESTION FIVE

(a) (i)

- Subscribing to the memorandum of association of the company.
- Transfer i.e. purchase of shares from a willing seller.
- Allotment by the company pursuant to an application.
- Transmission by death.
- Transmission by bankruptcy.
- Qualification shares of direction.
- Estoppel: a person who holds himself out as a member of a company or knowingly permits himself to be held out as a member by a company is estopped from denying the apparent membership for the sake of third parties.

(ii)

- Transfer of shares to a third party.
- Valid surrender of the shares
- Forfeiture of the shares
- Sale by the company in exercise of alien.
- Death of the member.
- Bankruptcy of the member.
- Repudiation by an infant.
- Rescission of contract
- Redemption of redeemable preference shares
- Winding up of the company

(b)

- This problem is based on mortgage of shares and the consequences thereof.
- Henry is entitled to use his shares as a security to borrow from Tumaini Bank Ltd as long as the bank is agreeable.
- This is because shares are items of property and can therefore be used as collateral.
- Whether or not Henry would still receive dividend depends on the type of contract entered into. The mortgage transaction may be legal or equitable.
- In the case of a legal mortgage Henry would transfer his shares to Tumaini Bank Ltd which would be the temporal owner with all the rights of a holder i.e. dividend, attendance of general meetings of the company and voting. As a consequence Henry would loose the right to dividend unless modified by the mortgage transaction.
- In the case of an equitable mortgage, Henry would only execute the transaction, hand over the share certificate to Tumaini Bank Ltd but retain membership of the company. He would thus be entitled to dividend.

QUESTION SIX

(a)

Directors	Auditors
– Are elected by members in general meeting – Every company must have a board of directors to manage its affairs. – The law does not insist that a director profess any profession. – Directors stand in a fiduciary position in	– Are engaged by the company to discharge certain obligations prescribed by law. – Are professionals registered by the relevant body and licenced to practice accountancy. – There is a contractual relationship between an auditor and the company.

relation to the company. – Directors owe their company a duty of care, skill and diligence. The degree of care, skill and diligence expected of them is that of a person of their knowledge and experience. A director is not bound to bring any special qualifications to his office, as observed by Neville J. in re: Brazilhan Rubber Plantations and Estates Ltd. However, if a director posses a particular skill he is bound to exercise the same for the benefit of the company. – They are not bound to give continuous attention to the affairs of the company and are entitled to rely on information provided by trusted servants of the company.	– One of the principal obligations of an auditor is to exhibit a degree of care, skill and caution of a reasonably competent careful and cautious auditor, as observed by Lopes L. J. in re: Kingston cotton mills. – An auditor is bound to approach his task with an inquiring mind and not with a foregone conclusion of wrong doing. – He must sensure that errors of commission and omission and downright untruths are ascertained. However, it is not his obligation to discover all fraud as he is not an investigator. "He is a watchdog but not a blood hound" – His task is not to ensure that the computation is correct. He is not a stock taker. "He is not to be written off as a professional adder-upper and subtractor." But must satisfy himself that the company"s security exist and are in safe custody.

(b)

- Under the provisions of the Companies Act, an auditor may be appointed by the board of directors, the annual general meeting or the registrar of companies.
- Board of directors: the provisions of the Companies Act, confer upon the board of director power to appoint the first auditor of the company before the first annual general meeting. If no appointment is made before this meeting directors loose this power. However, directors are empowered to fill a casual vacancy in the office of the auditor.
- Annual general meeting: at every annual general meeting an auditor must be appointed to hold office from the conclusion of the meeting to that of the next annual general meeting. However, at every annual general meeting a retiring auditor is always deemed to have been re-appointed without any resolution to that effect unless:
    - He is not qualified for re-appointment.
    - He has intimated to the company his unwillingness to be re-appointed.
    - The meeting has expressly resolved that he shall not be re-appointed.
    - The meeting has resolved to appoint some other person auditor.
- Registrar: if at an annual general meeting, no auditor is appointed is deemed to be re-appointed, the company must notify the registrar within 7 days of the meeting. The registrar may appoint an auditor or for the company.
- A special notice of the intended resolution to remove an auditor from office must be given to the company by the person proposing to move it.
- The company must send a copy thereof to the auditor concerned. The auditor is entitled to make written representations, not exceeding reasonable length as his defence and may request the company to notify its members that he has made representations.
- The company must summon a meeting to deliberate the matter among other matters. Notice of the meeting must be sent to all members and must embody the proposed

resolution. It must intimate to members that the auditor has made representations if any, and copies must be enclosed unless received too late by the company.

- If the auditors representations are received too late or are not enclosed by reason of the company"s default, the auditor is entitled to have them read out at the meeting.
- Copies of the auditors representations need not be enclosed in the notice or be read out at the meeting if an application by the company or other aggrieved person, the court is satisfied that the auditor is abusing his right to be heard to secure needless publicity for defamatory matter.
- The removal of an auditor from office take effect when the meeting by ordinary resolution so resolves.

QUESTION SEVEN

(a)

- Total number of shares allotted distinguishing the fully and the party paid.
- Total amount of cash received by the company in respect of the shares.
- An abstract of receipts and payments and the matters they relate to.
- Particulars of any contract submitted to the meeting for modification and the particulars of the proposed modification.
- Particulars of directors and the secretary, auditors and manager, if any
- An auditors certificate on the shares allotted, amount received and abstract of receipts and payments.

(b)

- Alteration of the objects clause of the memorandum.
- Alteration of the articles of association.
- Voluntary change of name by a company.
- Conversion of a private to a public company.
- Creation of reserve capital.
- Reduction of capital by a company.
- Compulsory or voluntary winding up of a company.

QUESTION EIGHT

(a) Under section 219 of the Companies Act, a company may be wound up by the court if:

- Members have by special resolution so resolved.
- The number of members of the company have fallen below two in the case of a private company or below seven in the case of a public company.
- The company has failed to commence business within one year of incorporation.
- The company has suspend its business for a whole year.
- The company has failed to hold the statutory meeting in accordance with the provisions of the Act.
- The company has failed to deliver a copy of the statutory report to the registrar for registration as required by law.
- The company is unable to pay its debts (insolvency)
- The court is of the opinion that it is just and equitable that the company should be wound up for example:
    - The company"s" substratum has failed.
    - The company is a "bubble"
    - Deadlock in management and membership
    - Members have justifiably lost confidence in the manner in which thecompany"s affairs are being managed.

- Winding up proceedings have been commenced outside Kenya against a company registered outside Kenya, but carrying on business in Kenya.

(b)

- Presentation of winding up petition to the Registrar: the petitioner or his advocate must present the winding up petition to the Registrar who determines the time and place at which the petition is to be heard. The petition must be advertised for at least 7 days before the hearing.
- Presentation of the petition to court : This is the filling of the Winding up petition in court as directed by the registrar. It is deemed to be the day of commencement of a winding up by the court.
- Appointment of a provisional liquidator: before the hearing of the petition the court may if the circumstances so justify appoint a provisional liquidator for the company.
- Hearing of the petition: the high court has jurisdiction to hear winding up petitions of companies registered in Kenya. The petitioner urges the court to order the winding up of the company on a particular ground(s).
- Making of the winding up order: Once the court has heard the petition it may if the circumstances so justify order the winding up of the company. Once the order is made, the official receiver becomes the interim liquidator and all servants of the company are ipso facto dismissed. In the same vein directors powers become functus offio.
- Meetings of members and creditors: The official receiver summons separate meetings of members and creditors to determine whether an application should be made to the court for the appointment of some other person as liquidator and a committee of inspection and who its members shall be. If the meetings so resolve, the application is made and the appointments duly made. If no resolution is passed, no application is made and the official receiver becomes the liquidator. His title changes to "Official Receiver and Liquidator."
- Winding up Process: the liquidator enters upon his obligations without undue delay and commences the process of winding up making such returns to the official receiver as the latter may require and in accordance with the Companies Act. The Companies Act center upon the liquidator certain powers.
- Dissolution: When the company"s affairs are fully wound up, the liquidator must apply to the court to order its dissolution and once the court so orders, a copy thereof must be delivered to the registrar of companies who removes the company"s name from the register of companies

SOLUTIONS
DEC 2013

QUESTION ONE

(a) (i)

- where it acquires its own fully paid shares otherwise than for valuable consideration.
- redemption of redeemable preference shares in accordance with the articles and the Companies Act
- acquisition of own shares pursuant to a court order
- where shares are forfeited for non-payment of a call or are surrendered in lieu of forfeiture.

(ii)

- It facilitates retention of family control of a private company
- Increases the marketability of the company"s shares since the company itself is a potential buyer
- enables companies to use surplus cash to the company"s advantage e.g. redeeming shares when it is cheaper to the company
- it makes it easier for the company to raise venture capital from merchant banks

(b) The proviso to Section 56(1) of the Companies Act sets out the circumstances in which a company finance the purchase of its shares.

- where the lending of money is part of the ordinary business of the company and the same is lent in the ordinary course of such business
- where the company has in force a scheme to advance loans to trustees to purchase or subscribe for fully paid shares of the company for the benefit of all employees including salaried directors.
- where the company has in force a scheme to advance loan to all bona fide employees other than directors to enable them purchase or subscribe for fully paid shares of the company to hold by way of beneficial ownership.

QUESTION TWO

- In simple legal Parlance, the so-called rule in Foss v Harbottle (1843) is the majority rule.
- It describes the policy of courts of law not to interfere with internal affairs of companies acting within their powers.
- The rule was formulated in Foss v Harbottle (1843) and consists of three principles namely:
  - proper plaintiff
  - Irregularity
  - Internal management

This rule serves certain purposes or functions:

- Promotes democracy in company management.
- Prevents multiplicity of actions on behalf of the company.
- Discourages frivolous and incompetent actions.
- Re-affirms the rule in Salomon v Salomon and Co Ltd that is the company is a legal person and should thus be left alone to enforce its rights manage its internal affairs and correct internal irregularities.

Exceptions to the rule in Foss v Harbottle are circumstances in which the majority rule does not apply. They are instances in which a person other than the company may sue to remedy the wrong in questions. Such circumstances include;

- Ultravires or illegal acts
  The majority rule does not apply if the company is acting or threatening to act in an ultra vires or illegal manner.

- Special or qualified majorities
  Where the majority purport use a simple majority to make a decision that can only be made by a qualified majority, the rule cannot apply Bailie V. Oriental Telephoneand Electric Ltd.

- Infringement of individual membership rights
  Where individual rights are violated or threatened with violation, a personal action for redress is available.

- Fraud on the minority: This is an abuse of power or misuse of a fiduciary position e.g. breach of duty or unfair use of majority voting power Cooks V. Deeks.

- Oppression of minority:
  Under Section 211 of the Companies Act, any member of the 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 apply to the court by petition for an order under this section. The petitioner must file a representative action and discharge the onerous burden of proof under this section.

QUESTION THREE

- It is a principle of law that on incorporation, a company becomes a legal person, distinct and separate from its members and managers. It becomes a body corporate with an independent legal existence, with rights and subject to obligations.

- It is a juristic person whose existence is only in the contemplation of law. This is the principle of legal personality which constitutes the foundation of company. It is often referred to as the "veil of incorporation."

- The conception of a company as a person separate and distinct from other persons who are its members and directors was enunciated by the House of Lords in Salomon vSalomon and Co Ltd (1897) where Lord MacNaghten opined that *"The company is at law adifferent person altogether from the subscribers to the memorandum"*

- The principle is now contained in Section 16(2) of the Companies Act.
  - As a legal personality a registered company has attributes that are peculiar to it for example,

    - Limited Liability: As provided by Section 4(2)(a) and (b) of the Companies Act, members liability is limited by shares or guarantee.

    - Perpetual Succession: Since a registered company is a legal person not susceptible to natural shocks, it has capacity to exist in perpetuity as its life lies in the intendment of law.

    - Owning of property: a registered company has capacity to own property e.g. land. Such property is vested in the company (Macauras case). It has an insurable interest in it.

- Sue or be sued: It has capacity to enforce its rights and may be sued on its obligations (Foss v Harbottle). It is Primafacie the proper plaintiff for redress.

- Capacity to contract: a company has legal ability to enter into contractual relationships (Lee v Lee Air Farming Co. Ltd)

- Common seal: Under Section 16(2) of the Companies Act, a registered company has a common seal to authenticate its transactions.

The foregoing demonstrates undoubtedly that a company has a separate legal personality from its members and managers.

However, this principle has been modified by courts of law and the Companies Act. These exceptions are collectively referred to as "lifting the veil of incorporation" or "piercing thecorporate shell," for example:

Statutory exceptions

- Reduction of number of members Section 33
- Non-publication or misdescription of the company"s name Section 109(4)
- Group accounts Section 150 - 152
- Investigation of company affairs Section 167
- Investigation of company membership Section 173 (1)
- Take over bid Section 210
- Fraudulent trading Section 323 (1)

Common law exceptions

- Agency, trustee or nominee.
- Ratification of corporate acts.
- Determination of residence.
- Fraud or improper conduct.
- Determination of character.
- Group enterprises.

QUESTION FOUR

a)

- The Companies Act does not define the term "promoter" generally. The "definition" contained in Section 45(5) is specific to Section 45(1) of the Act.

- In the words of Cockburn C.J in Twycross v Grant (1877) *"A promoter apprehend isone who undertakes to form a company with reference to a given project and set it going and who takes the necessary steps to accomplish that purpose."*

- This definition does not identify the role played by a promoter.

- A promoter is any person who has taken some part in bringing a company into existence or in procuring persons to join it as soon as it is technically formed.

- The role of a promoter may be active or passive.

- The question who a promoter is, is one of fact and varies from circumstance to circumstance.

b)

- This problem is based on pre-incorporation contracts. In this case the borrowing contract is between Mr and Mrs Karanja and Jijenge Bank. The proposed company, Central Construction Co. Ltd is not involved, and cannot therefore be held liable on the contract. At common law a pre-incorporation contract is generally unenforceable by or against the company. Mr and Mrs Karanja are personally liable on the contract. This position is consistent with the decision in Kelner v Baxter.

- Matatas contention is therefore sustainable since a pre-incorporation contract cannot be ratified by the company after incorporation. It was so held in Natal LandCompany Ltd v Pauline Colliery Syndicate.

- Central Construction Co Ltd cannot be burdened with obligations contracted before it was incorporated.

- Of equal importance is the fact that the company has not after incorporation entered into a new contract similar to the previous agreement. The bank has an action against Mr and Mrs Karanja for the amount due.

- The proposed alteration of the objects clause to provide for repayment of the amount by the company is invalid and cannot withstand judicial scrutiny even if passed by the majority.

QUESTION FIVE

a) - Prima facie directors are not entitled to remuneration unless the articles of association expressly provide. However, in practice directors are paid an allowance for attending meetings.

- With regard to compensation for loss of office, the operative principles are prescribed by Section 192(1) of the Companies Act. It is unlawful for a company to make to any director any payment by way of compensation for loss of, or as consideration for or in connection with this retirement from office unless:

  - particulars of the proposed payment including the amount has been disclosed to members of the company
  - the payment has been approved by the company in general meeting

Any payment made to a director in contravention of this provision is illegal and the director receives the same in trust for the company.

b) - An extra ordinary general meeting of the company must be convened to discuss the matter.
- The contract must be authorized by an ordinary resolution.

c) Directors are regarded as trustees in two respects namely:

- money in a company bank account which directors are authorized to operate is held by them in trust for the company.
- Property that comes into the hands of directors or under their control is held in trust for the company

As trustees directors are bound to;

- exercise all powers as such.
- account for any monies misapplied.
- avoid conflict of interest.

However, directors are not ordinary trustees in that;

- they have no proprietary rights in company property as it is vested in the company.
- They are bound to invest trust property for the benefit of the company.

QUESTION SIX

(a) - Special resolution
- Ordinary resolution if the duration for which the company was to subsist has lapsed.
- Ordinary resolution if an event contemplated by the articles has occurred.

(b) - Company
- Creditor or creditors
- Contributory or contributories
- Member or shareholder other than contributory
- Attorney General
- Official Receiver
- Commissioner of Insurance

(c)

- the company ceases to carry on business except such as may be required for beneficial winding up
- any transfer of shares or alteration in the status of members is void
- directors powers become functus officio on appointment of the liquidator
- if the winding up is based on insolvency, servants of the company are dismissed.
- the company"s corporate status and powers remain until dissolution.

QUESTION SEVEN

a) (i) Under Section 133 (1) of the Companies Act, notices of all general meetings of the company must be written and sent to all members of the company including the auditor. Under Section 158(1) of the Companies Act, a 21 day notice is necessary before an annual general meeting can be held. However, a shorter notice suffices if all members of the company have previously agreed.

(ii) The ordinary business of an annual general meeting include;
- adoption or confirmation of accounts
- declaration of dividend
- election of directors
- appointment of auditors

b) Mr Shidas problem is based on the failure of a company to hold an annual general meeting. Under the provisions of the Companies Act, every company much in each year hold a general meeting as an annual general meeting. The first general meeting must be held within 18 months of incorporation and subsequently 15 months must not elapse from the date of one annual general meeting to that of the next. In this case Excellent Home care Agencies Ltd has not held an annual general meeting as required by law. A criminal offence has been committed for which the company and officers in default are liable to a fine not exceeding Kshs. 2,000.

My advise to Shida is to:
- instigate the prosecution of the company and its directors for the default.

- apply to the registrar to call or direct the calling of an annual general meeting. A general meeting convened by or accordance with the directions of the registrar is duly constituted by one member present in person or by proxy.

QUESTION EIGHT

(a) Similarities

- Both shares and debentures are transferable
- Both are capital raising mechanisms for the company
- Preference shares and debentures have a prior claim
- Preference shares like debentures earn a fixed rate of interest
- Preferential dividend like interest on debentures is generally cumulative

(b) Differences

- Whereas shares are a unit of capital constituting a holder a member of the company, a debenture is a unit of a loan which constitute the holder a creditor to the company
- Whereas shares generally confer voting rights on members debentures do not
- Whereas shares are not secured, debentures generally are
- Whereas shares earn dividend, debenture holders are entitled interest
- Whereas dividend payable to shareholders generally vary with the company"s profitability, interest does not
- Whereas companies are not obligated to pay dividend on shares they are required to pay interest
- Shareholders rank after creditors in the satisfaction of claims
- Whereas shares participate in surplus profit, debentures do not.
- Whereas shares are generally irredeemable, debentures are generally redeemable.

b) This problem is based on the legal consequences of non-registration of a charge. In this case the charge to East Bank Ltd by Wheels Limited was not registered and the company is now in liquidation. It is evident that the unregistered charge cannot be relied upon by the bank to prove its claim. This is because under Section 96(1) of the Companies Act, if a charged is not registered within 42 days of its execution or such other extended time as the court may permit on application, the charge is void as against the liquidator and the amount secured becomes payable immediately.

- In this case the charge is invalid and the debenture to East Bank Ltd is therefore unsecured.
- My advise to East Bank is to prove and rank the debt as an unsecured creditor. This advise is based on the provisions of the Companies Act.

SUGGESTED SOLUTION
JUNE 2014 SITTING

QUESTION ONE

(a) Register of members:

Contents

- Name of the shareholder
- Postal address
- Number of shares or stocks held
- Date of entry of the name in the register
- Date of cessation of membership

Inspection
- by members of the company without charge.
- others subject to payment of the prescribed charge.

(b) Register of directors and secretaries Contents

- Christian and surnames of every director and secretary
- Postal address
- Nationality
- Business or occupation
- Other directorship,
- In the case of a company, its name registered office and postal address.

Inspection
- Members of the company without charge
- Others on payment of the prescribed charge
- Directors and secretaries of the company

(c) Register of directors interests Contents

- number, description and amount of shares or debentures held.
- nature and extent of the directors interest in the shares or debentures.

Inspection
- members of the company without charge
- debenture holders of the company.
- any person acting on behalf of the registrar.

(d) Register of charges Contents

- Particulars of all fixed and floating charged created by the company.
- Description of the property charged.
- Amount of charge
- Names of persons entitled thereto.

Inspection
- members of the company without charge
- creditors of the company without charge
- others on payment of the prescribed charge.

QUESTION TWO

Recent demands by regulatory authorities and shareholders have obviously affected the traditional role of an auditor in various ways for example:

- **Professional Competence and due care:** an accountant must not only attainprofessional competence but must maintain the same. General and specific education is necessary. He must be continually aware of developments in the profession. He must exhibit care, competence and diligence.
- **Professional behaviour:** must act in a manner consistent with the good reputation ofthe profession and refrain from any conduct which might bring discredit to the profession.
- **Confidentiality:** must respect confidentiality of information about a client acquired inthe course of rendering professional services and should not use or disclose the same without proper and specific authority.
- **Integrity:** entails fair dealing and truthfulness i.e. must be straight forward and honest inperforming professional services.
- **Technical standards:** an accountant should carry out professional services inaccordance with the relevant technical and professional standards. Must carry out the clients instructions with utmost care and skill.
- **Objectivity:** an accountant must be fair, intellectually honest and free from conflict ofinterest. Objectivity must be demonstrated in all circumstances.
- **Whistle blowing:** since the accountant has a responsibility to the public he is bound toblow the whistle whenever necessary to enable relevant bodies take the necessary action to protect the public.
- **Indoor/other information about the company** e.g. products, markets processes.
- **Investigation:** though traditionally the auditor is not an investigator unless appointed assuch shareholder are demanding more and more information from them and this compels the auditor to "dig deeper" for the information. It is apparent that the traditional statements of auditors no longer appease members who have become more inquisitive.

QUESTION THREE

(a)

- **Ascertainment and determination of the company"s name.** This is necessary beforethe application or reservation of the name is made to the registrar.
- **Determination whether the company is public or private.** This is critical as itaffects the contents of the articles of association.
- **Determination whether liability is limited by shares or guarantee.** For tradingcompanies liability is limited by shares while non-trading companies are limited by guarantee.
- **Determination whether the company shall have a share capital.** This depends on:
  - Whether liability is limited by shares or guarantee.
  - Intention of promoters.

(b) In law, promoters are not entitled to remuneration for incorporating a company for the simple reason that the company did not engage their services. However, promoters may be rewarded in other ways:
- acting as commission agents.

- being appointed the first directors of the company.
- being afforded the opportunity to take up extra shares at par value after market value has risen.
- being offered deferred or founders or management shares.
- upon disclosure, a promoter is free to sell overvalued assets to the company for a profit.
- upon, disclosure a promote is free to sell overvalued assets to the company is return for fully paid shares of the company.

(c) This is a rather interesting question. By default or design, the examiner opines that promoters exist even after incorporation. This proposition is not sustainable. A company has no promoters after incorporation and the question of their suspension does not arise. The purported reasons do not exist. (A figment in the imagination of the examiner.)

QUESTION FOUR

Directors practices that would promote and protect shareholders rights include:

- Ensuring that members have equitable terms in all that they do.
- Availment of information on the performance of the company.
- Ensuring that there is a secure method of transfer and registration of securities.
- Ensuring that shareholders are aware of their rights to participate in company affairs and vote in general meetings.
- Encouraging members to participate in deliberations at general meetings by way of questions and making substantive contributions.
- Recommending dividend regularly.
- Put in place an effective communication policy between the company and its members, creditors and other stakeholders.
- Ensuring that annual reports and accounts give a clear indication as to the company"s financial performance and prospects.
- Encourage and facilitate the establishment of a shareholders association to promote dialogue between the company and its members.
- Having a director"s charter in place.
- Distinguishing the roles of executive and non-executive directors and regular appointment of directors.

QUESTION FIVE

(a) Documentation

- Memorandum of Association – this is the external constitution of the company.
- Articles of Association – this is the internal constitution of the company.
- Statement of Nominal Capital – specifies the capital with which the company is to be registered.
- Declaration of Compliance – this is a requirement of Section 17(2) of the Act.
- List of directors and their particulars – names, postal address, date of birth, other directorships.
- Consent to act as director which must be written.
- Notice of location of registered office – city or town, name of building, plot number etc.

(b) Removal of Boaz for office

- Abel and David must give ABD Company Limited a special notice of the intended resolution i.e. to remove Boaz from office.
- On receipt of the notice, ABD Co. Ltd. must send a copy of the notice to Boaz.

- Boaz is entitled to make written representations as his defence and may request the company to notify its members that he has done so.
- Abel and David must instigate the convention of an extra ordinary general meeting of the ABD Co. Ltd to determine the issue.
- The removal of Boaz from the office of director will take effect when Abel and David pass an ordinary resolution to that effect.

(c) The facts of this case encapsulates a situation whereby the majority shareholders hatch a duplicity to remove one of their number from the office of director. These facts raise the question whether expulsion from management is a sufficient ground for compulsory winding up. It is our submission that if the expulsion is not based on anything substantial as is the case in ABC Co. Ltd., it tends to be unfair and borders malice and is thus sufficient to warrant a winding up of the company under the just and equitable ground.

In our view, Boaz has been unfairly expelled from the management of the company and can thus petition for the compulsory winding up of the company. Our position is consistent with the decision in Re Lundie Brothers Ltd. whose facts were substantially similar and the court decreed the winding up of the company under the just and equitable ground.

QUESTION SIX

A securities account with the Central Depository and Settlement Corporation may be suspended on various grounds or circumstances e.g.

- The entire issue has been suspended by the regulatory authorities e.g. Capital Markets Authority.
- Notice of the investor"s death.
- Instigation of the investor.
- Its existence is contract to public policy e.g. contrary to national security.
- The account was created illegally or unlawfully.
- The shares have been pledged as a security.
- Pursuant to a court order.
- Instigation of the Capital Market Authority or the Nairobi Stock Exchange.

QUESTION SEVEN

(a) This is information which:

- Relates to particular securities or a particular issuer of securities and not to securities generally or to issue of securities generally.
- Is specific or precise
- Has not been made public
- If it was made public would be likely to have a significant effect on the price of any securities.
- The information is known to directors or servants of the company, public servants employees of regulators or other persons who had some relation with the company.

(b)

(i) This problem is based on allotment of shares. In this case Sarah had applied for 4000 shares but ABC Co. Ltd. allotted her 2000 only. Can Sarah sue the company? The answer to this question is emphatically no for the following reasons:

- Sarah"s application for shares was an offer to the company which it was not bound to accept but accepted by allotting her 2000 shares. If the allotment

letter was posted, the contract was concluded on postage **(Household FiveInsurance Co. Ltd. V. Grant)**.

- Company prospectuses always provide that the company is not bound to allot the quantum of shares applied for. Since ABC Co. Ltd. is a public company there must have been a prospectus inviting prospective investors to apply for the shares.
- Since an allotment is an appropriation of a number of shares Sarah is bound to take up the number allotted to her.
- My advice to Sarah is to take up the shares allotted and drop the threat to sue the company. In any event she can always dispose them off.

(ii) Restrictions on Allotment of Shares

- no allotment should take place before the minimum subscription as stipulated in the company"s prospectus has been raised.
- no allotment must be effected before the delivery to the Registrar for registration, a prospectus or a statement in lieu of prospectus signed as required by law and containing the relevant particulars.
- no allotment of shares should be made to a state corporation without prior written consent of the treasury.
- no allotment of shares should be made before the beginning of the third day from that on which the prospectus was first issued.

QUESTION EIGHT

(a)

- The transferor and transferee enter into a legally binding agreement to sell and buy the shares.
- The transferor completes the instrument of transfer by entering all the particulars and signing the same.
- The transferor signs the relevant part of the document.
- In the case of a partial transfer of shares certification of the instrument of transfer by the company is necessary.
- Stamp duty on the transfer must be paid.
- The instrument of transfer and the share certificate must be lodged with the company for registration of the transfer.
- On registration of the transfer the share certificate is cancelled and another issued in the name of the transferee.

(b)

- A forgery has no effect. It is a legal nullity. It was so held in Ruben V. Great FingalConsolidated.
- In this case Otieno"s forgery on Mwinzi"s share certificate and transfer has no legaleffect of the shares. Thus Kuria acquired no title in the shares as he had none to pass to Wafula though the company issued a share certificate to Wafula.
- The legal position is that Mwinzi is still the legal and lawful owner of the shares as the purported transfer to Kuria has no legal effect.
- The fact that Mwinzi did not respond to the company secretary"s letter on the transfer is of no legal consequence. His conduct cannot be relied upon to legalize a nullity.
- With regard to Wafula"s case, the law is very clear, he is abonafide purchaser for value without notice. Since the company issued a share certificate to him it cannot be heard to say that he is not the holder of that number of shares or their value. The company is estopped from denying that fact. But since the transfer is void, Wafula has not title in the shares. He is entitled to sue the company in damages for the loss and the company is liable.

- Mwinzi is entitled to have the shares re-registered in his name and a new share certificate issued in his favour. This position is consistent with the decision in Balkis ConsolidatedV. Tompkinson.

Part III: Comprehensive Mock Examinations

QUESTIONS – MOCKS

MOCK ONE

QUESTION ONE

a) Outline a classification of registered companies on the basis of share capital.
b) What do you understand by the phrase "ultra vires" in the wider sense?
c) Section 22 (1) of the Companies Act has been interpreted to mean that when the articles are registered two contracts come into existence. Enumerate the characteristics of the so called "second contract".

QUESTION TWO

a) To what extent may a company alter the objects clause of its memorandum of association?

b) Josiah and Joachim and others incorporated a public company to carry on the business of exporting flowers to Europe and the United States. The company"s shares attracted a heavy subscription and the company has over 70 members whose shares are fully paid. For the last 5 years, the company has made enormous profit and members are very happy with their investment. However, recently, the European Union and the United States excluded Kenyan flowers from the market on the ground that they contained dangerous levels of poisonous chemicals. The company cannot now export flowers to Europe or the United States and shareholders are at a loss. Oliver and Ben, who are shareholders have approached you for advice on what action to take. Advise them.

QUESTION THREE

a) In what circumstances may a registered company pay a commission?

b) Under Section 45 (1) of the Companies Act persons who are party to the issue of a prospectus containing any untrue statement may be held liable to compensate a third party who has suffered loss or damage by reason of subscribing for shares or debentures on the faith of such statements. However an expert may escape liability in certain circumstances. Identify these circumstances.

c) In addition to the matters specified in Part I of the Third Schedule and the reports specified in Part II of that schedule, a prospectus must state certain other matters. Enumerate these matters.

QUESTION FOUR

a) "In considering an application for the reduction of capital of a company under the Companies Act, Cap 486, the Courts while affording adequate safeguards for the interests of creditors have ignored totally the interest of the shareholders and the public at large". Do you agree?

b) Distinguish between consolidation of shares and diminution of capital.

c) What do you understand by "corporate governance"?

QUESTION FIVE

a) Maridadi Company Limited a private company limited by shares has adopted Table A as its articles. In March 1997 the board of directors appointed Cook as managing director at a salary of Kshs100,000 per month. Under the terms of the appointment, Mr. Cook was to remain managing director for 5 years. Maridadi Company Limited has not made any profit for the last 4 years and the directors are very unhappy with Cook"s performance. At an acrimonious board meeting, Cook outrightly refuses the board"s proposals for improving the company"s performance. The board of directors now seekyour advice as to whether it can lawfully take the following causes of action:

i) order Cook to confine his attention to the affairs of a subsidiary of Maridadi Co. Ltd.
ii) dismiss Cook as managing director
iii) remove Cook from membership of the Board
iv) reduce his salary by reason of poor performance.

b) The Articles of Akim Ltd provide that Adam, one of the promoters and a lawyer be appointed the company"s advocate for life. It also contains a provision to the effect that any dispute between the company and a member be referred to arbitration. Adam holds 80% shares in the company and acts as the company"s advocate for 8 years after which the company begins to channel some of its legal work to a new form of advocates. Adams protests to the company but in vain. After 8 months all the company"s legal work is taken over by the new firm. Advise Adam.

QUESTION SIX

a) What are the principal functions of the managing director?

b) The directors of Unguja Farmers Co. Ltd a public company limited by shares have not convened an annual general meeting of the company since it was incorporated two and a half years ago. Makini, one of the shareholders is yearning for a meeting so as to participate in the decision making of the company. Advise him.

c) What are the criminal penalties for non-compliance with the provisions of the Companies Act in relation to the annual general meeting and the statutory meeting?

QUESTION SEVEN

a) Shareholders of Wakulima Co. Ltd. resolved by special resolution that the affairs of their company be investigated by an inspector appointed by the Court. Recently, the Court appointed two inspectors who investigated the company"s affairs in two weeks and a report on the same has already been handed over to the Court. The report shows that:

i) some directors of the company have misappropriated the company"s funds and property.
ii) some members of the company have committed fraudulent acts and misconduct against the company.
iii) members have lost confidence in the management of the company.

A copy of the report has been delivered to the Attorney General for further action. Advise the Attorney General.

b) In what circumstances:

i) may the High Court refrain a person from being directly or indirectly involved in the management of a company"s affairs.
ii) may a company make a loan to its directors?

c) Tirop who owns 500 shares in Mbao Co. Limited, a public company limited by shares contracted to sell them to Sironik. Neither of them has transferred shares before:
   i) Advise them on the procedure of transfer of shares.
   ii) What would the legal position be if Tirop transferred the shares to Joash before the transfer to Sironik was registered?

QUESTION EIGHT

a) "They cannot themselves usurp the powers which by the articles are vested in the board any more than the board can usurp the powers which are vested in the general body of shareholders". (Per Lord Greel in Shaw V Shaw (Sanford) and Sons Ltd) Do you agree?

b) Odipo and Associates, a firm of auditors has been in the business for the last 12 years. Last year two of its senior partners were convicted for fraud and imprisoned for 2 years and as a consequence were deregistered as practising accountants, leaving the firm with no partner but three accountants. Recently the annual general meeting of Wavuvi Co. Ltd. appointed Odipo and Associates as auditors.
What are the legal consequences of the appointment?

MOCK TWO

QUESTION ONE

a) Distinguish between "lifting the veil" and "raising the curtain".

b) Sometimes the corporate entity works like a boomerang and hits the man who was trying to use it" (Kahn Freud - Some Reflections on Company Law).
What do you think the writer meant by this statement?

QUESTION TWO

Write explanatory notes on the following:

- Peek V. Gurney (1873)
- Andrews V. Mockford (1896)
- misfeasances
- identification theory.

QUESTION THREE

a) What do you understand by "allotment"?

b) The provisions of the Companies Act Cap 486, render certain irregular allotment of shares and debentures valid, voidable or void. Set out the allotments in each category and illustrate the criminal sanctions, if any, for contravention of law.

c) Define "underwritten firm".

QUESTION FOUR

a) Who is liable to compensate a third party who has suffered loss or damage by reason of subscribing for shares or debentures of a company on the faith of a prospectus containing any untrue statement?

b) Examine the criminal liability in respect of prospectuses.

c) What do you understand by "overriding commission"?

QUESTION FIVE

a) Article 114 of Table A provides inter alia "The company in general meeting may declare dividends…". With reference to Table A and the common law state the rules that govern payment of dividend by companies.

b) The Articles of Reconstructions Co. Ltd. is similar to Table A. Reconstructions Co. Ltd. is a mining company with a registered office in Busia. It is anticipated that gold mining in Busia will be exhausted by the year 2005. Since 1994, the Company had not made any provision for depreciation in the value of its assets. During the 1999-2000 financial year Reconstructions Ltd made a trading profit of Kshs4 million. However, its accounts for the financial year 2000-2001 show a loss of Kshs5 million. During the same period the company sold a piece of land in Busia town realising a profit of Kshs3 million on the sale. Directors of Reconstruction Ltd would like to know whether they can recommend dividend. Advise them.

QUESTION SIX

a) In what circumstances may a company:
   i) Issue bonus shares?
   ii) Pay interest out of capital?
   iii) Redeem redeemable preference shares?
   iv) Issue share warrants?

b) What are the criminal penalties for
   i) Issuing and circulating an unsigned balance sheet?

ii) Failure to keep the company"s book of accounts?
iii) Appointing an unqualified person as auditor?

c) Explain the legal consequences of payment of a call in advance by a shareholder.

QUESTION SEVEN

a) Ponda Mali the principal shareholder of Mali Mingi Ltd would like the company to issue share warrants to at least half of the members but is unsure of the prerequisites under the provisions of the Companies Act. Two weeks ago, the company issued share warrants to all interested shareholders. Mali Mingi Ltd is required to file its annual return in the next few days. Ponda Mail now comes to you for legal advice on the following matters:

i) Effect of issue of share warrants on the register of members.
ii) Contents of the annual return in relation to the share warrants.
Advise him.

b) The affairs of Ibiza Ltd were recently investigated by an inspector appointed by the court and the report has already been handed over to the court. The court has forwarded a copy of the report to the Attorney General for further action and the Registrar of Companies has defrayed the costs of and other incidentals of the investigation. Karim, one of the directors of Ibiza Ltd is a worried man and would like to know:

i) The specific actions the Attorney General could take.
ii) Who is liable to pay the Registrar?
Advise him.

c) What are the annextures to the company"s balance sheet laid before the company in general meeting?

QUESTION EIGHT

a) In what circumstances may a winding up petition be presented to the court by:

i) A contributory?
ii) Shareholder other than a contributory?

b) In what ways may a person cease to be a member of a committee of inspection?

c) On October 22nd 2002, the shareholders of Ruwenzori Co. Ltd. passed a resolution to wind up the company which owed creditors Kshs10,000,000. A meeting of the company"s creditors was summoned in accordance with the provisions of the Companies Act and Kwishima, one of the directors of Ruwenzori Co. Ltd . presided over the meeting.

Whereas the members" meeting nominated Ogutu as liquidator, the creditors" meeting nominated Kato. Kwishima, has evidence that neither Ogutu nor Kato has undertaken such an onerous task in the recent past and there are other qualified persons.

i) Identify:
a) the resolution passed by shareholders of Ruwenzori Co. Ltd
b) the category or type of winding up in question
c) the commencement date of the winding up
d) the matters laid before the meeting of creditors

ii) Advise Kwishima.

MOCK THREE

QUESTION ONE

a. The House of Lords decision in Salomon V Salomon and Co. Ltd [1897] laid to rest certain principles. Identify those principles.

b. In re Lee Behrens and Co. Ltd [1932] Eve. J. observed that the validity of gratuitous payments is tested by the answers to "three pertinent questions".
What propositions are these?

c. "The corporate form is the normal solution that the law and business practice have evolved..." (Hahlo: Cases and Materials on Company Law, 1987, p.19) The limited company is the most advanced form of business association today. What factors in your opinion led to the emergence of the company?

QUESTION TWO

a) Under Section 40 (3) of the Companies Act, it is a criminal offence to issue any form of application for shares in or debentures of a company unless the form is issued with a prospectus which complies with the provisions of the Companies Act. In what circumstances may an application form be issued unaccompanied by a prospectus?

b) Identify the principal contents of a debenture trust deed.

c) Mashariki Co. Ltd, a private company limited by shares has articles in the form of Table A. Jesse and Jackson the only directors of the company own 2,000 shares out of a total of 15,000. Magharibi Co. Ltd makes a take over bid for Mashariki Co. Ltd. Jessee and Jackson are opposed to the bid since they know that they are likely to lose their directorship if the bid is successful. Subsequently the directors of Mashariki Co. Ltd:

1. Allot 5,000 shares to Umoja Ltd., a company that has been supplying goods to Mashariki Co. Ltd Umoja Ltd. believes that the allotment is intended to foster closer business relations with Mashariki Co. Ltd.
2. Give options to their wives to subscribe for 5,000 shares of the company.

Recently the general meeting of Mashariki Co. Ltd. ratified the above transactions. Solomon a minority shareholder who hoped to benefit from the take over bid wishes to have the transactions set aside. Advise him.

QUESTION THREE

a) In Ferguson V Wilson (1866) Cairns L. J. observed that "the company itself cannot act in its own person , for it has no person, it can only act through directors and the case is, as regards those directors, merely the ordinary case of principal and agent. Wherever an agent is liable those directors would be liable, where the liability would attach to the principal and the principal only, the liability is the liability of the company."

In what circumstances may a director be held personally liable in lieu of or in addition to the company?

b) Olympic Co. Ltd passed a resolution to increase its capital by the issue of new shares. Thereafter, directors entered into a contract with Mr. Peek under which he was to take up all the shares not taken up by existing shareholders at a premium. However Mr. Peek was unable to take up all the shares he was supposed to take. Consequently, directors of Olympic Co. Ltd took over from Mr. Peek a considerable number of shares

at the agreed price and afterwards disposed of them at a profit. Olympic Co. Ltd. insists that the profit made by the directors belong to it.
Advise the directors.

QUESTION FOUR

a) Identify the annextures to a company"s annual return to the registrar. What additional information is necessary in the case of the annual return of a private company?

b) In what circumstances may the High Court order rectification of the register of members? Who may apply for rectification and what orders may the court make?

c) What are the salient duties of the liquidator?

QUESTION FIVE

a) Under section 159 (1) of the Companies Act, "Every company shall...appoint an auditoror auditors to hold office..." Identify the salient obligations of the auditor.

b) In the words of Lord Denning in Fomento Ltd V Selsdon fountain Pen Co. Ltd [1958]
"an auditor is not to be written off as a professional adder-upper and subtractor. Hisvital task is to take care to see that errors are not made, be they errors of computation, or errors of omission or commission, or downright untruths. To perform this task properly he must come to it with an inquiring mind –not suspicion of dishonesty..."

In the light of the foregoing to what extent is an auditor an investigator?

c) How is the auditor"s remuneration fixed and in what circumstances may the registrar appoint an auditor for a company?

QUESTION SIX

a) What do you understand by the term "debenture"?

b) Identify the principal characteristics which a bearer debenture must be endowed with so as to make it negotiable?

c) In November 2000 Onyango a shareholder of Ujenzi Ltd. discovered that the statements he had relied upon in the company"s prospectus were untrue. On December 5th, he attempted unsuccessfully to sell the shares to Kajwang. On December 9th, 1986 Onyango received a circular from the Company Secretary notifying him that the statements were in fact untrue but had been made in good faith. On December 10th he telephoned the company secretary requesting the removal of his name from the register of members. On January 6th 2002 Onyango commenced rescission proceedings against the company. On January 8th 2002 Onyango discovered that the Company had gone into liquidation, a resolution to the effect having been passed on January 4th 2002.
Advise Onyango.

QUESTION SEVEN

a) What books of account is a company required by the Companies Act to keep and what provisions regulate group accounts?

b) Analyse the circumstances in which group accounts of a company need not deal with a subsidiary?

c) What are the statutory penalties for failure to keep proper books of account?

QUESTION EIGHT

a) In what circumstances may the official receiver petition for the winding up of the company?

b) State the advantages of winding up subject to the supervision of the court.

c) Section 219 (f) of the Companies Act provides that "a company may be wound up by the court, if the court is of the opinion that it is just and equitable that the company should be wound up".

Give a general account of the circumstances which will influence the court in exercising its discretion under this section illustrating your answer with relevant judicial authority.

MOCK FOUR

QUESTION ONE

Discuss the circumstances under which a company will be round up voluntarily, outlining how a member"s voluntary winding up is carried out.

QUESTION TWO

a) State the rule in Foss V. Harbottle.
b) What constitute the exceptions to this rule?
c) Maiko is a shareholder of Kakuma land Buying Co. Ltd. The Articles of Association of the Company state that the voting will be done by a show of hands. At a meeting to resolve a long standing disagreement between members over a land buying issue, Maiko votes against the expectation of the chairman of the Board of Directors who loudly decline to record his vote. Maiko is aggrieved by the decision of the chairman, but is unsure of how to proceed. Advise him.

QUESTION THREE

Write short notes on the following:
a) The authorized capital
b) The issued capital
c) The unpaid capital
d) The reserve capital

QUESTION FOUR

a) Who are promoters and what are their duties to the company?

b) Prior to Incorporation, Mang"ea and Wanyoike, promoters of Maendeleo Co. Ltd convened public meetings. Saidi and Mutuku requested to subscribe for shares in the proposed company. They paid for shares both before and after incorporation, but when the company was finally incorporated, it did not issue any shares to Saidi and Mutuku.

Advise Mutuku and Saidi

QUESTION FIVE

a) What are the requirements of the Companies Act (Cap486, Laws of Kenya) regarding calling the annual general meeting of a registered company?

b) What is an extra ordinary general meeting? How may members requisition an extra ordinary general meeting.

c) The director of Kusau Ltd, a company whose articles are similar to Table A, wish to give effect to the following matters;
   i) To change the name of the company to Mataa Ltd
   ii) To increase the company"s share capital.

Advise them.

QUESTION SIX

a) Explain the remedies available against promoters for breach of duty.
b) Write explanatory notes on the following:

   i) Newborn V. Sensolid (Great Britain) Ltd
   ii) Natal Land Co. Ltd V. Pauline Coiliey Syndicate Ltd.

QUESTION SEVEN

a) Explain the legal rules prescribing the circumstances in which a company may or may not pay a dividend.

b) How effective are these rules in ensuring that the company"s capital is maintained?

QUESTION EIGHT

a) In what circumstances may an official receiver be appointed?
b) Examine the legal consequences of the appointment of an official receiver.
c) Examine the circumstances in which the affairs of a company may be investigated by the registrar of companies.

MOCK FIVE

QUESTION ONE

a) Explain the circumstances in which a company may issue its shares at a discount.

b) How are the interests of the following persons protected when a reduction of a company"s capital is being considered by the court.

i) The company"s Creditors
ii) The company"s members
iii) The general public

QUESTION TWO

a) What is meant by the term "Fraud on the minority".

b) Gwanju Co. Ltd is in need of additional shares. The majority are willing to provide this capital if they could purchase the 20% of the shares held by the minority. The minority shareholders refuse to sell to the majority shareholders who then propose to alter the Articles of Association to provide for compulsory acquisition on a specified basis.

Discuss the legality or otherwise of this proposal.

QUESTION THREE

Chapati 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.

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

QUESTION FOUR

a) In relation to company securities, what is meant by;
   i) A floating charge;
   ii) Crystallization of a floating charge;
   iii) A negative pledge clause?

b) Explain the provisions of the Companies Act (Cap 486, Laws of Kenya) relating to registration of charges.

QUESTION FIVE

Discuss in details the rule and exceptions in **Royal British Bank V. Turguard**.

QUESTION SIX

a) In what circumstances, if any, will a director be treated as an agent of the company.

b) The directors of Usafi 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 Juma was eth secretary. Eventually became a director. At Juma"s very first board meeting, the earlier breach was ratified.
To what extent, would Juma be liable for the earlier breach.

QUESTION SEVEN

a) What is a "Statement in lieu of Prospects".

b) Outline the procedure for delivery of such a statement to the Registrar of Companies and indicate the information that must be disclosed by the statement.

QUESTION EIGHT

Distinguish a private company according to section 30 of the Companies Act (Cap.486) from a partnership.

ANSWERS - MOCKS

MOCK ONE

QUESTION ONE

a) Share capital constitutes the divisions into which a company"s capital is divided. A classification of Companies on the basis of share capital places companies into five categories, namely:

- Company limited by shares ipso facto has a share capital
- Company limited by guarantee with a share capital.
- Company limited by guarantee without a share capital.
- Unlimited company with a share capital.
- Unlimited company without a share capital.

b) Ultra vires literally means beyond the powers. It is a rule of capacity.

The so-called ultra-vires in the wider sense is nothing but an abuse of powers of the company by its officers often described as excesses of directors or transactions ultravires the directors.

- E.g. borrowing for ultra vires purposes
- A transaction ultra vires in the wider sense is ultra vires the company. However, it is voidable at the option of the company.
- Such a transaction may be ratified by members in general meeting whereupon it ceases to be voidable.
- A transaction ultra vires in the wider sense is enforceable, if the other party was unaware of the abuse of power. As was the case in David Payne and Co. Ltd. It is unenforceable if the other party had notice of the abuse of power. As was the case in re Introductions Ltd.

c) The so-called "second contract" has been acknowledged inobiter only in cases such as Quin and Axtens Ltd. v. Salmon and in Wood V. Odessa Waterworks Ltd.

- It is a contract between each member and every other i.e. members inter se
- The contract is generally unenforceable since a member cannot sue another to enforce the article. It can only be enforced by the liquidator in the course of winding up or under the exceptions to the rule in Foss V. Harbottle.

QUESTION TWO

a)

- A company has statutory power to alter the objects clause of its memorandum.
- Under Section 8 (1) of the Companies Act a company may by special resolution alter its objects clause.
- A copy of the resolution must be delivered to the registrar for registration within 30 days thereof. Whereupon the alteration becomes legally effective.
- However, under Section 8 (1) of the Act, a company can only alter the objects clause so far as may be necessary to enable it::
  - Carry on its business more economically or more efficiently.
  - Attain its main purpose by new or improved means.
  - Enlarge or change the local area of its operations
  - Restrict or abandon any of the objects specified in the memorandum
  - Sell or dispose off the whole or any part of its undertaking
  - Amalgamate with any other company or body of persons.

- Carry on some other business which under existing circumstances may conveniently or advantageously be combined with the business of the company.

Under Section 8 (2) of the Act a proposed alteration of the objects clause may be objected to by:

- Holders of not less than 15% in nominal value of the company"s issued capital
- Holders of not less than 15% of any class of shares of the company
- Holders of not less than 15% of the company"s debentures entitling them to object
- Not less than 15% of the company"s members.

Those objecting must be persons who did not consent or vote in favour of the alteration. The court may:

- Make an order cancelling or confirming the alteration either wholly or in part and on such terms and conditions as it deems fit
- Adjourn the proceedings for arrangements to be made to facilitate the purchase of the interests of dissentient members.

b)

- This problem is based on the principles relating to failure of a company"s principal or paramount object.
- In this case it is evident that the company"s substratum has disappeared since it can no longer export flowers to the European union or the United States the sole object it was incorporated to pursue.
- It is apparent that the company cannot embark on any other object as the same is likely to be ultra vires.
- My advice to Oliver and Ben is to petition for the compulsory winding up of the Company on the ground that it is just and equitable that the company be wound up. This is because failure of the substratum is one of the circumstances in which a company may be wound up under the just and equitable ground.
- My advice is based on the decision in re German Date Coffee Co. Ltd. where a company was formed to acquire a German patent to manufacture coffee from dates as a substitute. However it could not acquire a German patent. A shareholder petitioned for the winding up of the company on the ground that it was just and equitable. It was held that since the company"s substratum had disappeared altogether it was just and equitable to have it wound up.

QUESTION THREE

a) Under Section 55 (1) of the Companies Act a registered company may pay a commission to any person in consideration for his:
   - Subscribing for the company"s shares
   - Agreeing to subscribe
   - Securing subscription for the company"s shares
   - Agreeing to procure subscription for the shares.

The payment of such commission may be conditional or absolute.

However the commission is only payable if:

- It is authorised by the articles
- It does not exceed 10% of the price at which the shares are to be issued or the amount or rate authorised by the articles whichever is less
- Particulars of the discount are disclosed in the company"s prospectus

b)

- If he withdraws his consent in writing before a copy of the prospectus is delivered to the registrar for registration.

- If on becoming aware of the untrue statement after its delivery to the registrar for registration but before allotment, he withdrew his consent in writing and gave reasonable public notice of the withdrawal and reasons therefore.
- He was competent to make the statement in question and had reasonable ground to believe and did believe up to the date of allotment that the statement was true.

c)

- **Date**: Under Section 39 of the Companies Act, "a prospectus is issued by or on behalf of a company or in relation to an intended company shall be dated..."
- A statement to the effect that a copy of the document has been delivered to the registrar for registration.
- Specify, or refer to statements included in the prospectus which specify, any documents required by the Act to be endorsed on or attached to the copy so delivered.

QUESTION FOUR

a) On the one hand it is quite true to argue that whereas courts of law afford adequate safeguards for creditors, they have ignored the interests of shareholders and the public at large. This argument is premised on the following realities:

- **Primo**, under section 69 (1) of the Act, once an application for the confirmation ofreduction of capital is made, the court settles the list of creditors and must satisfy itself that all creditors have either objected or consented to the reduction.
- **Secundo**, if creditors have objected, the court must satisfy itself that such creditors' claims have been secured, discharged or determined. However the court is empowered to dispense with the consent of a creditor.
- **Thirdly**, under section 70 (1) of the Act a reduction of capital will only beconfirmed if the court is satisfied that objecting creditors claims have been secured, discharged or determined.

However, on the other hand it is arguable that the interests of shareholders and the public are also safeguarded. This assertion is justifiable on the following arguments:

- **Primo**, as a general rule a court of law will not confirm a reduction of capital if thesame is unfairly prejudicial to any class of members of the company.
- **Secundo**, the court may when confirming the reduction, for any special reason, butfor a specified duration order the company to add the words "and reduced" as the last words to its name and for the duration of the order, the words "and reduced"form part of the company"s name. This compulsory change of name is intended to protect the public at large by putting it on inquiry when dealing with the company.
- **Third**, the court may order that notice of reduction of capital by a company bepublished for all and sundry.

Arguably therefore, though courts of law accord more attention to creditors, the interests of shareholders and the public at large are not totally ignored. In any event the interest of shareholders and the public are generally safeguarded by the provisions of the Companies Act relating to reduction of capital: e.g. members must by special resolution authorise the reduction and the same is registrable in accordance with the Provisions of Section 71 (1) of the Act, hence potential investors are deemed aware of that fact courtesy of the doctrine of the constructive notice.

b)

- This is the process of combining a number of shares to form one larger share whose nominal amount is the aggregate of the shares so consolidated. Under Section 63 (1)(b) of the Act, a company having a share capital may if authorised by its articles consolidate its share capital into shares of larger amount than its existing shares. The consolidation must be authorised by an ordinary resolution and the registrar must be notified within 30 days thereof.
- This is the cancellation of the whole or part of the unissued capital of a company.
- Under Section 63 (1)(e) of the Act a company having a share capital may if authorised by the its articles diminish its capital.
- The articles must prescribe the attendant procedure.
- It must be authorised by an ordinary resolution and the registrar must be notified within 30 days.

c)

- This is the system by which companies are directed and controlled. It is the way the management of a firm is influenced by stakeholders e.g. owners, creditors, managers, employees, suppliers, customers, local residents and the government. The board of directors is responsible for governance of the company.
- The shareholders role in governance is to appoint directors and auditors and satisfy themselves that an appropriate governance structure is in place.
- It is the responsibility of the board to set up the company"s strategic aims, provide leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship.
- Principles of corporate governance address five issues:
- **Rights of shareholders**
- The corporate governance framework must protect the rights of its members.
- **Equitable treatment of shareholders**
- The framework must ensure that all shareholders i.e. majority and minority are treated equally.
- **Role of stakeholders**
- **Disclosure and transparency**
- **Responsibility of the board**

QUESTION

FIVE a)

- The board can legitimately instruct Cook to confine his attention to the affairs of the subsidiary of Maridadi Co. Ltd. This is because:

  - A company and its subsidiary are in essence one economic unit. It was so held in Harold Holdsworth v. Caddies.
  - Under Article 109 of Table A which is Maridadi"s Articles the board may entrust and confer upon a managing director any of the powers excercisable by it to exercise collaterally or to the exclusion of the board . It is also empowered to revoke, vary or alter all or any of such powers.

- The board it appears cannot dismiss Cook from his position as Managing Director. Since the terms of employment are explicit that he was to remain in office for 5 years. He can only be removed from office in accordance with the terms of the contract failing which the company may be held liable in damages for wrongful dismissal as was the case in Southern Foundaries Ltd. v. Shirlaw or in Shindler V.Northern Rain Coat Co. Ltd. Where managing directors had been appointed under contracts of service and the companies purported to remove them from office otherwise, the companies were held liable in damages for breach of contract.

- The board of directors cannot remove Cook from his position as a director. This is because directors are elected by members by ordinary resolution in general meeting, hence the power of removal is vested in the general meeting and the board cannot exercise this power. This position is exemplified by the principle of division of powers between the general meeting and the board.

- The board of directors cannot unilaterally reduce the managing director"s salary by reason of his poor performance. This is because the terms of employment ordain that he be paid a specific sum per month. Any purported reduction may precipitate an action in damages for breach of contract. The least the board can do is to persuade him to accept a lesser sum failing which it has no recourse in law.

b)

- This problem is based on the characteristics of the contract created between the company and its members when the articles are registered (Section 22 (1)).
- It is clear that Adam is a member of Akim Ltd and the articles provided that he be appointed the Company solicitor for life.
- It is evident that there is a dispute between Adam and Akim Ltd in that the company is now channelling its legal work to another firm of advocates contrary to the articles.
- The issue boils down to the question whether the article in question is enforceable by Adam.
- Since the contract created by the articles is between the company and its members only (Welton V. Saffery) (Hickman V. Kent)and can only be enforced by members in their capacity as members, ie, member qua member, it follows that the article is unenforceable.
- My advice to Adam is that he has no actionable claim against the company for the simple reason that he is an outsiders and hence cannot enforce the article. Secondly, if he sued as a member his action would still be unsuccessful as the rights conferred by the articles can only be enforced by members in their capacity as members. Adam would be suing to enjoy rights accruing to him as a solicitor.
- My advice is based on the decision in Eley V. Positive Government Life AssuranceCo. Ltd whose facts were substantially similar to those of the instant case.

QUESTION SIX

a)

- The office of managing director is created by the articles for purposes of internal management.
- Under Article 107 of Table A directors may appoint one or more of their body to the office of managing director for such period and on such terms as they think fit and subject to terms of any particular agreement, the board may revoke such appointment.
- A managing director has two functions and capacities, those of director and managing director. As managing director he is a party to a contract of employment or service with the company (Anderson V. James Sultherland(Peterhead) Ltd [1941])
- Subject to the articles the powers and duties of a managing director depend upon his contract of service with the company.
- The managing director is a full-time employee to whom some or all of the powers of management of the board are delegated.
- Under Article 109 of Table A directors may entrust to and confer upon a managing director any of the powers exercisable by them on such terms and conditions and subject to such restrictions as they may deem fit and either collaterally with or to

the exclusion of their own powers and may withdraw, revoke after of vary all or any of such powers as was the case in Harold Holdsworth and Co V. Caddies

- A managing director may have implied power to enter into certain agreements on behalf of the company even though there has been no express delegation of the power.

b)

- This problem is based on the law applicable if a company has failed to hold an annual general meeting.
- In the first instance it is a criminal offence for which the company and every officer in default are liable to a fine not exceeding KShs2,000.
- In this case Unauja Co. Ltd. and its directors are liable to a default fine.
- Under Section 131 (2) of the Companies Act if a company falls to hold an annual general meeting in accordance with Section 131 (1), any member of the company may petition the registrar to call or direct the convention of an annual general meeting. Such a meeting is duly constituted by one person present in person or by proxy.
- My advice to Makini is to petition the Registrar of Companies to call or direct the calling of a general meeting of the company. My advice is based on the Provisions of the Companies Act quoted herein above.

c)

- Under Section 130 (9) of the Act, failure to hold a statutory meeting renders every director of the company who is knowingly and wilfully guilty of the default or in the case of default by the Company, every officer in default liable to a fine not exceeding KShs1,000.
- Under Section 131 (5) of the Act failure to hold an annual general meeting in accordance with Section 131 (1) of the Act renders the Company and every officer in default liable to a default fine not exceeding KShs2,000.

QUESTION SEVEN

a)

- The Attorney General must institute criminal proceedings against the director for the offence. Officers and agents of the company are bound to assist him in the prosecution. My advice is based on the Provisions of the Companies Act.
- The Attorney General is advised to institute civil proceedings in the name of Wakulima Co. Ltd for the recovery of the property misapplied by the directors. This advice is based on the Provisions of the Act.
- The Attorney General is advised to institute civil proceedings in the name of Wakulima Co. Ltd. against the members guilty of fraud and misconduct, for damages in respect of the same.
- I would advise the Attorney General to petition for the winding up of the company on the ground that it is just and equitable to do so. Winding up is available on this ground if members have justifiably lost confidence in the manner and probity with which the company"s affairs are being conducted. My advise is based on the Provision of the Companies Act as well as the decision in Lock V. John Blackwood where the company was wound up on the ground that members had justifiably lost confidence in the management.

b)

i)

- If a person is convicted of any offence in connection with the promotion, formation or management of a company.
- If in the course of winding up it appears that a person was knowingly a party to the carrying on of the company"s business for any fraudulent purpose or with intent to defraud its creditors or creditors of any other person
- If an officer of the company is guilty of any fraud in relation to the company or of any breach of duty to the company.

ii)

- If the company is for the time being private
- A subsidiary of the company extending a loan to its holding company which is its director
- A company whose ordinary business includes lending of money, which is lent by the company in the ordinary course of business
- To enable a director meet expenditure incurred or to be incurred for purposes of the company or to enable him properly perform his duties as an officer of the company.

c)

- Both Tirop and Sironik must execute the proper instrument of transfer
- Sironik must thereafter present the executed instrument of transfer for stamping i.e., payment of duty
- Sironik must present the stamped instrument of transfer and Tirop"s share certificate to the company for registration of the transfer
- On registration of the transfer, i.e., entry of Sirnoik"s name in the register, the share certificate is cancelled and another issued in favour of Sironik.

d)

- Tirop"s conduct would be fraudulent in character. however, Joash would not acquire title in the shares
- Both Sironik and Joash have an equitable interest in the shares Tirop retains the legal interest.
- The equities are said to be equal and the first in time prevails.
- However, the first transferee to secure a valid registration acquires title.

QUESTION EIGHT

a)

- The words of Lord Greel in Shaw V. Shaw are an embodiment of the principle of division of powers between the general meeting and the board in company law.
- Company law recognises the general meeting and the board as the principal organs of the company and the articles of association vests powers in both.
- Some powers can only be exercised by the board while others are only exercisable by members in general meeting, e.g. the general meeting is empowered to elect directors, appoint auditors, remove directors or auditor from office, alter the articles and memorandum, authorise bonus shares, adopt accounts. The board of directors on the other hand is empowered to recommend dividend, borrow, appoint the managing director and the secretary, etc.

- The principle of division of powers ordains that each organ must exercise the power vested in it and must not hijack those of the other unless the powers are being abused, exceeded or exercised in bad faith or contrary to the articles.
- Courts of law have enthusiastically enforced the division of powers.
- The question as to which organ exercises which power is one of interpretation of the Articles. It was so held in Automatic Self-cleansing Filter SyndicateV.Cunninghame.
- Article 80 of Table A is emphatic that the business of the company shall be managed by the directors and who may exercise all such powers as are not required to be exercised by the company in general meeting. In Alexander Ward and Co VSamyang Navigation it was observed that article 80 means that the directors and no one else are responsible for the company"s management except in relation to matters specifically alloted to the company in general meeting.
- In Scott V Scott it was held that since the power to pay interim dividend was vested in the board the general meeting could not interfere. A similar holding was made in Shaw V Shaw.
- The principle of division of powers extends to powers not vested in either organ. If either organ purports to exercise such power, the other must not interfere with its exercise.
- However, it is contended that the general meeting is more dominant in that it is empowered to:
  i) Alter the articles
  ii) Remove directors from office, but before such a step is taken directors are free to ignore instructions of the general meeting on how to exercise a power vested in the board.
- The principle of division of powers is subject to three exceptions. These are circumstances in which the general meeting exercises powers vested in the board.
- **litigation**
  If directors refuse, fail or neglect to sue on behalf of the company or to defend an action against the company, the power becomes exercisable by the general meeting. Marshals Valve Gear Co. V. Manning Wardle
- **Ratification of excesses by directors**
  Whenever the general meeting ratifies an abuse of power by the board, the transaction becomes a valid act of the company.
- The general meeting by so doing exercises powers vested in the board.
- The transaction must have been intra vires the company. As was the case in Bamford and Another V Bamford and others.
- **Deadlock in management**
  If a company"s board of directors cannot function in any material respect by reason of a deadlock, the powers of the board becomes exercisable by the general meeting . As was the case in Barron V Porter. Evidently therefore the principle of division of powers generally holds.

b)

- This problem is based on qualification of auditors for appointment.
- To qualify one must be registered accountant practising individually or as a partner in a firm.
- In this case, the firm of Odipo and Associates is not qualified for appointment as auditor as it has no partner.

- The partners are guilty of professional misconduct pursuant to the provisions of the Accountants Act, Cap 531.
- The partners of Odipo and Associates, Wavuvi Co. Ltd. and every officer of the company in default are liable to a fine not exceeding KShs4,000.

MOCK TWO

QUESTION ONE

a) Lifting the veil

- It also referred to as "piercing the corporate shell" or ignoring the legal personality.
- These are modifications to the rule in Salomon V Salomon and Co. Ltd [1897]
- They are circumstances in which the law disregards the legal personality of the company in favour of the individual members or the economic realities of a company and its subsidiaries.
- These circumstances are recognised by the Companies Act as well as the Courts for example
- When the number of members of a company falls below the statutory minimum, group
- Accounts, investigation of company membership and fraudulent trading. Courts of law on
- The other hand have lifted the veil:
  - To prevent perpetration of fraud or misconduct
  - To ascertain a company"s residence
  - To ascertain a company"s character
  - To facilitate commerce.

Raising the curtain:

- These are circumstances in which the law facilitates access to information about a company, generally beyond the public eye e.g. employees of the company.
- It is accomplished by way of investigating the affairs of the company either by the registrar or
- By an inspector or inspectors appointed by the court or by registrar.

b) The writes uses these words with reference to circumstances in which persons have attempted to use the corporate personality for other purposes but failed. For example using the company to perpetuate fraud or misconduct or to avoid a legal obligation.

- **Fraud:** In reBuggle Press Ltdwhere the majority shareholders of a companydesirous of acquiring minority interest formed another company which made an offer to acquire all the shares in the first company which offer the majority accepted and the new company purported to use Sec 210 of the Companies Act to enable it acquire the shares of the minority who objected, the court lifted the veil and disallowed the take over bid.

- **Improper conduct:**Courts of law have lifted the veil of incorporation to preventpersons from using the company to evade existing legal obligations. As was the case in Gilford Motor Co V Home and Another where the first defendant had covenanted not to solicit the plaintiff"s customers after leaving employment. He formed a company which solicited the customers. The court granted an injunction to restrain the defendant and his company from soliciting since the company had been formed to enable the first defendant evade an existing legal obligation.

- A similar holding was made in Jones V Lipman and Another. In Macaura VNorthern Assurance Co Ltd the appellant owned a forest. He formed a company Irish Canadian Saw Mills Ltd to which he transferred the forest in return for 42,000 fully paid shares. He was the principal shareholder. He lent the company 19,000. The company fell the trees and stored the timber. The appellant insured the timber against fire with the respondent company but in his own name. Two weeks thereafter the timber was destroyed by fire. Macaura"s claim for indemnity for the

loss was refused. He sued. It was held that he was not entitled to indemnity as he had no insurable interest in the timber as it belonged to the company.

- These cases illustrate circumstances in which the corporate entity has worked like a boomerang.

QUESTION TWO

a)

- This case is authority for the proposition that since the ordinary purpose of a prospectus is to invite persons to subscribe for shares or debentures once this is accomplished, the prospectus becomes exhausted and cannot be relied upon by persons who deal with the shares thereafter.

- In this case, all the shares of the company were allotted between July and October. The plaintiff bought 2,000 shares in December on the Stock Exchange. He sued the directors of the company on the ground that he had bought the shares by reason of misrepresentation and suppression of material and important facts. It was held that the directors were not liable since the prospectus in question had already become exhausted when the plaintiff bought shares. He could not rely on it.

b)

- This case is authority for the proposition that if a prospectus is intended to influence both original and subsequent allotees, persons who deal with the shares after the original allotment can rely on the prospectus to avoid the contract of allotment of shares. Such a prospectus is not deemed to have outlived its usefulness.

- The defendants had formed a sham company for the purpose of mining gold in South Africa. Very few persons applied for shares. Subsequently the defendants fraudulently caused to be published in the Financial News, a telegram to the effect that the Company had struck gold. The plaintiff applied for and was allotted 50 shares. He sought to recover damages for fraudulent misrepresentation. It was held that the defendants were liable since the prospectus had not become exhausted by the time the plaintiff bought shares.

c)

- The Companies Act does not define the term "misfeasance" used in various Sections e.g. 166 (b) and 324 (1).

- This is a wrongful act or omission committed or omitted by a person charged with a specific
- Responsibility.
- It is neither a crime nor a tort and does not cover acts or omissions of negligence.
- It is a contravention of principles of law or equity.

- Misfeasance proceedings may be instituted against directors, promoters, liquidator or officers of the company and Courts of Law are empowered to assess the damages payable by such persons for the act or omission e.g. in the course of winding up.

Examples of misfeasances include:

- Making of secret profit by promoters or director
- Making of improper payments made by promoters or directors
- Application by directors of the company"s assets for an ultra vires or illegal object
- Payment of dividend out of capital
- Making of fraudulent preferences
- Sale of company assets at undervalue

d)

- This is the organic theory or the alter ego doctrine.
- It is a principle of Company Law that attempts to connect the living to the non-living.
- This principle imputes the state of mind of responsible officers of the company to the company.
- Under the organic theory, the thoughts and deeds of responsible officers of the company are deemed to be the thoughts and deeds of the company, i.e., the company thinks and acts through these persons.
- This theory attributes to the company the knowledge of the responsible officers. In Lennards Carrying Co Ltd V Asiatic Petroleum Co. Ltd, the managing director of the company knew or ought to have known that the ship was unseaworthy but took no steps and as a consequence the ship and its cargo were lost. It was held that the company was liable for the loss as it was aware of the ship"s unseaworthiness. Themanaging director"s knowledge was attributed to the company.
- The thoughts of responsible officers are deemed to be the thoughts of the company. It was son held in Bolton Engineering Co Ltd V Graham and Sons.
- If responsible officers of the company delegate to junior officers the company thinks and acts through the delegate.
- However, the thoughts and deeds of junior officers of the company are not attributable to the company. It was so held in Tesco Supermarkets Ltd V NatrassLtd.

QUESTION THREE a)

- An allotment is an appropriation of company shares to an applicant. It is an acceptance by the company of an applicant"s offer to take up shares.
- It concludes a legally binding agreement between the company and the applicant.
- The applicant does not become a member until his name is entered in the register.

b) Voidable allotments:

- An allotment of shares made before the minimum subscription is raised is voidable at the option of the applicant within one month of the statutory meeting or allotment.
- An allotment made before expiration three days from the date of delivery to the registrar for registration a statement in lieu of prospectus signed by every person named or proposed director and containing the particulars of Part I and II of the 4th Schedule is voidable at the option of the applicant.

Void allotment:

- An allotment of shares to a state corporation without prior written consent of the treasury is void. The company and every director who knowingly or wilfully permits or authorises the contravention are liable to a fine not exceeding Kshs2,000.

Valid allotment:

- An allotment of shares before the beginning of the third day after that on which the prospectus was first issued is irregular but valid. However the company and every officer in default are liable to a fine not exceeding Kshs10,000.

c)

- These are shares which an underwriter undertakes in an underwriting agreement, to take up as his own whether the issue is over-subscribed or under-subscribed.
- The underwriter earns no commission on the shares allotted.

QUESTION FOUR

a)

- Every person who was a director of the company at the time of the issue of the prospectus.
- Every person who authorized himself to be named and was named in the prospectus as a director.
- Every person who had agreed to become a director either immediately or after an interval of time.
- Every person who was a promoter of the company.
- Every person who authorized the issue of the prospectus

b)

- It is a criminal offence to issue any form of application for shares or debentures of a company unaccompanied by a prospectus. A person guilty of this offence is liable to a fine not exceeding Kshs10,000.
- It is a criminal offence to issue a prospectus containing a statement purporting to have been made by an expert without such expert"s written consent. A prospectus issued in contravention thereof renders the company and every person who was knowingly a party to the issue liable to a fine not exceeding Kshs10,000.
- It is a criminal offence to issue a prospectus before a copy thereof has been delivered to the registrar for registration. A prospectus issued in contravention thereof renders the company and every person who was knowingly party to the issue liable to a fine not exceeding Kshs100 until a copy thereof is delivered.
- It is a criminal offence to deliver an unendorsed copy of a prospectus to the registrar for registration. A prospectus delivered in contravention thereof renders the company and every person who was knowingly a party to the delivery liable to a fine not exceeding Kshs100.
- It is a criminal offence to deliver to the registrar for registration a copy of a prospectus without the necessary annextures. A prospectus delivered in contravention thereof renders the company and every person who was knowingly a party to the delivery liable to a fine not exceeding Kshs100 for every day.
- It is a criminal offence to authorize the issue of a prospectus containing any untrue statement. Any person guilty of so doing is liable to imprisonment for a term not exceeding 2 years or a fine not exceeding Kshs10,000 or both. However, the accused escapes liability by proving either that:

  - The statement was immaterial
  - He had reasonable ground to believe and did believe up to the time of issue of the prospectus that the statement was true.

c)

- This is the difference between the underwriting commission paid by the company to the principal underwriter and the commission paid by the principal underwriter to the sub-underwriter.
- The underwriting commission paid by the company must be disclosed in the prospectus.

QUESTION FIVE a)

- Dividend is said to be the return on a member"s investment. Technically, it is themember"s share of a company"s profit.
- Payment of dividend by companies is governed by various rules:

- Under Article 116 of Table A "No dividend shall be paid otherwise than out ofprofit."
- Under Article 114 of Table A directors recommend dividend and the same is declared by members in general meeting. However members cannot declare dividend in excess of the amount recommended by the board.
- Under Article 115 of Table A directors may from time to time pay to members such interim dividend as is justified by the profits of the company.
- Directors may before recommending dividend set aside out of the profits of the company such sums as they deem proper as reserve.
- Directors may deduct from any dividend payable to any member all sums of money payable by him to the company on account of calls or otherwise.
- Under Article 122 of Table A "No dividend shall bear interest against the company".
- Dividend is generally payable within 42 days of declaration.
- Dividend may be paid in cash or by cheque or warrant.
- Companies are not legally obliged to make provision for depreciation before dividend is declared.
- Dividend cannot be paid if this would result in the company"s inability to pay debts as they fall due.
- Losses of fixed assets need not be made good before treating a revenue profit as available for dividend.
- Losses of circulating assets in the current accounting period must be made good before dividend is paid.
- A realised profit on the sale of fixed assets may be treated as a profit available for dividend.
- Unrealised profit may be treated as profit available for distribution.
- Losses on circulating assets made in previous accounting periods need not be made good before dividend is paid.

b)

- This problem is based on the principles that govern payment of dividend.
- It is evident that Reconstructions Co. Ltd. has not made profit capable of being distributed to members as dividend.
- My advise to directors of Reconstructions Co. Ltd is that it is unlawful to recommend dividend. This advise is justified on the premise that dividend is payable out of profit and Reconstructions Co. Ltd has not made any distributable profit during the 2000-2001 financial year. In fact the company made a loss of Kshs5 million. The profit of Kshs3 million realised from the sale of land cannot be distributed since losses of circulating assets of the current accounting period must be made good before dividend is paid.
- The underlying principle in the distribution of dividend is that each financial year is considered on its own.

QUESTION SIX

a) Bonus Shares:

- Is recommended by the board.
- Is authorized by members in general meeting.
- Nominal share capital of the company must be sufficient.
- Payable in accordance with the articles.
- A return must be made to the registrar.
- Authorized by the articles.

Payment of Interest out of capital

- Must be authorized by the articles or special resolution.

- Previous sanction of the registrar must have been obtained.
- Circumstances of the payment have been inquired into by the registrars appointee.
- Payment is for such period as may be determined by the registrar.
- The interest does not exceed 5% p.a. or such other rate as the minister may prescribe.

Redemption of Redeemable Preference Shares

- Must be authorized by the articles.
- Must be redeemed out of profit or proceeds of a fresh issue for that purpose.
- Must be fully paid.
- The premium payable must be provided out of profit or the share premium account.
- If redeemed otherwise than out of the proceeds of a special issue, the capital redemption reserve fund must be created.
- The registrar must be notified within 30 days thereof.

Issue share warrants

- The company must be limited.
- Must be authorized by its articles.
- The shares in question must be fully paid.

b)

- The company and every officer in default are liable to a fine not exceeding 1,000.
- Every director is liable to imprisonment for a term not exceeding 12 months or a fine not exceeding KSh.10,000. However, the accused escapes liability by proving that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty and way in a position to discharge the same.
- The person so appointed, the company and every officer of the company in fault are liable to a fine not exceeding KSh.4,000.

c)

- The shareholders liability is reduced or extinguished.
- The shareholder becomes a creditor to the company to the extent of the payment.
- The company cannot be compelled to repay the amount.

QUESTION SEVEN

a) The members name is struck off the register and the following particulars entered:

- Fact of issue of the warrant.
- Date of issue.
- A statement of the shares included in the warrant.
- A total number of shares in respect of which warrants are outstanding.
- Number of shares comprising a warrant.
- Total number of warrants issued and surrendered.

b)

- Institute criminal proceedings against any person alleged to have committed an offence.
- Institute civil proceedings in the name of the company for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation of the company or management of its affairs.
- Institute civil proceedings in the name of the company for the recovery of any property of the company which has been misapplied or wrongfully retained by any person.

- Petition for the winding up of the company on the ground that it is just and equitable to do so.
- Any person convicted on a prosecution instituted by the Attorney General on the basis of the report.
- Any person who is ordered to pay damages or to restore any property in proceedings instituted on the basis of the report.
- Any body corporate dealt by the report.
- Any body corporate in whose name proceedings are instituted.
- The applicants for the investigation

c)

- The profit and loss account.
- Any group accounts
- auditors report
- Directors report.

QUESTION EIGHT a)

- If the number of members has fallen below the statutory minimum or
- The shares in respect of which he is a contributory either:
- Were originally allotted to him
- Have been held by him and registered in his name for at least 6 months, during the 18 months immediately proceeding the commencement of winding up.
- Devolved on him through the death of the former holder.
- As a general rule, a fully paid shareholder has no locus standi to petition for the winding up of the company. However, in re Rica Gold Washing Co. Ltd it was held that a fully paid member may sustain a petition by proving that:
- He has a tangible asset in the company.
- There will be a surplus for distribution to members.

b)

- If declared bankrupt by a Court of Law.
- If he enters into an arrangement with his creditors to compound his debts.
- If he absents himself from five consecutive meetings of the committee without leave of the persons with whom he represents members or creditors.
- If he resigns office by a written notice to the liquidator.
- If removed from office by ordinary resolution of members or creditors.

c)

- A resolution for voluntary winding up.
- Creditors voluntary winding up.
- October 22nd 2002.
- A full statement of the position of the company"s affairs.
- A list of the creditors of the company and an estimate of their claims.
- This problem is based on the courses available to directors members or creditors if the meetings of members and creditors nominate different persons as liquidator.
- The provisions of the Companies Act are emphatic that the creditors nominee becomes the liquidator.
- However, within 7 days of the creditors nomination any director member or creditor may apply to the court for an order that:
- The members nominee be liquidator.
- The appointee act as joint liquidators or

- Some other person be liquidator.
- My advise to Kwishima is to apply to the court for some other person to be appointed liquidator. My advise is based on the provisions of the Companies Act.

MOCK THREE

QUESTION ONE

a) Salomons Caseis authority for the proposition that "a company is at law a differentperson altogether from the subscribers to the memorandum". Additionally, the decision established that:

- Even the so-called one-man company was a legal person distinct and separate from its members.
- Incorporation was available not only to large companies but to partnerships and sole proprietorships as well.
- In addition to membership it was possible for a member to subscribe for the company"s debentures.

b)

- Is the transaction reasonably incidental to the carrying on of the company"s business?
- Is it a bona fide transaction?
- Is it done for the benefit and to promote the prosperity of the company?

c)

- The need for large scale investment for large scale production to satisfy surging demands of the market
- The need to limit the liability of entrepreneurs with respect to debts and other obligations of the company

QUESTION TWO

a) If the form of application was issued:

- In connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures
- In relation to shares or debentures which were not offered to the public
- In relation to shares or debentures uniform with shares or debentures previously issued by
- The company

b)

- The trustees have a legal mortgage over the company"s assets.
- A covenant by the company to pay debenture holders the principal and interest.
- A clause specifying the events in which the security is to become enforceable e.g. default in payment of interest or principal, cessation of business etc.
- Covenant by the company to keep a register of debenture holders, and to insure the security as well as keep the same in repair
- Provision for meetings of debenture holders
- Type of nature or security given
- Details of any sinking fund proposed by the company to provide for stock redemption

Powers of trustees to:

- Take possession of the property charged when the security becomes enforceable
- Regulate dealings with the property charged
- Appoint a receiver when the security becomes enforceable
- Sell the security

c)

- This problem is based on fiduciary duties of directors. One of the basic equitable duties of directors is to exercise powers for the particular purposes for which they are conferred.
- In this case, it is apparent that Jessee and Jackson exercised the power to issue shares for an improper purpose, i.e., abuse of power. As was the case in Punt VSymons and Co. Ltd and Piercy V Mills and Co Ltd
- The two directors issued shares to Umoja Co. Ltd. and gave options to their wives to take up company shares to retain their positions in the board.
- However, the general meeting of Mashariki Co. Ltd. ratified the transactions thereby
- Validating them, hence no action can be taken against Jessee and Jackson.
- My advise to Solomon is that he has no actionable claim against the directors of Mashariki Co. Ltd. This advise is based on the reality that when the general meeting of the Mashariki Co. Ltd. ratified the abuse of power by Jessee and Jackson the directors "obtained absolution and forgiveness of their sins" since the transactions were validated.
- My advise is based on the decision in Bamford and Another V Bamford and Others (1908) whose facts were substantially similar to the facts of this case. A similar holding was made in Hogg V Crampton.

QUESTION THREE

a)

- Breach of warranty of authority, i.e., where he has added beyond his powers unknown to the other party. As was the case in West London Commercial BankLtd. V. Kitson [1884] where a director had accepted bills on behalf of the company without authority to do so.
- Where he has acted fraudulently as against the other party. As was the case in OrkinBros. Ltd V Bell [1921] where directors ordered goods on credit while aware that it had no capacity to pay. It was held that they were personally liable for acting fraudulently.
- Where a director assumes a direct duty of care to a 3rd party dealing with the company. As was the case in Fairline Shipping Corporation V Adamson [1975].
- Where he has bound himself personally for the liability of the company e.g. as a surety or as maker or endorser of a bill.
- Where the company"s name is not published or is misdescribed in a negotiable instrument signed by a director.
- Where he has contracted on behalf of an illusory company. As was the case in Harill V Davis.
- Where he has formed a company or used it for a wrong purpose. It was so observed in Rainbow Chemical Works Ltd V Belvedere Fish Guano Co Ltd [1921].

b)

- This problem is based on fiduciary duties of directors. A fiduciary is obliged to ensure that he does not place himself in circumstances in which his personal interests and his duties to the other party conflict.
- In this case, directors of Olympic Co. Ltd. placed themselves in a position of conflict of interest, i.e., by taking up shares without disclosure and selling the same at a profit.
- These directors are in breach of their fiduciary duties of conflict interest and are therefore liable to account to the company.
- My advise to the directors is to account for the secret profit to the company, i.e., Olympic Co. Ltd. This position is consistent with the decision in Parker V Mckenna

whose facts were substantially similar to those in this case where it was held that the directors were liable to account to the company.

QUESTION

FOUR a)

- A copy of the balance sheet laid before the company in general meeting.
- A copy of the directors report.
- A copy of the auditors report.
- These copies must be certified by a director and secretary of the company to be true copies of the originals if any of these documents is in a foreign language a translation to English must be annexed.
- A certificate signed by a director and Secretary of the Company to the effect that the company has not from the date of incorporation invited the public to subscribe for its shares or debentures.
- If the number of members exceed 50, a director and the company secretary must sign a certificate to the effect that the excess members are or have been employees of the company.

b)

- If a person"s name is without sufficient cause entered in the register of members.
- If a member"s name is without sufficient cause omitted from the register of members.
- If default is made or unnecessary delay takes place in entering the fact that a person has ceased to be a member of the company.

Application for rectification of the register of members may be made by:

- Any member of the company
- The company
- The aggrieved party

and the court may:

- Dismiss the application or
- Order rectification of the register and payment of damages by the company to the aggrieved party
- Additionally the court is empowered to determine any question relating to the title of any person who is privy to the application.

c) General duties

- Act in good faith and for proper purpose
- Not fetter his discretion
- Avoid conflict of interest
- Be impartial
- Exercise the degree of care and skill appropriate to the circumstances
- Exercise discretion personally unless appointed jointly
- Secure control of the company"s assets and papers
- Realise the assets
- Ascertain the company"s liabilities and discharge them in the proper order
- Distribute any surplus amongst the contributions and to adjust their rights

QUESTION

FIVE a)

- To examine the books, accounts and vouchers of the company and to consider information and explanation provided during their tenure of office.

- To make a report to members on the accounts examined by them and on every balance sheet, profit and loss account and on all group accounts laid before the company in general meeting. This report must contain the statements mentioned in the Seventh Schedule to the Act.
- To acquaint themselves with their duties under the Companies Act and the articles of association of the company whose accounts they are appointed to audit. It was so held in re Republic of Bolivia Exploration Syndicate [1914].
- To satisfy themselves that the companies securities exist and are in safe custody. If not they must demand that urgent action be taken. It was so held in re CityEquitable Fire Insurance Co. Ltd [1925].
- To exercise the care and skill of a reasonably competent careful and cautious auditor. It was so held in re Kingston Cotton Mills no 2 [1896].
- To approach his task with an inquiring mind and with a foregone conclusion that something is wrong. It was so held in re Kingston Cotton Mills no 2 [1896].
- To provide professional advise if called upon to do so. It was so held in FomentoLtd V Selsdon Fountain Pen Co. Ltd.
- To act honestly, by not certifying as true what he does no believe to be true and exercising care and skill before certifying something as true. It was so held in re London and General Bank Co. Ltd [[1895].

b)

- An auditor is not an investigator. His vital task is to approach his task with an inquiring mind.
- "He is a watch dog but not a blood hound"
- He is bound to inquire into the substantial accuracy of the balance sheet and ascertain that it is properly drawn up so as to contain a true and correct representation of the state of the company"s affairs.
- As observed in re Kingston Cotton Mills" an auditor is not bound to be a detective".
- An auditor is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest.
- An auditor is bound to exhibit the care, skill and caution of a reasonably competent, careful and cautious auditor. He is not bound to do more.
- An auditor does not guarantee the discovery of all fraud.
- He does not guarantee that the books do correctly show the true position of the company"s affairs.
- It is not the auditor"s responsibility to ascertain whether the business of the company is being conducted prudently or imprudently, profitably or unprofitably. However the auditor may be deemed to be an investigator in certain circumstances:
  i) If appointed to investigate the affairs of a company in relation to a particular matter
  ii) If there is anything calculated to excite suspicion he must probe it to the bottom

c)

Under Section 159 (7) (a) of the Companies Act the auditors remuneration may be fixed:

- By the registrar if appointed by him.
- By directors if appointed by them
- By the company in general meeting
- In such manner as the company in general meeting may determine.
- Under Section 159 (3) of the Companies Act where at an annual general meeting no auditors are appointed or are deemed to be reappointed, a vacancy arises.

- The company must notify the registrar within 7 days thereof and the registrar may appoint an auditor for the company. Failure to notify the registrar of the failure renders the company and every officer in default liable to a default fine.

QUESTION

SIX a)

- It has been observed that the term debenture is not a technical term.
- Under Section 2 (1) of the Companies Act debenture includes "debenture stock, bonds and any other securities of a company whether constituting a charge on any assets of the company or not."
- In the words of Lindley J. in British India Co. V. I.R.C.[1881] "I do not find anywhere any precise definition of it. We know that these are various kinds of instruments commonly called debentures. You may have mortgage debentures which are charges of some kind on property. You may have debentures which are bonds. You may have a debenture which is nothing more than an acknowledgment of indebtedness...it is a statement by two directors that the company will pay a certain sum of money and will also pay interest..."
- In the words of Chitty J. in Levy V Abercolis Slate and Slab[1887] "The term itself imports a debt- an acknowledgment of a debt..."
- In modern commercial usage debenture denotes an instrument issued by the company providing for the payment of or acknowledging the indebtedness of the company.
- The term is also used to describe the instrument creating the transaction.

Debentures may be issued as:

- Secured and unsecured
- Redeemable and irredeemable
- Registered and bearer
- Convertible and non-convertible

b)

- Transferability by delivery
- Transferability free from equities
- The bearer"s right to sue the company in his own name if necessary
- A transferee in good faith for valuable consideration acquires a good title
- The delivery of the debenture and any interest coupon is a good discharge of the company

c)

- This problem is based on the remedies for misrepresentation in prospectuses.
- In this case, it is clear that the prospectus of Ujenzi Ltd contained untrue statements and Onyango is aggrieved by reason of having relied upon the statements.
- The secretary"s circular notifying Onyango that the statement was made in good faith is immaterial and Onyango is entitled to a remedy.
- Onyango opted to rescind the contract and has even commenced proceedings.
- The essence of this remedy is to restore the parties to the position they were before the contract. However, the remedy is not available in certain circumstances e.g. if the innocent party sleeps on his rights for too long, or affirms the contract or 3rd party rights accrue or restitutio in integrum is not possible.

- In this case, it is evident that Onyango cannot rescind the contract. This position is premised on the following facts:
  - Onyango slept on his rights for too long. He learnt of the untrue statements in November 2001 but did not sue until Janaury 6th 2002.
  - Onyango affirmed the contract. His attempt to sell the shares to Kajwang on December 5th 2001 is a clear indication of this fact.
  - Restitutio in integrum is not possible i.e. the parties cannot be restored to the position they were before the contract since the company is already in liquidation.
  - My advise to Onyango is to discontinue rescission proceedings against the company and sue the directors of Ujenzi Ltd for compensation pursuant to section 45 (1) of the Companies Act.
  - This advise is based on the reasoning that an action in damages does not lie for innocent misrepresentation and the right to rescind the contract has been lost.

QUESTION SEVEN

a) The provision of the Companies Act require all companies to keep certain books of accounts in the English language. These are books with respect to:

- All sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place.
- All sales and purchases of goods by the company
- The assets and liabilities of the company.
- These books must give a true and fair view of the state of the company"s affairs and explain its transactions.
- If at the end of the financial year a company has subsidiaries there must be laid before the company in general meeting group accounts of the company and its subsidiaries.
- The group accounts shall be consolidated accounts comprising:
- A consolidated balance sheet dealing with the state of affairs of the company and all subsidiaries dealt with.
- A consolidated profit and loss account dealing with the profit or loss of the company and those subsidiaries.
- The group accounts may be wholly or partially incorporated in the company"s own balance sheet and profit and loss account.
- The group accounts must give a true and fair view of the state of affairs and profit or loss of the company and the subsidiaries dealt with as a whole.

b) The group accounts laid before the company in general meeting need not deal with a subsidiary if directors of the company are of the opinion that:

- It is impracticable
- It would be of no real value to members of the company in view of the insignificant amounts involved
- It would involve expense or delay out of proportion to the value to members of the company
- The result would be misleading

- The result would be harmful to the business of the company or any of its subsidiaries
- The business of the holding company and that of the subsidiary are so differentthat they cannot be reasonably be treated as a single undertaking.
- If directors are of such an opinion about each of the company"s subsidiaries, group accounts shall not be required.

c)

- Every person who is a director of the company is liable to a fine not exceeding Kshs10,000 or imprisonment for a term not exceeding 12 months or both. However the accused may escape liability by proving that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty and was in a position to discharge the same.

QUESTION EIGHT a)

- If winding up proceedings have been commenced outside Kenya against a company incorporated outside Kenya which carries on business in Kenya.

- For the continuation of a voluntary winding up or a winding up subject to the supervision of the court as a compulsory winding up so as to safeguard the interests of creditors and contributories.

b)

- The court may when making the order for a winding up subject to supervision or by a subsequent order appoint an additional liquidator for effective winding up.

- An order for the continuation of winding up subject to the supervision of the court gives creditors, contributories and others liberty to apply to the court for such orders as are necessary for the beneficial winding up of the company.

c) Although it has been suggested that there is an exhaustive list of circumstances that may fall within the scope of the "just and equitable" clause, judicial authority is emphatic that no such list is feasible. Courts have ordered the winding up of companies on the ground that it is just and equitable to do so in various circumstances e.g.

- **Failure of substratum**:

  This is the principal or paramount object of the company and it is deemed gone if it is no longer attainable. In re German Date Coffee Co [1882] it was held that since it was impossible to acquire a German patent, the main object of the company, it was just and equitable to wind up the company. A similar holding was made in re BakuConsolidated Oil Fields Co.

- **Fraudulent or illegal purpose**:

  In re Thomas Edward Brinsmead and Sons [1897] it was just and equitable to wind up a company if it was evident that it had been formed to pursue a fraudulent or illegal purpose.

- **Loss of confidence in management**:

  It is just and equitable to windup a company if members have justifiably lost confidence in the manner and probity with which its affairs are being managed. There must be a consistent course of conduct on the part of the management which justifies the petitioners loss of confidence. As was the case in Loch V JohnBlackwood.

- **Expulsion or exclusion from management**:

  The inequitable exclusion or expulsion from the management of a company"s affairs renders it liable to be wound up under the just and equitable ground. In Ebrahim VWestbourne Gallaries Ltd [1973] the petitioner had been unfairly excluded from the management of the company while in re Lundie Brothers Ltd [1965] the petitioner had been unfairly expelled from the Company"s management.

- **Company is a "bubble":**

  These are circumstances in which there is no bona fide intention on the part of the directors to pursue the declared objects of the company or pursue them lawfully. It was so held in re London and County Coal [1867].

- **Oppression of minority**:

  It is "just and equitable" to wind up a company if it is established that its affairs arebeing conducted in a manner oppressive to the minority.

- **Deadlock in management and membership:**

  If both organs of the company cannot function in any material respect by reason of a deadlock or otherwise, it is just and equitable to wind up the company. This generally arises where the company"s shares and voting rights are equally divided between two persons or groups of persons with irreconcilable differences. As was the case in re Yenidje Tobacco [1916] as well as in re Modern Retreading Co. Ltd.

- **Facts would justify dissolution of partnership**:

  This circumstance can only be relied upon in cases of small private companies. It is based on the premise that such companies are in substance partnerships and hence grounds that justify the dissolution of a partnership may equally apply in the winding up of the company. This argument was relied upon in Ebrahimi VWestbourne Gallaries Ltd [1973].

MOCK FOUR

QUESTION ONE

- Voluntary winding up is the winding up of a company by members or creditors without judicial intervention. It is recognized by sec 272 (1) of the Act.

- A voluntary winding up may be members or creditors.

- Under section 271 (1) of the Act, a company may be wound up voluntarily in the following circumstances.

1) **Lapse of time:**
   If the duration if any prescribed by the articles has expired and members have resolved to have the company wound up voluntarily.

2) **Occurrence of an event:**
   If an event contemplated by t he articles has occurred and members have resolved that the company be wound up voluntarily.

3) **Special resolution:**
   If members by special resolution resolve that eh company be wound up voluntarily. Under section 273 of the Act, a voluntary winding up commences at eh time of passing the resolution for winding up. Under section 271 (2) of the Act, a resolution to winding up a company voluntarily is referred to as a resolution for voluntary winding up and within 14 days of its passage, notice must be given in the Kenya Gazette and in some newspaper circulating in Kenya.

Members Voluntary Winding Up

This is the winding up of a solvent company at the option of the members. It is managed by shareholders who appoint a liquidator answerable to them. No meetings of creditors are held and there is no committee of inspectors.

It is characterized by declaration of solvency. Pursuant to section 276 (1) of the Companies Act.

Conduct of a Members Voluntary Winding up;

Members in general meeting pass the resolution for voluntary winding up and must appoint one or more liquidators to wind up the affairs and distribute the assets of the company.

Under sec 281 (1) if at any time the liquidator is of the opinion that the company cannot pay its debts in full, within the stipulated duration he must;

1) Notify the registrar of companies
2) Convene a meeting of the creditors an lay before it a statement of the assets and liabilities of the company failing which the liquidator is liable to a fine not exceeding Sh.1,000.

- Under section 282 (1) of the Act, if winding up continues for more than 1 year, the liquidator must convene a general meeting of the members and must do so after every other year and lay before it an account of his acts and dealings and of the conduct of the winding up during the preceeding year.

- Under section 283 (1), when the affairs of the company are fully wound up, the liquidator must prepare a winding up account shown how it has been conducted and the property of the company disposed off.

- He must then, by a 30 day notice in the Kenya Gazette and in some newspaper circulating in Kenya, summon a general meeting of the members and lay before it account giving any explanations necessary.

- Within 14 days of the meeting, the liquidator must deliver a copy of the account to the registrar and on expiration of 3 months, from the date of registration, the company is deemed dissolved. However, the dissolution of a company may be deferred by the court on the application of the liquidator or other interested party.

- The court order must be delivered to the registrar within 7 days of its making. If the liquidator fails to convene the last general meeting of the company, he is liable to a fine not exceeding Ksh.1,000.

QUESTION TWO

(a)

- This is the majority rule, which governs the enjoyment of corporate membership rights.
- The rule was laid down in Foss V. Harbottle (1873) where the plaintiffs purported to enforce a wrong done to the company. The acton was struck out on the ground that they had no Locus standi.
- The rule consists of three principles namely:
  - Proper plaintiff principle.
  - Internal management principle
  - Irregularity principle.

(b) The exceptions to the rule in Foss V. Harbottle are circumstances in which the majority rule does not apply. They are instances in which a representative action may be instituted to remedy the wrong in question.

- **Ultra Vires or illegal acts**: a member is entitled to file a representative action torestrain the company from engaging or proceeding with an ultra vires or illegal transaction.

- **Special or qualified majorities**: if a transaction can only be effected by a qualifiedmajority, but members purport to use a simple majority, e.g. ordinary resolution, the majority rule is inapplicable. It was so held in Cotter V. National Union of seamen.
- **Fraud on minority**: an act may amount to fraud on minority if it is an abuse of afiduciary position or unfair use of majority voting power. If the minority is being defrauded the rule in Foss V. Harbottle is excepted to enable the complaint reach the court. As was the case in Menier V. Hooper Telegraph wires.
- **Violation of individual membership rights**: if the rights violated are personal innature, the member has a personal right of action for redress. As was the case in PenderV. Lushington.
- **Oppression of minority**: under the provisions of the Companies Act any member of acompany who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members including himself may apply to court by way of a petition for a remedy. The member files are presentative action.

(c)

- This problem is based on the members right to vote in general meeting and have the vote recorded.
- In this case it is evident that Maiko is a shareholder of Kakuma Land Buying Co. Ltd and is thus entitled to vote and have his vote recorded.

- The chairman of the board refused to record Maikos vote in toto violation of his individual membership right. This entitle Maiko to an action against the chairman of the board for breach of duty.
- My advise to Maiko is to file an action against the chairman of Kakuma Land Buying Co. Ltd for an order compelling the chairman to record Maikos vote. This advise is consistent with the decision in Pender V. Lushington whose facts were substantially similar.

QUESTION THREE

(a)

- This is the nominal or registered capital.
- It is the maximum capital which a company is authorized to raise by the issue.
- It is the amount specified in the capital clause of the memorandum and statement of nominal capital.
- It is the basis upon which stamp duty is paid for purposes of incorporation.
- A company is not bound to issue the entire amount.
- A company is free to reduce or increase the nominal capital.

(b)

- This is the subscribed or allotted capital.
- It is that portion, if any of the authorized capital that has been taken up by members for which they are liable.
- It is in principle regarded as a permanent fund or fund of last resort available to creditors.
- Creditors are entitled to insist that no part thereof is wasted or returned to members.

(c)

- It is that portion if any of the issued capital which members are yet to pay up.
- It is the subject matter of calls.

(d)

- This is reserve capital or liability.
- It is a portion of capital which a company may create by special resolution.
- Under the provisions of the companies Act, a company may resolve by special resolution that the whole or any part of its uncalled up capital shall not be capable of being called up except in the event of or for purposes of winding up. This is the reserve capital. It cannot be dealt with otherwise.
- Cannot be reconverted to ordinary uncalled up capital.
- Cannot be used as a security for a loan.
- It is available to creditors in the event of winding up.

QUESTION FOUR

(a)

- According to one judge a promoter is one who undertakes to form a company with reference to a given project and set it going and who takes the necessary steps to accomplish that purpose.
- This definition does not postulate the role a person must play to be regarded as a promoter.
- Is not a promoter the person who prepares the necessary documentation registers the company, secures the services of directors and provides all the instrumentalities to enable the company pursue its objects?

- A promoter is any person who has taken some part in bringing a company into existence or in procuring persons to join it as soon as it is technically formed.
- The question who a promoter is one of fact. It all depends on the role the person played may be active or passive.
- Act bona fide for the benefit of the company in formation.
- Render a proper account of his activities.
- Disclose any person interest in contracts made on behalf of the company.
- Determine and settle the company"s name.
- Prepare or cause preparation of the requisite documentation.
- Register or cause registration of the company.
- Secure the services of directors
- Meet all the preliminary expenses.
- Ensure that the company in formation has an independent board of directors.
- Prepare the requisite prospectus, if any
- Acquire assets for use by the company
- Enter into contracts on behalf of the company.

(b)

- This problem is based on pre-incorporation contracts.
- In this case Saidi and Mutuku bought shares before and after incorporation of the company.
- The purchase of shares from Mangea and Wanyoike before incorporation is enforceable since the company entered into a similar transaction after incorporation.
- My advise to Saidi and Mutuku is to apply to the high court for the rectification of the register of Maendeleo Co. Ltd to include their names.
- This is because at common law, a pre-incorporation contract is enforceable if after incorporation the company has entered into a new contract similar to the previous agreement.
- This advice is based on the decision in Mawogola Farmers and Growers Co. Ltd. V.Kayanja and others.

QUESTION FIVE

(a)

- This is an ordinary general meeting.
- Under the provisions of the Companies Act every company must in each year hold a general meeting on its annual general meeting.
- Notice of the meeting must state that it is the annual general meeting.
- The first annual general meeting must be held within 18 months of incorporation and subsequently 15 months must not elapse from the date of one annual general meeting to that of the next.
- If the first annual general meeting is held, no other meeting need be held within 2 years of incorporation.
- The annual general meeting is ordinarily convened by a 21 day notice.
- Failure to hold the meeting renders the company and every office in default liable to a fine not exceeding Kshs. 2,000.

(b)

- This is a general meeting of a company other than the statutory or annual general meeting.
- Such a meeting may be held at anytime when need arises.
- It is ordinarily summoned by a 21 day notice.

- It ordinarily considers special business e.g. alteration of the articles or memorandum removal of auditor or directors.
- Under the provisions of the Companies Act, members may requisition an extra ordinary general meeting of the company.
- Holders of not less than $\frac{1}{10}$ of the paid up capital or total voting rights of the company may instigate the convention of a meeting by depositing a requisition with the company at its registered office.
- The requisition must specify the objective of the proposed meeting and must be signed by each of the requisitionists. It consists of more than one document each must be signed by at least one of the requisitionists.
- Directors of the company must convene a meeting of the company within 21 days of deposit of the requisition failing which the requisitionists or not less than one half of them may convene the meeting.
- A meeting convened by requisitionists under this section must be held within 3 months of deposit of the requisition.
- Such a meeting must be held in a manner similar to a meeting convened by directors.
- Any reasonable expenses incurred by the requisitionists is recoverable from the company which in return recovers from the directors in default from the amounts due to them by way of remuneration.

(c) (i)

- To effect the change of name from Kusau Ltd to Mataa Ltd, the following steps are necessary:
- Reservation of name: a written application must be made to the registrar of companies for reservation of the name "Mataa Ltd."
- Extra ordinary general meeting: Directors of Kusau Ltd must summon an extra ordinary general meeting of the members. Notice of the meeting must indicate that a special resolution to change the name of the company from Kusau Ltd to Mataa Ltd is proposed to be passed.
- Special resolution: members at the extra ordinary general meeting must by special resolution authorize the company to change its name from Kusau Ltd to Mataa Ltd.
- Notification: the registrar of companies must be notified of the change of name within 14 days of the resolution so that he enters the new name in the register of companies, issues a certificate of change of name and publishes the change in the Kenya Gazette.

(ii) To increase the companys" share capital, the following conditions are necessary,

- Articles: the articles of Kusau Ltd must embody a provision authorizing the company to increase its capital.
- Extra ordinary general meeting: Directors of Kusau Ltd must convene an extra ordinary general meeting of members to authorize the increase.
- Ordinary resolution: the increase of capital must be sanctioned y an ordinary resolution of members in general meeting.
- Notification: the registrar of companies must be notified of the increase within 30 days thereof.

QUESTION SIX

- Rescission of contract: a company may rescind a contract entered into by a promoter on its "behalf" before incorporation. This remedy restores the parties to the position they were before the contract. However, the remedy may be lost in various circumstances e.g. delay or affirmation.

- Recovery of profit or account: a company is generally entitled to any secret profit made by a promoter in breach of his fiduciary duties. The amount is recoverable under an action for money had and received.
- Damages: a company has an action in damages against a promoter for breach of his fiduciary duties. This action is sustainable even in the absence of fraud.
- Compensation: a promoter is liable to compensate any person who has suffered loss or damage by reason on subscribing for company"s securities on the faith of a prospectus containing any untrue statement.
- Public examination: under the provisions of the companies Act the High Court of law has jurisdiction to subject a promoter to a public examination over his conduct during the incorporation of the company.

(b) (i) Newbone V. Sensolid (Great Britain) Ltd (1954)

- This case is authority for the proposition that a contract purportedly entered into with or by an non-existent person is void.
- In this case, Mr. Leopold Newborne, who was in the process of incorporating a company entered into a contract to supply the defendant company with a quantity of harm. He however, signed the contract in the company"s name. His signature showed that he was a director of the company. In an action to enforce the contract it was held that the purported contract was void as one of the parties did not exist.

(ii) Natal Land Co. Ltd. V. Pauline Colliery Syndicate.

- This case is authority for the proposition that a company cannot after incorporation ratify a contract purportedly entered into on its behalf before incorporation.
- In this case a company purported to ratify a contract entered into by a promoter before incorporation. It was held that the purported ratification had no legal effect.

QUESTION SEVEN

(a)

- No dividend shall be payable by a company otherwise than out of profit.
- Dividend does not earn interest against the company.
- Directors recommend dividend and members declare the same in general meeting.
- Members cannot declare dividend in excess of the rate recommended by the board.
- Once dividend is declared, it becomes a debt payable to members.
- Directors may from time to time pay to members such interim dividend as the profits of the company may permit.
- A company must not pay dividend, it the same renders it unable to pay debts as and when they fall due.
- Losses in circulating assets of the current accounting period must be made good before dividend is declared.
- Losses in circulating assets of the previous accounting period need not be made good before dividend is declared.
- A company is not legally obliged to make provision for depreciation before dividend is declared.
- A profit made on the sale of a fixed asset may be treated as profit available for distribution.

(b)

- These rules are effective in ensuring that the company"s capital is maintained in that: i. They prohibit the payment of dividend from capital.

ii. Dividend is only payable if a company is solvent and a going concern.
iii. The rate of dividend payable to determined by directors who are entrusted with the management of the company.

However, these rules are not as effective as may be required in that members are free to alter a good number of them to the detriment of the company"s capital.

QUESTION EIGHT

(a)

- If the company"s security is in jeopardy.
- If the company threatens to dispose of its undertaking in contravention of the rights of debenture holders.
- If winding up is taking place or is imminent.
- If there are disputes between directors of the company.
- If the principal or interest or both are in arrears.

(b)

- All floating charges of the company crystallize and become fixed.
- If he is appointed for the undertaking of the company directors powers become functus officio.
- If appointed by the court, servants of the company are automatically dismissed.
- Company receipts, invoices business letters and other documents must state that the company is in receivership.

(c)

- If the registrar has reasonable cause to believe that the provisions of the Companies Act are not being complied with by the company.
- If a document submitted to the registrar in compliance with the provisions of the Companies Act, does not disclose a full and fair statement of the matters which it purports to relate to.
- If the registrar has good reason to investigate the ownership of any shares or debentures of a company.

MOCK FIVE

QUESTION ONE

a) Under section 59 (i) of the Companies Act, it shall be lawful for a company to issue at a discount shares in the company of a class already issued provided that:

1. The issue of the shares of a discount shall be authorized by resolution passed in general meeting for the company, and shall be sanctioned by the court; and

2. The resolution shall specify the maximum rate of discount at which the shares are to be issued; and

3. Not less than one yea shall, at the date of the issue, have elapsed since the date on which the company was entitled to commence business; and

4. The shares to be issued at a discount shall be issued within one month after the date on which the issue is sanctioned by the court or within such extended time as the court may allow.

b) The procedure for reduction of capital prescribed by the companies Act, safeguards the interests of shareholders, creditors and future investors in the following ways;

Shareholders:

1. Special resolution of members – can refuse the resolution.
2. Confirmation of reduction by the courts. If unfairly prejudicial to the shareholders the courts may not confirm it.

Creditors:

1. Confirmation of reduction by the courts.
2. Registration of the reduction.
3. Right to object the reduction .

Future Investors:

- Registration of reduction which protects all but existing shareholders.
- Special resolution of members.
- Confirmation of reduction by the courts.
- Publication of the reduction as directed by the court.
- Change of name.

QUESTION TWO

a) Fraud on Minority

- It has been asserted that the term fraud denotes an abuse of power or misuse of a fiduciary position.

- The majority rule cannot apply if the conduct complained for amounts for fraud on minority e.g.
  1. Expropriation of corporate assets.
  2. Breach of duty by directors.
  3. Unfair use of majority voting power.

- A representative action may be instituted to remedy the wrong. The plaintiff must establish Interalia that those perpetrating the fraud are in legal or factual control of the company"s affairs and hence cannot permit the company to sue.

- A majority shareholder is deemed to be in legal control of the company.

- Factual control was explained by Vinelott. J. in Prudential Assurance Company V. Newman Industries, "De facto control arises where members though not holding a majority of the shares in the company, are able by manipulating their position to ensure that the majority will not allow such a claim to be brought by the company for the alleged wrong doers are in factual control of the company.

- This exception was developed to ensure that wrongs committed against the minority found their way ,to the court where the majority are in control.

b) An alteration of articles must be bonafide for the benefit of the company as a whole. Regard must be had to existing and future shareholders of the company.

- Whether the alteration is made in good faith or not is for the court to determine on the basis of circumstances.

- In **Sidebottom V. Kershow Leese and Co.** the plaintiff who was a shareholder of the private company was interested in a business which competed with that of the company was interested in a business which competed with that of the company.

- Members in the general meeting resolved to add to the articles a provision to the effect that a member had to transfer his shares to nominees of directors if a written request requiring him to do so was served upon him by the board.

- A request was served upon the plaintiff who filled action challenging the validity of the new article. It was held that the alteration was valid since it was beneficial to the company to get rid of competitors among its members. However, **in Brown V. British Abrassive Wheel**, a public company required further capital urgently on risk of being wound up. The majority holding 98% of the shares were ready and willing to provide a capital on condition the bought the minority. The minority refused to sell their shares. Subsequently, the majority resolved to add to the articles, a provision to the effect that t member was bound to transfer his shares. If a written request was served upon him by holders of not less than 90% of the shares. The minority filed an action challenging the validity of the new article. The alteration was disallowed on the grounds that it was not made in good faith for the benefit of the company as a whole but exclusively for the benefit of the majority.

- In the case of Gwanju Co. Ltd is not bonafide for the benefit of the company as a whole.

- Therefore, minority should file an action in court for the alteration to be disallowed

QUESTION THREE

a) Registration of a public company limited by shares.

- To obtain registration the following steps are followed;

3) Application for reservation of name.

Under Sec 19 (1) of Act, the registrar may on written application reserve the name pending the registration or change of name by a company.

The name is reserved for 30 days in the first instance during which time it"s unavailable to other persons. The registrar may on application extend the reservation by any number of days not exceeding 30.

Under section 19 (2) of the Act, the registrar cannot resolve or register a company by a name which I his opinion is undesirable.

Note: The parties is association to form a public company limited by shares have to subscribe to the memorandum.

4) Preparation of constitutive and other documents

a) Memorandum of Association:
under section 2 (1) of the Act the memorandum means Memorandum of Association of a company as originally formed or as altered: it is one of the basic/constitutive documents.

b) Articles of Association:
Under section 2 (1) of the Companies Act, articles means articles of association of a company as originally formed or as altered by special resolution. Including so far as they apply to the company the regulations contained in Table A

c) Statement of normal capital:
This document is a requirement of the Stamp Duty Act Cap 490.
It contains the name of the company and the capital with which the company pro0oes to be registered. It promotes assessment and payment of duty for purposes of incorporation.

d) Declaration of Compliance
Under section 17 (2) of the Companies Act, this is a statutory declaration either by the advocate engaged in the formation of the company or by a person named by the articles as director or secretary to the effect that subscribers to the memorandum have complied with the provisions of the Act and are desirous of being formed to a company. It sworn evidence of compliance with the provisions of the Act.

NB: In law the documents identified here in below ought to be delivered to the registrar within 14 days of registration of the company. However, in practice all the documents must be delivered to the registrar at eth same time.

e) List of directors and their consent;
The list of directors identifies the persons who have agreed to act as directors of the company. It contains:

i) The names of directors
ii) Their postal addresses
iii) Their date of birth
iv) Occupation
v) Other directorships if any.

The list must be a complied by a written consent of every director to act as such. The consent must be signed by the director or his duty authorized agent.

f) Notice of Location of Business It specifies

1) The physical address of the company i.e. the city or town in which the registered office is situated, plot numbers and building.

2) The postal address of the company.

3) Stamping of documents;
The Memorandum, Articles of Association and the Statement of Nominal Capital must be presented for stamping, i.e. payment of the duty payable for purposes of Incorporation. Upon payment, the duty imprint is fixed on the documents on the face of the documents.

4) Presentation of documents to the registrar;
Under section 15 of the Companies Act the Constitutive and other documents must be lodged with the Registrar of Companies for registration of the company.

5) Registration of the company and issue of Certificate of Incorporation;
Under section 16 (1) of the Act, if the registrar is satisfied that the documents have been prepared in accordance with the provisions of the Act, he registers the memorandum and articles and issue a Certificate of Incorporation authenticated by his seal and signature. This Certificate signifies Incorporation of a company.

b) A public company limited by shares has a memorandum stating that I has been registered as such.

- The private company is the residual class of companies, without any special requirements.

- There are three requirements for registration of a company as a public company limited by guarantee: These are substantial differences in the capital requirements as applied to public and private companies. They are:

1) It must state it is a public company limited by shares both in its memorandum and by its name. There must be a clause to that effect in the memorandum and its name must end with words "Public Limited Company" (PLC). A private company uses the traditional "Limited" or (Ltd) at eth end of its name.

2) The memorandum must be in the form specified in Table F of the Companies regulations 1985

3) The company must have an authorized capital figure of at least the authorized minimum.

- The particular, a Public Company Limited by shares cannot commence business or exercise any borrowing powers unless it has actually allotted shares up to the authorized minimum and has received at least one guarantor of that amount.

- A public company must have at least two directors whereas a private company need only one.

- A private company needs no minimum capital either for registration or the commencement of business.

QUESTION FOUR

a) A Floating charge:

This is an equitable charge securing a debenture on the asset of a going concern. Its essence is that it remains dormant until crystallization. In the words of Lord MacMaghten in **Illingworth V. Holds worth (1904),** "A floating charge on the other hand is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which its intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp."

The characteristics of a floating charge were laid down by Romer J. in **re Yorkshire Wool Combers Association.**

1) It is a charge on a class of assets of the company both present the future.
2) The asset belongs to a class that keeps on changing from time to time in the ordinary course of business of the company.
3) The charge remains dormant until crystallization.

Advantages of the Floating Charge;

1) It enables companies with no fixed assets to borrow.
2) It enhances the borrowing capacity of companies with fixed assets.
3) It enables companies to use future asses as collateral.
4) The charge does not prevent the company from carrying on business. It is free to dispose off and acquire new stock.
5) The charge is empowered to appoint a receiver in the event of default.
6) Upon crystallization, the chargee becomes entitled to sell any fixed asset within the reach and grasp of the charge.

Disadvantages of the Floating Charge;

1) The value of the security remains unknown since the company continues to carry on business.
2) A fixed charge created subsequent to the floating charge, has priority in the satisfaction of claims.
3) Certain other interest e.g. landlords distress for rent has priority over floating charges.
4) Under section 31 of the Act, a floating charge created within six months before the commencement of winding up is deemed to be a fraudulent preference and is void.
5) Under section 314 of the Act, a floating charge created within twelve (12) months before the commencement of winding up is invalid unless it is proved that the company was solvent immediately after its creation.

b) Crystallization of Floating Charges;

1) A floating charge crystallizes the following circumstances:
2) When the company ceases to be going concern.
3) Upon commencement of recovery proceedings against the company.
4) When a receiver is appointed by a debenture holder pursuant to the terms of a debenture or by the court on application.
5) Failure to pay the principle or interest when due and payable provided the chargee takes some steps to enforce the security.
6) Occurrence of an event which under the terms of the debenture causes crystallization.

When a floating charge crystallizes it becomes a fixed charge.

A negative Pledge Clause

- This is a clause in a debenture to the effect that the company or borrower will not create a charge in priority to the current one.
- It ensures that the chargee has priority in the satisfaction of claims.

c) Registration of Charges:

Under Section 96 (1) of the Act, a copy of every charge created by the company must be delivered to the registrar for registration within 42 days of its creation. However, under sections 10Z, the High court is empowered to extend the duration on application if its satisfied that the non-presentation was accidental or due to in advertence or some other sufficient cause or does not prejudice the position of the creditors or shareholders of the company. Hence the charge must be delivered to the registrar within 42 days of its creation or such extended time as the court may grant on application failing which;

i) The charge is void as against the liquidator and money becomes payable immediately.
ii) The company and every offices in default are liable to a fine not exceeding sh.1,000.

Particulars to be registered;

Under section 97 (1) of the Act, it"s the duty of the company to deliver to the registrar for registration particulars of every charge created by the company. However, where registration is affected on the application of another person, the person is entitled to recover from the company the amount of any fees properly paid to the registrar.

The registerable particulars include:

1) Date of transaction
2) A description of the instrument creating the charge.
3) The amount secured.
4) A short description of the property charged or mortgaged.
5) Names, postal addresses and descriptions of the parties etc.

Effect of Registration of Charge;

Under section 99 of the Act, upon registration of the charge, the registrar issues a certificate of registration which is conclusive evidence that the requirements of the Act relating to registration of charges have been complied with. The certificate cures all defects. In the words of Buckley J in **re Mechanizations Ltd 1966**, "It shall be conclusive evidence that the particulars delivered to the registrar are accurate particulars …. The effect of sec 99 appears to me to be that when the registrar gives his certificate, it is to be conclusive in fact not only that the registrar has entered the particulars in the register of charges but also that the steps preliminary thereto have been carried out".

In **National Provincial and Union Bank of England V. Charnley** the instrument creating the debenture, omitted the security which was a motor vehicle. A third party purported to attach the motor vehicle in the event of default. Question was whether the motor vehicles in the event of default. Question was whether the motor vehicle could be attached. It was held that since the charge had been registered and a certificate issued, all the defects of the documents were used and the motor vehicle could be attached.

A similar holding was made in re Nye Ltd. A bank lent money to a company and obtained a charge over the company"s land as security. The charge instrument was undated and the banks solicitor forgot to register it with the registrar of companies. Several months later the bank sought to enforce the security. The banks solicitor inserted a date on the charge, delivered it to the registrar where upon it was registered and a certificate issued.

The company"s l iquidator disclaimed liability on the ground that the charge was notregistered within the required time. However, it was held that the charge was enforceable as it had been registered and a certificate issued curing all its defects.

QUESTION FIVE

Royal British Bank V. Turguant

- This is the indoor management rule. It is concerned with the liability of a company for acts of its officers.

- It answers two questions;
  1) Can a company escape liability by pleading an internal irregularity
  2) Are third parties who deal with the company bound to satisfy themselves that the rules of Internal Management have been complied with.
- These questions were answered in the negative in **Royal British Bank V. Turguand (1856).**

The articles of the company provided that directors could borrow on board such monies as were authorized by an ordinary resolution of members in general meeting. Directors of the company borrowed from the plaintiff bank without any resolution. In liquidator who denied liability on the ground that the borrowing was irregular. However, it was held that eh company was liable. The court formulated the so called in door management rule: that a person who contracts and deals with a company in good faith is entitled to assume that it is acting within its constitutional powers. He is entitled to assume that what appears regular is in fact regular. He is entitled to assume that officers of the company who are held out by the company as particular sort of officers, are the officers of the company concerned.

- In **Mahony V. Easthlyford Mining Co**. Lord Harthery says, "Where there are persons conducting the affairs of the company in a manner which appears to be perfectly in consonance with the articles of association, then those dealing with them externally are not affected any irregularities which may take place in the internal management of the company".

- In **Freeman and Lockyear V. Backhurst Parker Properties (Freeman"s case)** the company"s articles created the position of managing director.

At the material time, non had been appointed. However, one director with knowledge of the others purported to act as managing director. He engaged the plaintiff a firm of

architects to work for the company. The Plaintiff was not paid for services rendered and sued the company. The company denied liability on the ground that the director was not its managing director and hence had no authority. It was held that the company was liable since it represented this director as its managing director who therefore had apparent authority to bind it.

- The indoor management rule protects third parties against the company in case of internal irregularities. It is justified on two grounds;

  1) It is fair to third parties to prevent the company from denying liability by relying on an Internal Irregularity.

  2) It facilitates commercial transactions in that third parties are not bound to inquire whether the rules of internal management have been complied with.

- However, the indoor management rule does not protect the third partying certain circumstances and the company may escape liability. These are the exceptions to the rule in Turguants case:

1) Public documents of the Company:
   If the defect or irregularity would have been ascertained by an inspection, of the company"s public documents which the third party did not do, he is not protected by therule. It was so held in **Irvine V. Union Bank of Australia**. This is because, the public documents are registrable and open for inspection e.g. special resolutions.

2) Knowledge of the Irregularity:
   If the third party is aware of the irregularity or lack of authority, on the part of the officer dealt with, he is not deemed to be acting in good faith and cannot rely on the indoor management rule. It was so held in **B Liggetts (Liverpool) Ltd V. BarclaysBank Ltd**where the defendant was aware of the irregularity.

3) Suspicion:
   If the circumstances are such that they put the third party on inquiry, but the party does not inquire to ascertain the true position, he is not protected by the rule as a reasonable third party would have enquired. It was so held in B. Liggetts (Liverpool) Ltd V. Barclays Bank Ltd.

4) Abuse of power by an officer:
   If the officer dealt with by the third party purports to exercise powers not ordinarily exercised by that sort of officer and the third party does not inquire, it cannot rely on this rule.

5) Forged Documents:
   The indoor management rule cannot protect a third party or hold the company liable if the document relied upon forgery. Such a document is a legal nullity. It was held in Reuben V. Great Fingall Consolidated:

6) Insiders;
   As a general rule, the Indoor Management rule cannot be relied upon by an Insider. These are persons who by virtue of their positions regulations have been complied with e.g. directors. It was so held in Howard V. Patent Ivory Manufacturing Company Ltd. Where the third parties in question were directors. It was held that hey were deemed to know of the irregularities and could not rely on the indoor management rule.

Question has arisen as to whether directors are insiders. It all depends on the nature of character of the transaction. If it is so closely interwoven with the position of the director as a director of the company, he is deemed to know the circumstances affecting it and is therefore deemed to be an inside. If it is not closely intertwined with his position as director, he may rely on the indoor management rule.

QUESTION SIX

a)

Directors are deemed to be agents of the company whenever they contract on its behalf. The relationship is governed by principles of agency and the company is generally liable as the principle.

In borrowing contract, employment, and in contracts entered in to promote the purposes of the company directors act as agents and the company is liable. However, in those circumstances in which the agent is personally liable, the directors are liable, the directors are liable.

In the words of Cairns L.J in Ferguson V. Wilson, "The directors are more agents of the company. It can only act through directors and the case as regards those directors is merely the ordinary case of principal and agent. Whenever or agent is liable, those directors could be liable. Whenever, the disability would attach to the principal and the principal only, the liability is the liability of the company"

b)

The act of Usafi Ltd was ultravires in the wides sense which is nothing but an abuse of power of the company by its officers often described as "Excess of directors" or transactions.

- Ultravires the directors or transactions the objects of the company and be ratified by members in the general meeting where upon it becomes an enforceable transactions.

- If directors exceed or improperly exercise their powers, their action can be ratified by an ordinary resolution of the company in general meeting.

- If they act contrary to the company"s articles or memorandum, it must be ratified by a special resolution.

- In **Banford V. Banford (1970)** by way of defense to a takeover bid, directors allotted 500,000 shares at par for cash to a third company which was the principal distributor of the products of the company to be taken over. The articles provided that the unissued shares were to be at the director"s disposal. Two shareholders brought an action against the three directors, the third company, and the company, claiming a declaration that the allotment was invalid in that the directors had not acted bonafide in the interests of the company.

- Add; assuming that the allotment was intravires the company and the directors but not bonafide in the interests of the company and therefore voidable, it could after full disclose be ratified by an ordinary resolution at a general meeting.

- In the case of Usafi Limited, Juma ratified the earlier breach therefore making the transaction enforceable.

- He therefore cannot be held liable for the earlier breach.

QUESTION SEVEN

a)

The companies Act do not define the phrase „Statement in lieu of prospects". However, this is a document prepared and issued by companies in certain circumstances either in place of an ordinary prospectus or in addition to a prospectus. The Companies Act prescribes the content of such document.

A statement in lie of prospectus may be prepared in the following circumstances.

1) When a private company goes public

Under section 32 (1) of the Act, if a private company by special resolution alters its articles converting itself to public it ceases to be a private company on the date of the alteration an must within 14 days thereof deliver to the registrar for registration either;

An ordinary prospectus

A statement in lie of prospectus containing the particulars of part 1 and 2 of the 2nd schedule to the Act. Contents of this schedule include:

a) Nominal share capital and the divisions thereof
b) Redeemable preference shares
c) Earliest date of redemption
d) Particulars of directors
e) Commission paid and discount allowed
f) Amount paid to promoters
g) Auditors of the company.

2) **Restriction on allotment of shares**:

Under section 50 (1) of the Companies Act, if a 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 to the public for subscription no share out to be allotted unit at least after 3 days from the date of delivery to the registrar for registration, a statement in lie of prospectus signed by every person who is named or proposed director of the company and containing the particulars of part 1 and 2 of the fourth schedule to the Act. Contents of this schedule include:

a) Auditors of the company
b) Particular of material contracts
c) Rate of commission
d) An estate of the preliminary expenses
e) Particulars of directors
f) Nominal share capital and divisions thereof
g) Redeemable preference share if any
h) Earliest date of redemption.

3) Restriction on commencement of redemption:

Under section 111(2) of the Act if a company having a share capital has not issued a prospectus inviting subscription for its shares or has issued one, but failed to raise the minimum subscription, there must be delivered to the registrar for resignation inter alia a statement in lieu of prospectus to facilitate the issue of a certificate of trading. However, section 111 (2) does not prescribe the contents of the statements in lieu.

b)

Under section 50 (1) of the Act, a company having share capital which does not issue a prospectus on or with reference to its formation, or which has issued such a prospectus

but has not proceeded to allot any of the shares offered to the public for subscription, shall not allot any of the shares or debentures unless at least 3 days before the first allotment of either shares or debentures there has been delivered to the registrar for registration a statement in lieu of prospectus signed by every person who is named there in as a director or proposed director of the company or by his agent authorized in writing, in the form and containing the particulars set out in part 1 of the fourth schedule and, in the cases mentioned in part II of that schedule, setting out the reports specified therein, and said parts I and II shall have effect subject to the provision contained in part III of that schedule.

Under Section 50 (2), every statement in lieu of prospectus delivered under subsection (1), shall where the persons making any such report as aforesaid have made therein or have, without giving reasons, indicated therein any such adjustments as are mentioned in paragraph 5 of the fourth schedule have enclosed thereon or attached there to a written statement signed by those persons setting out the adjustments and giving the reasons therefore.

QUESTION EIGHT

- A private company has many advantages over partnership.

- Partnership is a relationship which subsists between persons carrying on business in common with a view of profit.

- The difference between a private company and partnership are:

a) Limited Liability:
Members in private company are generally not liable for debts and other obligations of the company since their liability is limited by shares or guarantee. This is not the case in partnership.

b) Wide capital base:-
Compared to partnership private companies generally have more capital by reason of wide spectrum of membership.

c) Perpetual succession.
A private company can exist in perpetuity unlike partnership which is affected by death or bankruptcy of any of the members.

d) Qualified or specialized management
Under section 177 of the Act, every private company must have at least one director. Directors are elected by members in general meeting. Members have an opportunity to elect qualified persons as directors.

e) Owing property and Capacity to Contract
The fact that a private company can own or hold property or enter into contractual relationship makes it different from a partnership.

f) Sue or be sued
Shareholders are not obliged to sue to remedy wrongs done to the company and generally cannot be sued for the wrongs of the company. This attribute is not present in partnerships.

g) Transferability of Shares

Shares in private companies are not freely transferable. Under section 75 of the Companies Act, the shares or other interest of any member shall be movable property transferable in the manner provided by the articles. The fact that shares are transferable means that the company membership keeps on changing from time to time.

Under section 30 (1) (a) of the Companies Act, a private company is restricted to transfer its shares.

However, a partnership cannot transfer its shares.

b) Borrowing by floating charge:

- Private companies can utilize the facility of floating charge to borrow. This is an equitable charge securing a debenture on the assets of a going concern.

- A partnership cannot utilize this facility

Other differences include:

- Both partnerships an private companies are subject to different taxation rates.

- It is more expensive to form a private company than to form a partnership. Formation expenses of companies include legal fees, registration fees, stump duty etc.

Part IV: Revision Questions and Answers

QUESTIONS

REVISION PAPER ONE

QUESTION ONE

"Both they (i.e. Directors) and the members in general meeting are primary organs of the company between whom the company"s powers are divided". Discuss.

QUESTION TWO

Cham, Luchi, Manga and Sibwor set up a company (Ndobolo Enterprises) whose objects clause states that the company shall "carry out the business of promoting the Ndobolo dance and all related types of dancing". Recently, the company has been promoting the benga dance. Thuruwa, a Kin follower of the benga dance thinks that the Ndobolo enterprises have no right to promote the benga dance since it (benga dance) is not related to the Ndobolo dance. Ndobolo Enterprises insist that they are empowered through their objects clause to promote the benga dance. The two have come to you for advice. What advice would you offer them?

QUESTION THREE

Define floatation and explain the different methods employed in floatation.

QUESTION FOUR

Konde lent Sh.1 million to Bahari Ltd, on the security of 100,000 shares of Sh.100 each. He was given a certificate which showed that these were fully paid up shares and the payment had been paid in full. But he was surprised to learn, during winding up that he had been placed on a list of contributories, with regard to the shares were part of the shares. Evidence is adduced in court that the shares were part of the company"s unissued shares and nothing had been paid for them.
Discuss the relevant law and advise Konde.

QUESTION FIVE

State the ways in which a person can acquire membership of a company. How can such membership be lost?

QUESTION SIX

What are the rules relating to keeping of company"s accounts? Explain the format of suchaccounts.

QUESTION SEVEN

Odulla is a member of XYZ Ltd. he doest clearly understand the companies Act (cap 486) provision in relation to company shares. He requests for your advice on the following matters.

(i) Share warrants
(ii) Mortgage of shares
(iii) Lien on shares Advice him accordingly

QUESTION EIGHT

Discuss the provisions related to the making of calls and payment of calls in advance

REVISION PAPER TWO

QUESTION ONE

Joseph, a wealthy businessman comes to you for advice on the Act (cap 486) provision on holding and subsidiary companies. Advise him accordingly.

QUESTION TWO

a) What is the significance of the procedures which are followed for the transfers of shares in a company?

b) In what circumstances may the company deny the title in shares evidence by a share certificate?

QUESTION THREE

a) Explain what is meant by the "constitutive documents of a company". List any four such documents.

b) Ancient Ltd was set up under articles which provided for the appointment of a director to serve for five years. In 1986, when the company stated operations, Maina was appointed Director; In 1989, the company amended the articles relating to the appointment of a director and subsequently. Maina was removed as Director. He has now come to you to seek legal advice.
Advice him as to his legal remedy under the law.

QUESTION FOUR

Usiku Holdings Ltd is a private company Limited by shares. A clause in its articles of Association provides:

> "If any member intends to transfer shares he shall inform the director who will take the said shares equally between them at fair value"

Usiku holdings has made no profits for three years running, and one of its shareholders, Kamau, now wants to get rid of his share. He request the company"s management to buy his100 shares at the price of Sh. 10per share, which is double the original purchase price five years earlier. The company rejects his proposition and argues that there is in any case no obligation to take back the shares. Advise Kamau.

QUESTION FIVE

Discuss the companies Act (cap 486) provisions relating to the register of members.

QUESTION SIX

A liquidator is a person appointed for the purpose of collecting and realizing the company"s assets, ascertaining and making good liabilities and distributing the remainders, if any, to members.

Discuss the rules relating to the appointment, legal position and duties and obligations of liquidator.

QUESTION SEVEN

Peter Kinuthia was recently appointed as a director of a company whose articles of association correspond with Table A. Francis Mwangi, the chairman of the company has told him that the companies Act (cap 486, laws of Kenya) will govern his dealings with the company. Peter has come to you for advice regarding:

(i) Restriction on appointment of directors
(ii) Disqualification of directors.
(iii) Removal of directors.

QUESTION EIGHT

What is the effect of a borrowing on behalf of the company by directors when borrowing is

(i) Ultra vires the directors; or
(ii) Ultra vires the company?

REVISION PAPER THREE

QUESTION ONE

After ego doctrine is the antithesis of the doctrine of separate corporate personality. Citing relevant cases, explain the principle of after ego.

QUESTION TWO

(a) Define a quorum
(b) Are there any circumstances when one person may constitute a meeting?

QUESTION THREE

Companies are obliged to make a return to the registrar at least once every year. Discuss the law relating to making of annual return.

QUESTION FOUR

The chairman is very essential in a general meeting. Clearly discuss the law relating to the chairman, his powers and duties.

QUESTION FIVE

"When there are persons conducting the affairs of the company in a manner which appears to be perfectly consonant with the Articles of Association, then those dealing with them externally are not to be affected by any irregularities which may take place in the internal management of the company."

As per Lord Hatherby in **Mahony v. East Holyford Mining Company (1875) L.R. 7 H.L. 869**

You have been invited to give a short but elaborate, expensive and class bow tie lecture to the Shares Excluding the Havenots Association at the Windsor Gold Club.

We are listening.

QUESTION SIX

Discuss how the affairs of the company may be invested.

QUESTION SEVEN

Section 22(1) of the Companies Act (Cap 486, laws of Kenya) provides as follows, "The articles shall when registered, bind the company and the members there of …"
Explain this provision by reference to decided cases.

QUESTION EIGHT

In relation to Board of Directors, explain:
(a) Loans and other payments to directors
(b) Compensation to directors for loss of office.
(c) Appointment of directors.

REVISION PAPER FOUR

QUESTION ONE

Discuss:

(i) Duties and powers of an inspector appointed by the court.
(ii) Causes of action or proceedings on an inspectors report.
(iii) Costs and expenses of investigation.

QUESTION TWO

Outline the ways in which minority shareholders are protected in company law.

QUESTION THREE

Discuss:
(a) Circumstances in which a company may be compulsorily wound by the court.
(b) Winding up subject to the supervision of the court.

QUESTION FOUR

Ann is about to attend her first ever general meeting of Borg plc. The documentation for the meeting mentions various people, but Ann is not sure what their exact roles are within a public limited company. Nor is she clear about the procedure for voting or how one becomes, or ceases to be a director.

(a) Briefly explain to Ann the role and power of the following:

Chairman of the Board;
Managing director

(b) Briefly explain what is meant by:

A poll vote
A proxy vote.

QUESTION FIVE

Njuguna is a shareholder of Maji Maji Ltd. being a primary school leaver, he doesn"t know the validity or otherwise of gratuitous payments. He comes to you for advice.

Advice him accordingly.

QUESTION SIX

(a) What do you understand by the term “body corporate”, as used in company law?
(b) What are the merits and shortcomings of a corporation as a business entity?

QUESTION SEVEN

Outline the rules according to which the assets of a company are to be distributed in the winding up of an insolvent company?
What are secured creditors?

QUESTION EIGHT

Consider the position of secretary in a company, setting out the provisions for appointment, the duties and liabilities.

ANSWERS

REVISION PAPER ONE

QUESTION ONE

During the 19th Century, it was generally believed that the general meeting was the company and that the directors were agents of the general meeting and their function was to implement resolutions of the general meeting. However, the position changed from the beginning of the 20th century where upon company law recognized the general meeting and the board f directors as the principal agents organs of the company. By 1948, the law had crystallized by recognizing the two and Table A, vested powers in both.

Some company powers are only exercisable by the general meeting while others can only be exercised by the board. The board is empowered to:

(vii) Recommend dividend
(viii) Recommend a bonus issue
(ix) Pay interim dividend
(x) Make calls
(xi) Forfeit shares
(xii) Appoint managing director and secretary etc

The general meeting on the other hand is empowered to:

(i) Elect directors
(ii) Appoint auditors
(iii) Authorise a bonus issue
(iv) Declare dividend
(v) Alter the memorandum or articles
(vi) Remove directors or auditor from office

The law relating to division of powers is that if a power is vested in one organ, the other must not interfere, with its exercise unless:

(i) It is being abused
(ii) It is being exceeded
(iii) Exercised contrary to the articles

Each organ is bound to exercise powers vested in it by the articles.

The question as to which organ exercises which power is one of interpretation of the article. It was so held in **Automatic self cleansing filter syndicate V. Cynninghome.**

Under Table A, company management is vested in the board. Article 80 of Table A provides „the business of the company shall be managed by the directors… and may exercise all such powers of the company, as are not by the Act or by these regulations required to be exercised by the company in general meeting". This Article has been interpreted to mean that the directors and no one else are responsible for the company"s management except in the matters allotted to the company in general meeting. It was so held in:
Alexander Ward & Co. V. Samyang Navigation

Courts of law have enforced the division of powers between the general meeting and the board. In **Scott V. Scott** the articles empowered directors t pay to members from time to time such interim dividend as was justified by the profits of the company. Shareholders in

general meeting revolved that the directors pay an interim dividend. The directors declined and were sued. It was held that they were not bound to implement the resolution since the power to pay interim dividend was vested in the board and the general meeting was interfering with its exercise.

In **Shaw V. Shaw** the articles of the company empowered the board to manage its monies. The board had resolved to institute proceedings against a party to recover certain monies owed to the company. The general meeting resolved that the action be discontinued. The directors refused and were sued. It was held that they were not bound to discontinue the action since the power to manage the company was vested in them and the general meeting was interfering with its exercise. In the words of Lord Greel **"**If powers of management are vested in directors, they and they alone can exercise those powers. The only way in which the general body of shareholders can control the exercise of the powers vested by the articles in the directors is by altering the articles, or if opportunity arises under the articles by refusing to re-elect the directors whose actions the disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders**"**.

The division of powers between the two organs goes beyond the powers vested in either organ. If a power is vested in neither of them and either of them purports to exercise that power the other must not interfere with its exercise. However the general meeting appears more dominant in that:

(i) It is empowered to alter the articles
(ii) It is empowered to remove directors from office.

However, until such step is taken, directors are entitled to ignore instructions of the general meeting on how to exercise a power vested on the board by the articles.

Exeptions;

These are circumstances in which the general meeting exercise powers vested by the articles in the board.

(i) **Litigation**

If directors fail, refuse or neglect to sue on behalf of the company or to defend an action against the company, the power becomes exercisable by the general meeting as was the case in **Marshalls Value Gear Company V.Manning Warlde.**

(ii) **Ratification of abuse of power by directors:**

Whenever, the general meeting ratifies an abuse of power by directors, e.g. borrowing for an ultra vires purpose, it in effect exercises power vested by the articles on the board. In **Bamford V. Bamford** where directors were empowered to issue shares, but issued them foran improper purpose, and the general meeting ratified the issue, it became a valid act of the company, hence the general meeting was exercising a power vested in the board. A similar holding was made in **Hogg V. Cramptorn**

(iii) **Deadlock in the management**

If a company"s B.O.D, cannot function in any material respect, by reason of a deadlock, its powers become exercisable by the general meeting. It was so held in **Barron V. Parter.** The company"s Articles created 10 positions for directors. 2 years after incorporation, the company had only 2 directors, Barron and Porter who were not in talking terms. The power

to appoint additional directors was vested in the board and a quorum for board meeting was two. The board could not meet since Barron and Porter could not sit on one table. The company"s management came to a standstill. It was held that in the circumstances, the power to appoint additional directors had become exercisable by the general meeting.

In conclusion, it may be argued that the old idea that the general meeting was the company and the directors as agents always subservient to the general meeting is no longer the law as it is certainly not the fact.

QUESTION TWO

Under section 5(1) (c), the memorandum of every company must state the objects of the company. These are the purposes for which the company is incorporated. Since a company is a legal person, its capacity is conferred by law and hence must be set forth in the memorandum. The objects clause therefore defines the contractual capacity of the company. It delimits the doctrine of ultra vires. The purpose of setting out the objects in the memorandum was explained by **Lord Parker in Cotman V. Bougham (1918)** where he observed; "The statement of a company"s objects in its memorandum is intended to serve adouble purpose. In the first place, it gives protection to subscribers who learn from it the purpose to which their money can be applied. In the second place, it gives protection to persons who deal with the company and who can infer from it the extend of the company"s powers. The narrower the objects expressed in the memorandum, the less is the subscribers risk; But the wider such objects, the greater is the security of those who transact business with the company.

The doctrine of ultra vires

Ultra vires literally means beyond the powers. This is a rule of capacity contained in section 5(1) (c) of the Act. It was not until 1875 that it was accorded a judicial interpretation

In **Ashbury Railway Carriage and Iron Co. Ltd V. Riche (1875)** the objects of the company were:

(i) To make, sell, lend on hire railway plant carriages and wagons
(ii) To carry on the business of mechanical engineers and general contractors.
(iii) To purchase and sell timber, coal, metal and other materials.

Directors of the company entered into a concession for the construction of a railway in Belgium. Members subsequently ratified the contract and were sued. It pleaded that the contract was ultra vires. The court was called upon to determine. It was held that since the memorandum of the company had no provision for the purchase of concessions, or construction of railways the contract was ultra vires and, therefore null and void. Lord cairnes observed, "The contract was entirely beyond the objects in the memorandum of association…If it was a contract void at its beginning, it was void because the company would not make the contract: the court gave the doctrine of ultra vires a very rigid interpretation thereby restricting a company"s capacity. Companies could only engage in transactions set forth in the objects. However, the first in road into the doctrine came in 1880 in**Attorney General V. Great Eastern Railway Company.** A company was formed to acquire the undertaking of 2 existing companies and to construct and operate other railways. It entered into a contract to supply another company with locomotive power for 5 years and carriages and wagons for 2 years. Question was whether the contract was intra or ultra vires the company. It was held that it was intra vires the company. Lord Selbourne observed, "The doctrine of ultra vires as was explained in **ashbury"s case**should be maintained… this doctrine ought to be reasonably and not unreasonably understood andapplied, and whatever may fairly be regarded as incidental to or consequential upon those things that the legislature has authorized ought not unless expressly prohibited to be held by judicial construction to be ultra vires"

By this decision, the contractual capacity of a company was expanded to include:

(i) Transactions specified in the objects
(ii) Transactions reasonably incidental to the attainment or pursuit of the express objects.

These two cases represent the common law doctrine of ultra vires in relation to registered companies. This position was upheld by the House of Lords in **London Country V. AG:** The doctrine of ultra vires has been wanted down and companies enjoy almost unrestricted capacity.

In Bell Houses Ltd V. City Wall Properties Ltd (1966). The plaintiff company"s businesswas property development. It acted as money brokers in a financial deal to enable the defendant company obtain a loan of £ 100 000 at a commission of £ 20 000. Sub – clause 3(c) of the objects provided that the company could engage in any other trade or business which can in the opinion of the B.O.D be advantageously carried on by the company. The defendant company refused to pay the commission and was sued. Question was whether the plaintiff company had capacity to act as money brokers. It was held that sub-clause 3(c) of the objects enabled the company to engage in such a transaction as long as in the genuine opinion of the board it could be carried on advantageously by the company

The object clause of Ndobolo enterprises state that, Ndobolo Enterprises could also carry out all other related types of dancing.

If Benga dance can genuinely be carried out in pursuit of the primary object, then it is not ultra vires;
Therefore, Ndobolo Enterprises are empowered through its objects to promote benga dance.

QUESTION THREE

Floatation is the process by which companies make shares/debentures available for subscription. It enables companies to raise capital from the public. Companies generally employ any of the following methods;

1. **Direct Invitation by the company/Public/Prospectus issue:**

By this method, the company floating the shares prepares and issues a prospectus inviting subscription. The prospectus must contain so far as applicable the matters and reports specified in part 1 and 2 of the 3rd schedule to the Act. An application form must be enclosed. The prospectus must set out the advantages of investing in the company and may identify the underwriter if any. The company is responsible for the administrative tasks of the issue and the risk if the issue is unsuccessful. To spread such risk, the company arranges for the issue to be underwritten whereby an underwriter undertakes to take up all or a specified number of shares as his own. These shares are often taken at a discount and are called **Underwritten firm.** The underwriter undertakes to take up a specified number of shares if not take up in return for commission. The difference between the underwriter and the commission paid by the Principal underwriter to the sub-underwriter and is the **Overriding Commission**

2. **Offer for sale:**

This is the method by which a company allots all the shares to an issuing house which in turn prepares and issues a prospectus inviting subscription. The issuing house offers the shares at a premium to recover its costs and make a profit upon application of the shares;

the issuing house renounces its allotment in favour of the applicant. This method has 2 advantages:

If relieves the company the administrative tasks of the issue.
The company receives the entire consideration on the shares since they are all taken up by the issuing house.

For purposes of spreading risk, the issuing house may have the shares underwritten

3. **Placing:**

By this method, the company arranges with an issuing house to purchase all the shares or take them up without a purchase and then place them with its clients privately. If the issuing house does not purchase the shares, it acts as an agent in return for brokerage and incurs no liability if the shares are not taken up. In a placing, there is no direct or indirect invitation to the public and the shares are generally offered in blocks to clients of the issuing house. This approach ensures that the shares on offer are taken up by the selected individuals or institutions.

Invitation to Treat:

Whichever method a company employs to issue shares or debentures, invitations may be made to prospective tenders to submit tenders for shares in large quantities. The company or issuing house fixed the minimum number of shares and price and reserves the right to accept any bid or accept bids in parts. The tender is generally awarded to the highest bidder. An offer by tender has 2 advantages:

(i) It makes available to the company or issuing house any excess above the issuing price.
(ii) It discourages stags who submit bids for speculative purposes.

A company may raise capital from existing members if authorized by its articles. This may be effected by a rights or bonus issue. In a rights issue shares are offered to existing members in proportion to their current holding. They are offered by way of renounceable allotment letters. A member is free to renounce his rights in favour of another. The shares are generally offered on favourable terms to encourage subscription. These shares prevent the dilution of rights of existing members. In the case of bonus shares, shares are offered to existing members at no direct consideration. The shares often referred to as capitalization issue are generally financed by reserves or the share premium account. A company may only issue bonus shares in the following circumstances:

(i) The issue must be authorized by the articles of the company
(ii) The issue must be issued in the proportion specified in the articles
(iii) The nominal share capital of the company must be sufficient
(iv) The issue must be recommended by the Board of Directors in board meeting
(v) The issue must be authorized by an ordinary resolution of members in the general meeting.
(vi) A return of allotment must be delivered to the registrar for registration within 60 days thereof.

QUESTION FOUR

The contents of a share certificate with respect to the name of the registered holder, the number of shares and the extend to which they are paid up, is a representation by the company to third parties and a bonafide third party who suffers loss or damage by reason of relying upon the representation may hold the company liable in damages. The company is estopped from denying:

(a) The fact of having made the representation
(b) The fact that the representation was true.

Hence it is argued that a company must take great care when issuing share certificates. This is necessary as they could render the company liable.

However, for the company to be estopped and held liable, it must be proved that:

(a) The representation was contained in a genuine share certificate of the company
(b) The third party relied upon the representation in good faith.
(c) The third party had changed the legal position to its detriment as a result of the reliance.
(d) It is fair to estoppel the company or hold it liable.

In **Bloomenthal V. Foor,** a company borrowed money from X and as security gave him a share certificate describing the shares as fully paid and X believed so. However, it was not the case. In liquidation, the liquidator sought to recover the amount due on the shares from X. X pleaded estoppel by the share certificate. It was held that the company could not claim the amount due since its share certificate described the shares as fully paid, a fact it could not deny.

A similar holding was made in **Burkinshaw V. Nicolls** where a company issued shares to a party under a share certificate describing the shares as fully paid which was not the case. The party sought to recover the amount due from Nicolls who pleaded estoppel and the company was estopped.

In **Balkis Consolidated V. Tompkison** X sold his shares to I. X had no title but had fraudulently induced the company to issue a share certificate to U. I resold the shares to a third party but the company refused to register on the ground that I had no title like X before him. I was compelled to purchase other shares to fulfill third party claims. I sued the company in damages for the loss. It was held since the company had issued a share certificate o him describing him as the owner, it could not deny that fact and was liable.

A similar holding was made in **re Oho Kopjes Diamond Mining company and in re Bahia and San Fransisco Railway Company.**

However, the doctrine of estoppel does not apply and the company can deny title evidenced by a share certificate in two circumstances:

1. If the third party had notice of the falsity of the representation.
2. **The representation relied upon was contained in a forged share certificate since such a document is a legal nullity.**

Bahari Limited cannot therefore claim the amount due since its share certificate described the shares as fully paid; a fact it cannot deny.

QUESTION FIVE

A person may become a member of the company in the following ways:

1. **Subscribing to the memorandum:**
   Under Section 28(1) of the Act, the subscribers to the memorandum of a company shall be deemed to have agreed to become members of the company and on its registration shall be entered as members in its register of members.

2. **Allotment:** A person to whom shares have been allotted by the company upon

application becomes a member of the company when his name is entered in the register of members.

3. **Transfer**: This is the purchase of shares from a will seller. A transferee of sharesbecomes a member when his name is entered in the register.

4. **Transmission by death:** The shares of deceased member are by operation of law,transmitted to his personal representative who becomes a member when his name is entered in the register.

5. **Transmission by bankruptcy:** The shares of a member declared bankrupt by acourt of law are by provisions of the bankruptcy Act transmitted to his trustee in bankruptcy who becomes a member when his name is entered in the register.

6. **Share qualification for directors:** Under Section 182(2) of the Act, a person whohas signed and delivered to the registrar for registration, an undertaking to take up and pay for his qualification shares is deemed to be in the same position as a subscriber to the memorandum for that number of shares.

7. **Estoppel:** A person who is not a member may be deemed to be a member by theequitable doctrine of estoppel if either:

   (i) He knowingly permits himself to be held out by the company as a member and third parties rely upon the representation to their detriment.

   (ii) He with the company"s knowledge holds himself out as a member and third parties rely upon the representation to their detriment.

In either case, a person is estopped from denying their parent membership as it would be unfair to third parties.

Cessation of Membership:

A person may cease to be a member in the following ways:

1. **Transfer:** A transferor of shares ceases to be a member when the transfer isregistered and the transferee"s name entered in the register.

2. **Forfeiture of shares:** A shareholder whose shares have been forfeited for non-payment of calls and in accordance with the articles, ceases to be a member in respect of such shares.

3. **Sale by Company in exercise of lien:**
   A shareholder whose shares are sold/or otherwise disposed of by the company to enforce a lien conferred upon it by the articles, ceases to be a member of the company.

4. **Valid surrender:** A shareholder whose shares are acquired by the company at hisoption ceases to be a member of the company by reason of the surrender.

5. **Death:** The death of a shareholder terminates his membership since his shares aretransmitted to the personal representative.

6. **Bankruptcy:** A shareholder declared bankrupt by a court of competent jurisdictionceases to be a member and his shares are transmitted to his trustee in bankruptcy.

7. **Rescission of contract:** If a shareholder rescinds a contract of allotment orpurchase of shares within a reasonable time, the register of members is rectified and he ceases to be a member.

8. **Repudiation by an infant:** A contract for the purchase of shares by an infant isviodable at its option during infancy or within a reasonable time after attaining the age of majority. If the contract is avoided, the infact ceases to be a member of the company.

9. **Redemption of Redeemable preference shares:**
A shareholder whose preference shares are redeemed, in accordance to the provisions of the Act and the Articles, ceases to be a member of the company.

10. **Winding up or liquidation:**
It is contended that the winding up of a company terminates the membership of all shareholders.

11. **Disclaimer by Trustee in bankruptcy:**
If a trustee in bankruptcy disclaims the shares of an undischarged bankrupt, he ceases to be a member of the company.

QUESTION SIX

Under the provisions of the companies Act, companies are obliged to keep certain books of accounts in the English language. Under Section 147(1) every company shall cause to be kept proper books of accounts with respect to:

1. All sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place.
2. All sales and purchases of goods by the company.
3. The assets and liabilities of the company.

These books must give a true and fair view of the state of the company"s affairs and explain its transactions.

Under Sec 147(3) these books of accounts must be kept at the registered office of the company or at such other place as the directors may determine but must at all times be accessible to directors for inspection. However, with the registrars consent, the books may be kept at a place outside Kenya but at intervals not exceeding 6 months they must be brought at some place in Kenya where they are open for inspection by directors.

Failure to keep books of accounts renders every director in default liable to a fine not exceeding Sh.10,000 or imprisonment for a term not exceeding 12 months or both.

However, the director may escape liability by establishing he had reasonable ground to believe and did believe that a competent and reliable person was charged with the responsibility and was in a position to discharge the same.

Under Section 148(1) of the Act, directors of every company must lay before it in general meeting a balance sheet and a profit and loss account or an income and expenditure account within 18 months of incorporation and at least once every calender year subsequently.

However, the registrar may for any special reason permit a company to lay the accounts before a general meeting held after 18 months or after the end of a calendar year.

It is the duty of directors to ensure that the necessary accounts are prepared and laid before the general meeting failing which they are liable to a fine not exceeding Sh.10,000 or imprisonment for a term not exceeding 12 months or both.

Format of the Accounts:

Under Section 149(2) of the Act, a company"s balance sheet and profit and loss account must comply with the requirements of the 6th Schedule so far as applicable. Under Section 155(1), every balance sheet of a company must be signed by 2 directors on behalf of the board or by the only director of the company.

In the case of a bank, it must additionally be signed by the secretary and manager if any: if the bank has 3 directors, all must sign. If more than 3, at least 3 must sign.

However, if the number of directors of a company present in Kenya is less than that required to sign the balance sheet, the only director present must sign but attaché a statement explaining the reason for the non-compliance in the provisions of the Act. It is a criminal offence to issue, circulate or publish unsigned copies of a balance sheet. The company and every officer in default are liable to a fine not exceeding Sh.1,000.

Group Accounts

Under Section 153(1), unless there are good reasons against it, directors of the holding company must ensure that its financial year, and those of its subsidiaries coincide. Under Section 150(1), if at the end of the financial year, a company has subsidiaries, directors must lay group accounts of the company and its subsidiaries before the general meeting of the holding company.

Under Section 150(1), the group accounts laid before the holding company must be consolidated accounts comprising:

1. A consolidated balance sheet dealing with the company and the subsidiaries.
2. A consolidated profit and loss account dealing with the profit or loss of the company and its subsidiaries.

Under Section 152(1) of the Act, the group accounts laid before the company must give a true and fair view of the state of affairs and profit or loss of the company and the subsidiaries dealt with as a whole. However, under Section 150(2). The group accounts laid before the general meeting need not deal with a subsidiary if directors are of the opinion:

1. That its impracticable.
2. That it will be of no real value to members of the company in view of the insignificant amounts involved.
3. That it would involve expense or delay out of proportion to the value to the members of the company.
4. That the result would be misleading
5. That it would be harmful to the business of the company or any of the subsidiaries.
6. That the business of the company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking.

If directors form such an opinion in respect of each of the subsidiaries; no group accounts are required. However, the registrar"s approval is necessary if the boards opinion is based onthe group that the result would be harmful or that the business of the company and the subsidiary are different.

Annextures to the Balance Sheet:

Under the provisions to the Companies Act, certain documents must be attached to the balance sheet:

1. The profit and loss account and any group account to be laid before the company in general meeting.
2. The auditors report.
3. The directors report stating the boards opinion on the affairs of the company and the amount, if any, recommended as dividend and proposed as reserves.

It is a criminal offence to issue, circulate or publish a balance sheet unaccompanied by the profit and loss account or the auditors report.

The company and every officer in default are liable to a fine not exceeding Sh.10,000 or imprisonment for a term not exceeding 12 months. However, the accused may escape liability by proving that he had reasonable ground to believe and did believe that a competent and reliable person was responsible and was in a position to discharge the duty.

Under Section 158(1) of the Act, a copy of the balance sheet and its annextures to be laid before a company in general meeting must be sent to every member of the company, every debenture holder and every other person so entitled at least 21 days before the date of the meeting.

QUESTION SEVEN

(i) **Share Warrants**

This is a document issued by a company under its common seal stating that the bearer is entitled to the shares therein specified. A warrant is a title dead entitling the bearer to the shares there in specified and divided payable thereon.

Under section 85(1) of the Act, a company may issue share warrants in the following circumstances:

1. It must be limited by shares
2. The issue must be authorized by the articles of the company
3. A warrant can only be issued with respect to fully paid shares of the company

Under section 85(1), a warrant may also provide a coupon to facilitate payment of dividend.

Effect of Issue of Share Warrants:

Under section 114(1) of the Act, whenever a company issues a share warrant, the members name is struck off the register of members and the following particulars entered:-

1. The fact of issue of the warrant.
2. Date of issue
3. A statement of the shares included in the warrant

A share warrant holder is not in fact a member of the company. However, under section 114(5) of the Act, the articles of a company may deed a share warrant holder a member of the company for all or certain purposes.

Under section 114(2), a share warrant holder may surrender a warrant where upon his name entered in the register as holder of the shares and the warrant is thereby cancelled. If a company has issued share warrants, its annual return to the register must show;

1. The number of shares comprised in each warrant.

2. The number of shares in respect of which warrants are outstanding
3. The total amount of share warrants issued and surrendered

A share warrant differs from a share certificate in the following respects;

1. It is a contractual document entitling the bearer to the shares and dividend payable thereon.
2. It can only be issued in respect of fully paid shares
3. The bearers name struck off the register
4. It is a negotiable instrument transferable by mere delivery
5. The shares comprising a warrant are transferable by mere delivery.

(ii) **Mortgage of Shares**

As items of property, shares may be disposed off by way of transfer or as a security for a loan. Mortgage of shares entails the use of shares as a security and the transaction may be legal or equitable

Legal Mortgage

This is a mortgage transaction whereby the shareholder or borrower transfers his security (i.e. the shares) to the lender subject to a retransfer upon repayment of the amount borrowed. The lender becomes the temporal owner of the shares with all the rights of a member. He is entitled to the dividend payable thereon and can attend and vote in general meeting of the company. Other terms of the contract are contained in the mortgage instrument. Upon repayment, the shares are retransferred to the shareholder. However, in the event of default the transfer becomes absolute. A legal mortgage has 2 disadvantages:

1. Formalities of transfer and retransfer of shares
2. Payment of stamp duty on transfer

Equitable Mortgage

This is a mortgage transaction whereby the borrower deposits the executed mortgage instrument and the share certificate with the company as security

The borrower remains the registered holder of the shares capable of exercising all the rights of a member. The mortgage instrument sets out the terms of the contract. In the event of default, the mortgages rights are enforced by court action. The share certificate may be redeemed by paying the total amount due.

(iii) **Lien on Shares**

The articles may give the company alien on shares held by a member for his unpaid cal or installment or for some other debt due from him to the company

A lien is essentially a right, a company or third party may have on a persons shares. It is a n equitable change upon the shares and gives rise to the same rights as if the shares were expressly charged by the member in favour of the company

Under Article 11 of Table A, "The company shall have a first and paramount lien on every share (not being a fully paid share) for all monies (whether presently payable or not) called or payable at a fixed time in respect of that share, and the company shall also have a first and paramount lien on all shares (other than fully paid shares) standing registered in the name of a single person, for all monies presently payable by him or his estate to the company, but the directors may at any time declare any share to be wholly or in part exempt from the provisions of this regulation.

The company"s lien, if any, on a share shall extend to all dividends payable thereon.

The article may grant a lien on shares which are fully paid in rare circumstances. If the lien given by the articles extends only to shares not fully paid, the company can alter its articles so as to give a lien on all shares even if any one member will be affected by the alteration.

A shareholder against whom a lien is to be enforced, can compel the company to assign its lien to his nominee who is willing to pay off the amount of the lien.

A lien is enforced like other equitable charges, by a seal. If the power is not conferred by the articles, the company must apply to the court for an order. Additionally, the article may give the company power to nominate a person to execute the transfer as embodied in article 13 of Table A

If a third party advances money on the security of shares, question has arisen as to whether the third party"s lien has priority over the company"s. If the third party gives notice of his security to the company before the company"s lien arises, the third party has priority. It was so held in **Bradford Banking Company V. Brigg & Co. 1886.** The articles of the company gave a first and paramount lien and change on the shares for debts due from a shareholder. A shareholder, created an equitable mortgage of its shares by depositing the share certificate with a bank as security for an overdraft and the bank gave notice of the deposit to the company. The shareholder subsequently became indebted to the company whereupon a lien arose in favour of the company. Issue was which lien had priority. It was held that the bank had priority as the company"s lien arose after of the Banks equitable mortgage.

QUESTION EIGHT

A call is a demand by directors pursuant to a resolution of the board to shareholders with amounts outstanding on their shares to pay the whole or any part of the balance. Calls are necessary if the company"s issued capital is not fully paid up.

Rules Relating to Making of Calls

1. Calls are necessary if company"s issued capital is not fully paid up
2. A call may be made during the life of a company or by the liquidator in the course of winding up. Under Article 15 of Table A, directors may from time to time make calls upon the members in respect of any monies unpaid on their shares.
3. Under Table A, a call must not exceed a quarter of the nominal value of the shares or be payable in less than one month from the date of the preceding call
4. A shareholder is entitled to at least a 14 day notice to make good the call
5. Under article 16 of Table A, a call is deemed to have been made when the resolution of the board authorizing it is passed.
6. A call may be postponed or revoked in accordance with the wishes of the directors.
7. Under article 17 of table A, joint holders of a share are jointly and severally liable to pay all calls
8. The liability of a call creates a debt due to the company enforceable by the company or the liquidator in the course of winding up.
9. If a shareholder fails to pay a cal or installment thereof, his shares are liable to be forfeited

Payment of Calla in Advance

If authorized by its articles a company may accept payment from a member of the whole or part of the amount remaining unpaid on his shares though the same has not been called up.

Under Article 21 of table A, "directors" may receive from any member will to advance thesame or any part of the monies uncalled and unpaid upon his shares.

Payment of calls in advance has certain legal consequences:

1. The shareholders liability to the company is extinguished or reduced as the case may be
2. The shareholders becomes a creditor to the company to the extend of the advance
3. The company cannot be compelled to repay the payment
4. The company cannot repay without the consent of the shareholder.

REVISION PAPER TWO

QUESTION ONE

Under section 154(1) of the companies Act, A company is a subsidiary of another is either:

(i) The holding company is a member of it and controls the composition of its board of directors.

(ii) The holding company holds more than half in nominal value of the subsidiaries equity share capital.

(iii) The subsidiary is a subsidiary of another company which is a subsidiary of the holding company.

- It is important to ascertain whether a company is a subsidiary of another since the relationship is regulated by specific provisions of the companies Act.

(a) Under section 29 of Act, a body corporate cannot be a member of its holding company and any allotment or transfer of shares of a company to its subsidiary is void.

(b) Under section 150(1) of the Act, if at the end of the financial year a company has subsidiaries, directors of the company must lay group accounts of the company and its subsidiaries before the general meeting of the company

(c) Under section 161(3) of the Act, a person disqualified for appointment as auditor for the holding company is likewise disqualified for the appointment as auditor for the subsidiary and vice versa.

(d) Under section 167 of the Act, an inspector appointed by the court to investigate the affairs of the holding or subsidiary and company is empowered to investigate the affairs of the other company if such investigation is necessary.

(e) Under section 191(1) of the Act, as a general rule it is unlawful for a company to make a loan to any person who is its director or a director of the holding company.

(f) Under section 201 of the Act, a company with subsidiaries must keep a register of its directors and secretary and those of its subsidiaries.

- Under section 154(4) of the Act, a company shall be deemed to be another"s holding company if, but only if, that other is its subsidiary

QUESTION TWO

(a) Transfer of shares is the voluntary conveyance of title in shares by a party to another. Ownership changes hands at the option of the parties.

- Under section 75 of the Act, the shares or other interest of any members in a company shall be movable property transferable in manner provided by the article of the company.

Procedure of Transfer of Shares:

Total Transfer;

(i) Both parties must execute the proper instrument of transfer.

(ii) The executed instrument of transfer must be presented for stamping i.e. payment of duty.

(iii) The stamped instrument of transfer and the share certificate must be presented to the company for registration of the transfer.

(iv) Upon registration of the transfer, the share certificate is cancelled and a new one issued in the name of the transferee.

Partial transfer;

(i) Both parties must execute the proper instrument of transfer.

(ii) The executed instrument of transfer and the share certificate must be presented to the company for certification of the transfer. The share certificate is retained by the company for cancellation.

(iii) The share certified instrument of transfer must be presented for stamping.

(iv) The stamped instrument of transfer must be presented to the company for registration.

(v) Upon registration of the transfer the share certificate is cancelled and two others issued. One in the name of the transferor for the shares retained and the other in the name of the transferee of the shares acquired.

- A contract of transfer is a contract of sale whereby the transferor agrees to sell and the transferee agrees to buy the shares.

Though the obligations of the contract may be embodied in the contract itself, the law implies certain terms in the contract;

1. That the transferee will pay the price.

2. That the transferee will hand over a genuine instrument of transfer and the share certificate.

3. That the share certificate carries the rights and interests which it purports to convey.

4. That the transferor will do nothing to prevent the transferee from having the transfer registered or delay the process.

5. That the transferee will indemnify the transferor all calls or any liability arising in respect of the shares after the transfer.

(b) A company may deny title in shares evidence by a share certificate in two circumstances:

1) If the third party had notice of the falsity of the representation.

2) The representation relied upon was contained in a forged share certificate since such a document is a legal nullity as was held Ruben V. Great Fingall Consolidate The transferee does not acquire tithe in the shares.

QUESTION THREE

(a) Constitutive documents are documents which must be prepared by a company to be formed.

They are the basic documents for preparing formation of a company.

Constitutive documents include:

(1) Memorandum of Association;

Under section 2(1) of the Act, memorandum means memorandum of association of a company as originally formed or as altered from time to time. I must be prepared by the company to be formed. It is the external constitution of the company. It regulates the relations between the company and third parties. Its contents include;

1. Name.
2. Registered office (Domicil)
3. Objects
4. Liability
5. Capital
6. Association/ declaration
7. Particulars of subscribers
8. Date

(2) Article of Association;

Under section of the companies Act, articles means articles of association of a company as originally framed or as altered by special resolution including so far as they apply to the company the regulations contained in Table A. It is the internal constitution of the company contained the rules of internal management. It regulates the relations between the company and its members. If a company adopts Table A, as its articles,
Its contents include:

Calls	Winding up
Lien on shares	Dividend
Forfeiture of shares	Bonus shares
Transfer and transmission of shares	Convention and conduct of meetings
Office of managing director	Borrowing
Accounts.	Division of powers between general meeting and board

(3) Statement of Nominal Capital;

This document is a requirement of the stamp duty Act cap 490. It contains the name of the company and the capital with which the company proposes to be registered. It facilitates assessment and payment of duty for purposes of incorporation.

(4) Declaration of compliance;

Under section 17(2) of the companies Act, this is a statutory declaration either by the Advocate engaged in formation of the company or by a person named by the article as director or secretary to the effect that the subscribers to the memorandum have complied with the company. It is sworn evidence of compliance with the provisions of the Act.

(b) A director appointed to office in accordance with the articles remains in office as long as the article remain uncharged. If altered by the company in exercise of its

statutory power, in such a way in which a director loses office, he has no actionable claim against the company.

In Shuttleworth V. Cox Brothers & Co. Ltd. The article of the defendant company incorporated in 1926 provided that the plaintiff and four others would be appointed directors of the company and hold office permanently unless removed on certain specified grounds. The plaintiff had on several occasions (22) refused to account to the company monies received on its behalf. Members in general meeting resolved to ad to the articles another ground for disqualification of the director. A director had to resign office if a written request requiring him to do so was served upon him by board members. 10 – 11 months later, a written request was served upon the plaintiff who filed an action challenging the validity of the new article. He sought a declaration that he was still a director of the company. It was held that the alteration was valid and the plaintiff had ceased to hold office as director of the company.

In the words of Atkin L. J., " It is a contract made upon the terms of an alterable article, and therefore neither of the contracting articles can complain if the article is altered. Consequently, I cannot find that there has been any breach of contract making the alteration". Therefore, Maina has no actionable claim against the company.

QUESTION FOUR

The nature of contract created by section 22(1) of the companies Act in relation to the articles has certain special characteristics.

The rights conferred by the contract can only be enforced by members in their capacity as members.

In the words of the Judge," No right merely purporting to be conferred by the articles to aperson in a capacity other than that of a member e.g. director, promoter can be enforced against the company".

In Eley V. Govt life Assurance Co Ltd. the articles of the defendant company provided that Mr. Eley be employed as company solicitor to transfer all the company"s legal business at a fee. He could only be removed from office for misconduct.

After incorporation, Eley was appointed solicitor and transacted the company"s legal business for some time. He then bought shares and became a member of the company. After some time the company ceased to employ him preferring other solicitors. He sued the company to enforce the contract contained in the articles. It was held that the article was unenforceable since Eley was an outsider.

Though he was a member, he was suing to enjoy rights accruing to him in a capacity other than of a member.

A similar holding was made in Beattie V. Beattie Ltd (1938) where it was held that the article in question would not be given effect since it referred to director in their capacity as directors.

In Rayfields V. Hands (1960) article ii of the articles provided that any member wishing to transfer shares had to inform the directors who were to take up the shares equally between them at a fair value. Rayfields who held 725 shares informed the director of his intention to transfer the shares. The directors who were also members refused to take up the shares. Rayfields sued to enforce article ii. It was held that the article was enforceable since it referred to the category of directors who are members of the company. In the words of Vaise J.

"In my judgement the relationship here is between the plaintiff as a members and the defendants not as directors but as members"

In the case of Kamau, it would depend with whether the directors are members of the company, in which case he would succeed in an action against them.

QUESTION FIVE

Under section 112(1) of the Act, every company must keep a register of its members. Under section 112(2), the register must be kept at the registered office of the company. However;

1. If the work of making it up is being done in some other office of the company, it may be kept in that office.
2. If the company has engaged some other person to make up the register it may be kept in such person"s office but must not be kept outside Kenya.

- The register must be notified of the location or any change thereof within 14 days of incorporation or change thereof failing which the company and every offices in default are liable to a default fine

Index of members

Under section 113(1) of the Act, every company with more than 50 members, must have an index of the names of the members unless the register is in the form of an index. The register may be in the form of a card and must contain sufficient indication to facilitate access to a members account in the register. The index must be kept at the same place as the register. Changes on the register must be effected on the index within 14 days thereof. Failure to keep an index renders the company and every office in default liable to a default fine.

Contents of the Register;

1. Name of every shareholder
2. Postal address
3. Number of shares or stocks held
4. Date of entity of the name in the register
5. Date of cessation of membership

- Under section 114(1) if a company issues a share warrant, the members name is struck off the register and the following particulars entered.

1. Fact of issue of the warrant
2. Date of issue
3. A statement of the shares included in the warrant

Closure of the Register;

Under section 117 of the Act, a company may be a notice in some newspaper circulating in Kenya or in that part of Kenya in which the registered office is situate close the register of members for any time or times not exceed 30 days in a year.

Inspection of the Register and Index:

Under section 115(1) of the Act, the register and index kept at registered office must be open for inspection by members without charge for at least 2 hours every business day subject to reasonable restrictions as may be imposed by the general meeting. Other persons may pay the requisite fee. Members and others are free to apply for copies of the register and the same must be furnished within 14 days of the request subject to payment of the requisite charges.

It is a criminal offence for a company to deny any person the right to inspect the register or refuse to furnish copies on request. The High court is empowered to compel a company to facilitate immediate inspection of the register or to furnish copies as requested.

Legal Status of the Register:

Under section 120 of the Act, the register of members is prima facie evidence of the matters there in stated.

Rectification of the Register:

Under section 118(1) of the Act, the High court has jurisdiction to order rectification of the register of members in the following circumstances;

1. If a person"s name is without reasonable cause entered in the register
2. If a members name is without reasonable cause omitted on the register.
3. If there is default or unnecessary delay in removing a persons name from the register.

The application for rectification may be made by:

1. The company
2. Any member of the company
3. The aggrieved party

Upon such application, the court may:

1. Order rectification of the register and damages to the aggrieved party.
2. Refuse to order rectification
   The court has jurisdiction to determine the question of ownership of the shares in question.
3. If rectification is ordered, a copy of the order, must be delivered to the registrar if the court so directs

Branch register:

Under section 121(1) of the companies Act, a company may if authorized by its articles keep a branch register in some part of the commonwealth in Kenya. The registrar must be notified of its opening, change of location or discontinuation within 1 Month of the same failing which the company and every officer in default are liable to default fine. A branch register is deemed to be part of the principle register. A duplicate of such register must be kept at the company"s registered office. A copy of every entry in the branch register must be transmitted to the registered office as soon as it"s made. To close a branch register, notice must be advertised in some newspaper circulating in that part of the country in which the branch register is situate. The branch register must be kept in the same manner as the principle register. A company may discontinue a branch register or transfer all entries to the principle register. If a company has no power t keep a branch register it may alter the articles to give itself such power. A transfer of shares registered in a branch register does not attract stamp duty Payable in Kenya unless it is executed in Kenya.

QUESTION SIX

The company Act does not define the term liquidator nor his qualifications. However, a body corporate cannot be appointed liquidator. A liquidator is a person appointed for the purpose of collecting and realizing the company"s assets, ascertaining and making good liabilities and distributing the remainder if any to members.

Appointment

1. In a compulsory winding up, he is appointed by the court on application failing which the official receiver becomes the liquidator
2. In a members voluntary winding up he is appointed by the members
3. In a creditors voluntary winding up, he may be appointed by the members or by the creditors or both members and creditors or by the court.

In a winding up subject to the supervision of the court, he may be appointed:

1. By members
2. Creditors
3. Both members and Creditors
4. By the court

The appointment of a liquidator must be published in the Kenya Gazette

A liquidator other than the official receiver is bound to:

1. Furnish the official receiver with any information which he may require
2. Deliver to the official receiver any books or documents as the official receiver may specify.

Legal Position of the Liquidator

Its exact legal position is difficult to define. However, if appointed by the court he is an officer of the court and is answerable to it. He must act honestly and impartially

Liquidator as an Agent

He acts as an agent on behalf of the company hence the company is generally liable as principle. In Knowles V. Scott Romer J. observed. "I think any rate, agency more nearly defines his true position than trusteeship".

In Stead Hosel V. Cooper Lawrence J. observed, "A liquidator is the agent of the company".

Liquidator as Trustee

The liquidator is a trustee for the general body of creditors. He is not a trustee for individual creditors or contributories. In the words of Romer J. in Knowles V. Scott, In my judgement, the liquidator is not a trustee in the strict sense….no doubt in a sense and for certain purposes, a liquidator may fairly enough be described as a trustee".

The duties of a liquidator are equitable in character and he may be regarded as a fiduciary of the company

Duties or obligations of the liquidator

1. He must act in good faith for the of the company
2. He is bound to exercise powers for the proper purposes
3. He must exercise unfettered discretion
4. He is bound to avoid conflict of interest
5. He must act impartially and honestly
6. He must exercise his discretion personally unless appointed with others
7. He must demonstrate a degree of care and skill appropriate to the circumstances
8. He must secure control of the company"s assets.
9. It is his duty to ascertain and pay the company"s debts

10. He must keep proper books of accounts
11. He must ensure that minutes of proceedings of meetings are kept.
12. He must pay monies received by him to a separate account for the credit of the company"s winding up.

QUESTION SEVEN

(i) Restrictions on appointment of directors:

1. Number of directors: The Companies Act fixes the minimum number of directors a company may have. Under Section 177, the maximum number is fixed by the articles.

2. Consent: Under Section 182(1), a person appointed director, must deliver to the registrar for registration his written consent to act as such. The consent must be signed by the director in person or by his duly authorized agent.

3. Share qualification: Under Article 77 of Table A the articles, may prescribe the minimum number of shares a person must hold to quality for appointment as director. If the articles so require, persons named as directors, must hold this number of shares. However, a person is deemed to have acquired the shares if:

   He has signed the memorandum for a number of shares not less than his qualification.
   He has taken up and paid or agreed to pay for his share qualification.
   He has delivered to the registrar for registration a written undertaking to take and pay for his share qualification, or
   He has delivered to the registrar for registration a statutory declaration to the effect that a number of shares not less than his qualification are already registered in his name.

   Under Section 183(1), the share qualification must be taken up within 2 months of appointment or shorter time as may be fixed by the articles failing which the appointee ceases to be a director.

4. Age: Under Section 186(1) of the Act, a person is not capable of being appointed name or proposed director unless he has attained the age of 21 and has not attained the age of 70. It is the duty of persons proposed as directors to disclose their age to the company. A director who attains the age of 70 while in office, retires at the conclusion of the next AGM. However, such a director may be reappointed if he offers himself provided a special notice of the resolution to reappoint him has been given to the members.

5. Soundness of mind: To qualify for appointment as director a person must be of sound mind. Under Article 88 of Table A, the office of director must be vacated if a director becomes of unsound mind.

6. Disqualification by the court: Under Section 189(1), the High Court is empowered to disqualify a person from being directly or indirectly involved in the management of comparing affairs for a duration not exceeding 5 years, if the person:

   (i) Is convicted for an offence relating to the promotion, formation or management of the company.

(ii) Is in the course of winding up found guilty of an offence of being involved in carrying on the company"s business for any fraudulent purpose or with intent to defraud its creditors or creditors of any other person.

(iii) Is in the course of winding up found guilty of fraud as an officer of the company or in breach of duty to the company. If a disqualified person is appointed director, he is liable to a fine not exceeding Sh.10,000 or imprisonment for a term not exceeding 2 years or both.

7. Undischarged Bankrupt or Insolvent Persons:

Under Section 188 of the Act, a person declared bankrupt or insolvent by a court of law is not qualified for appointment as director without leave of the court. If such a person is directly or indirectly involved in company management, he is liable to a fine not exceeding Sh.10,000 or imprisonment for a term not exceeding 2 years or both.

(ii) Disqualification of Directors:

Under Article 88 of Table A, the office of director shall be ……. if the director:

(i) Fails to acquire his share qualification within the stipulated time.
(ii) Attains the age of 70.
(iii) Is declared bankrupt or enters into an arrangement with his creditors to compound his debt.
(iv) Is disqualified from holding office by a court order made pursuant to Section 189 of the Act.
(v) Becomes of unsound mind.
(vi) Resigns office by a written notice to the company.
(vii) Absents himself from directors meetings held in over 6 months.
(viii) Is removed from office by an ordinary resolution of members in general meeting.
(ix) Making up of a winding up order.

(iii) Removal of Directors:

Under Section 185(1) of the Act, a company may by ordinary resolution remove a director from office before expiration of his period of office not withstanding anything in the articles or in any agreement between the company and the director. The Companies Act prescribes the circumstances in which a director may be removed from office:

4. Notice of the intended resolution to remove a director from office must be delivered to the company.

5. Upon receipt of the notice, the company must send a copy thereof to the director who is entitled to make written representations as his defence. The director may request the company to notify its members that he has made representations.

6. The company must convene an extra-ordinary general meeting of the members. A special notice of the intended resolution must be sent to all members. The notice of the meeting must state that the director has made representations, if any, and copies must be enclosed unless received too late by the company. If they are not enclosed by reason of lateness or

default by the company the director is entitled to have them reach out a the meeting. However, copies of the directors representations need not be sent to members or read out at the meeting if upon application by the company, or any other aggrieved person, the court is satisfied that the director is abusing his right to be heard to secure needless publicity for defamatory matter.

4. The removal of a director from office takes effect when the meeting by ordinary resolution so resolves.

QUESTION EIGHT

The doctrine of ultra vires in relation to Companies is often confused with abuse of power by directors hence the distinction between ultra vires in the narrow and wider sense. This distinction was formulated by the High Court in Rolled Steel Products Holdings Ltd v. British Steel Corporation and others (1986). However, the distinction was disqualified by the court of appeal.

Ultravires in the Narrow sense:

This is the common law doctrine of ultravires in company law. This is a rule of capacity defined by the objects clause of the company. At common law, a company"s capacity is restricted to transactions expressed in the objects and those that are reasonably incidental to the attainment or pursuit of such objects. It was so held in Ashbury"s V. Attorney Generals
Case. Transactions beyond the powers of a company are ultravires since the company has no capacity to enter into them. Whether a transaction is ultra vires or not, is a question of interpretation of the object clause.
An ultra vires transaction is void and unenforceable and nothing can be done to render it intra vires the company.

Ultra vires in the Wider sense:

This is nothing but an abuse of power of the company by its offices often described as „Excesses of Directors" or „Transactions ultra vires" the directors e.g borrowing for a purpose outside the objects of the company. Such a transaction is intra vires the company and may be ratified by members in the general meeting where upon it becomes an enforceable transaction as was the case in Bamford V. Bamford.

However, a transaction ultra vires in the wider sense is voidable at the opinion of the company i.e. the company may escape liability by avoiding it. However, such a transaction may be enforceable. It is enforceable if the other party to the transaction was unaware of the abuse of power as was the case in re David Pyne & Co. Ltd (1904). The defendant company had a general power to borrow. It borrowed £6250 from the plaintiff company but for a purpose outside its objects. The lending company was unaware of the purpose for which the money was intended. In an action to enforce the borrowing, it was held that the transaction was unenforceable since the bider was unaware of the abuse of power. Buckley J. observes, „A corporation cannot do anything except for the purposes of its business, borrowing or anything else, anything else beyond its powers is ultra vires … if you find apower to borrow, which would arise only to the happening of a particular event, then think it would lie upon the lender to say, „I cannot lend to you until you can satisfy me that the condition has been complied with, but where the power is merely a general power to borrow limited only as it must be for the purposes of the company"s business … I think the matter is to be treated in this way, that the lender cannot investigate what the borrower is going to do with the money".

However, such a transaction is unenforceable if the other party is aware of the abuse of power as was the case in re Introductions Ltd. A company was formed in Britain to

accommodate and entertain visitors. It did so for 3 years after which it engaged in the business of pig breeding. It borrowed from the plaintiff bank to promote the pig breeding business which was not among its objects. The bank had a copy of the company's memorandum of association. In an action to enforce the borrowing, it was held that the transaction was unenforceable since the lending bank was aware of the abuse of power. The court of appeal observed "The borrowing was not for a legitimate purpose of the company, the Bank knew it and therefore cannot rely on its debentures".

REVISION PAPER THREE

QUESTION ONE

This is the organic theory or identification theory.
This is a principle of company law which attempts to connect the living to the non-living.

This principle attributes to the company the mind and will of the natural persons who manage and control its affairs. Under the doctrine, the thoughts and deeds of the responsible officers of the company are deemed to be the though and deeds of the company. The company thinks and acts through them.

Under this theory, the knowledge of the responsible officers of the company is deemed to be the company"s knowledge. It was so held in **Lennards Carrying Company Ltd v.Ascatic Petroleum Co.** where under the Merchants Shipping Act a ship owner was onlyliable for loss in certain circumstances. He let the ship set sail. As a consequence, there was an explosion and the ship and its cargo were lost.

Held: The company was liable for the loss since it was aware of the faulty boilers. Themanaging directors knowledge was imputed to the company. In the words of Haldane L.J

„A corporation is an abstraction. It has no mind of its own any more than it has a body of its own. Its acting and directing will most consequently be sought in the person of somebody who for some purpose, may be called an agent but who is actually the directing mind and will of the corporation".

Under the organic theory, the thoughts of the responsible officers are deemed to be the thoughts of the company. Their mind is the company"s state of mind and their intention is that of the company.

In **Bolton Engineering Co. v. Graham & Sons** a company owned rental premises. The tenant was entitled to a renewal of the tenancy unless the company intended to occupy the premises. Directors of the company had thought of the company occupying its premises but had not resolved in board meetings. The company refused to renew the lease and was sued. It was held that the company was not liable since it had manifested its intention to occupy the premises. The thoughts of the directors were imputed to the company. In the words of Lord Benning, "a company may in many ways be likened to a human body. It has a brain and a nerve center which controls what it does. It also has hands which hold the tools. Some of the people in the company are mere servants and agents who are nothing more than mere hands to do the work. Others are directors and control what it does. The state of mind of these managers is the state of mind of the company and is treated by law as such".

If the responsible officers of the company delegate powers to junior officers, the company thinks and acts through the delegate. However, under the organic theory, the thoughts and deeds of junior officers of the company, are not deemed to be those of the company. It was so held in **Tesco Supermarkets v. Natrass Ltd** where it was held that the manager of a supermarket was not a responsible officer for purposes of the organic theory hence his acts would not be imputed to the company.

QUESTION TWO

(a) A quorum is the minimum number of persons who must be present for a company meeting to transact business. The number is ordinarily fixed by the articles failing which Section134(c) applies, where:

i) Two members present in person constitute quorum for a private company meeting.
ii) Three members present in person constitute quorum for a public company meeting.

It is the duty of the chairman to determine whether a quorum of members is present. This must be done within 30 minutes of the appointed time. If a quorum is not present, the meeting, if convened by directors stands adjourned to the following week, same day, time and place. But if convened by requisitionists, it stands dissolved.

Under Article 53 of Table A, no business shall be transacted at any general meeting unless a quorum of members is present at the time the meeting proceeds to business. Quorum is only essential at the commencement of the meeting. A fall in the number of members present after the meeting has commenced has no effect.

In determining whether a quorum is present, persons not entitled to attend are not counted.

A meeting with no quorum is invalid and any purported proceedings are void.

(b) One person may constitute a meeting in the following circumstances:

(i) Directors meeting:
If a private company has one director pursuant to Section 177 of the Act, that director constitutes a valid board meeting for purposes of the exercise of the powers conferred upon the board by the articles.

(ii) Class meeting
If a company"s capital has been divided into different classes of ` shares,e.g. ordinary, preference, deferred, employee etc and all the shares of a particular class are held by 1 member, that member constitutes a meeting of the holders of the class of shares. It was held in **East v Bannet Brothers.**

(iii) Adjourned meeting
This is a continuation of an earlier meeting. Under Article 54 of Table A, if a meeting convened by directors has no quorum within 30 minutes of the appointed time, it stands adjourned to the following week, same day, time and place unless the directors otherwise decide.

Such a meeting is duly constituted by one member present in person or by proxy.

(iv) Creditors meeting:
If in the course of winding up, only one creditor has proved his debt in accordance with Section 307 of the Act, such a creditor constitutes a creditors meeting for purposes of winding up.

(v) Annual general meeting convened by/at the instance of the registrar; under Section 131(2) of the act, if a company fails to hold an AGM in accordance with the provisions of Section 131(1) of the Act, any member may petition the registrar to call or direct the convention of an AGM. Such an AGM is duly constituted by 1 member present in person or by proxy.

(vi) Meeting convened pursuant to a court order:
Under Section 135(1) of the act, if for any reason, it is impracticable to call a meeting of the company in the ordinary manner, or to conduct a meeting in the manner prescribed by the articles and the Companies Act, the court may either on its own motion or upon application by a director or any member order the convention or conduct of a meeting. A meeting convened pursuant to such an order in duly constituted by 1 member present in person or by proxy.

QUESTION THREE

1. **Companies with share capital**

Under section 125(1) of the Act, every company with a share capital must at least once every year, make a return to the registrar with respect to:

- The registered office of the company
- Registrar of members
- Registrar of debenture holders
- Registrar of shares and debentures
- The indebtness of the company
- Past and present members of the company
- Matters specified in Part I of the 5th schedule of summary of the shares.

2. **Companies with no share capital:**

Under Section 126(1) of the Act, every company without a share capital must at least once every calendar year make a return to the registrar stating:

- The situation and postal address of the registered office
- The situation and postal address of:
    - The registrar of members;
    - The registrar of debenture holders if not kept in the registered office
    - Particular of directors and the secretary
    - A statement of total indebtedness of the company.

Annextures to the Annual returns:

Under Section 128(1) of the Companies Act, the following documents must be annexed to the annual return.

- A copy of the balance sheet laid before the company in general meeting with its annextures.
- A copy of the directors report
- A copy of the auditors report

These copies must be certified by a director and the secretary to be true copies of the original and if any of the documents is in a foreign language, a certified translation in English must be annexed. Failure to file returns renders the company and every officer in default liable to a fine not exceeding Sh.1000.

Time of making the annual return:

Under Section 127 of the Act, annual returns must be completed and delivered to the registrar within 42 days after the AGM for the year.

The copy delivered to the registrar must be signed by a director and the co. secretary failing which the company and every officer in default are liable to a default fine.

Annual return of private companies

Under Section 129 of the Act, the annual return of a private company must be accompanied by a certificate of a director and the secretary to the effect that the company has not from the date of incorporation invited the public to subscribe for its shares or debentures.

If a private company has more than 50 members, a director and the secretary must certify that the excess members are or have been employees of the company.

Note that:

If a company has issued share warrants, its annual return must contain the following additional information:

No. of shares comprising a warrant;
Number of shares in respect of which warrants are outstanding;
Total number of warrants issued and surrendered to the company.

QUESTION FOUR

General meetings are ordinarily conducted by the chairman of the board. If unavailable or unwilling, one director must act as chairman. If none is available or willing, a member must be elected as chairman. Under Table A, a company meeting must have a chairman within 15 minutes of the appointed time. The powers and functions of the chairman, resemble those of a chairman of other assembling bodies.

In **National Dwelling Society v. Sykes (1894)** after a resolution proposed by the chairman was defeated, he declared the meeting dissolved and left the venue with a few members. The other shareholders elected another chairman and proceeded with the agenda of the meeting. The other chairman and his supporters refused to recognize the validity of the decisions arrived at. However, it was held that the decisions were valid since the chairman had no power to declare the meeting dissolved as he had done. In the words of Chitly J, "It is the duty of the chairman and his function to preserve order and to take care that the proceedings are conducted in a proper manner and the sense of the meeting is properly ascertained with regard to any question which is properly before the meetings:.

Powers and duties of the chairman

Functions/Duties:

1. To determine that the meeting is properly constituted;
2. To determine whether a quorum is present.
3. To inform himself the objects and business of the meeting.
4. To preserve order in the conduct of those present at the meeting.
5. To confine discussion within the scope of the meeting and reasonable limits of time.
6. To determine whether proposed motions and amendments are in order.
7. To formulate for discussion and decision questions moved for consideration of the meeting.
8. To ascertain and ensure that the sense of the meeting is kept by putting relevant questions to the meeting.
9. To make decisions on points of order and other incidental questions and his decisions are prima facie correct.
10. To ensure that minutes of the meeting are kept.

Power of the chairman:

1. To call the meeting to order
2. To determine who to speak and for how long.
3. To adjourn the meeting with consent of members.
4. To close discussion on an issue after reasonable debate.
5. To demand voting by poll.
6. To declare results of any vote by show of hands or by poll.
7. To make decisions on points of order.

8. To close the meeting.
9. To vote again or have a casting vote in the case of a tie.

If the chairman is obstructive, incompetent or partial, he may be removed by a resolution sponsored at the meeting and another person elected chairman.

QUESTION FIVE

The indoor management rule which is also called the rule in Turquands case, is concerned with the liability of a company for acts of its officers.

This rule answers two questions:

(i) Can a company escape liability of pleading an internal irregularity?
(ii) Are third parties who deal with the company bound to satisfy themselves that the rules of internal management have been complied with.

These questions are answered in the negative in **Royal British Bank V. Turquand (1856).** The articles of the company provided that the directors could borrow on board such monies as were authorized by an ordinary resolution of member in general meeting. Directors of the company borrowed from the plaintiff bank without any resolution. In liquidation, the bank sought to recover the amount from the liquidator who denied liability on the ground that the borrowing was irregular. However, it was held that the company was liable. The court formulated the so called indoor management rule that a person who contracts and deals with a company in good faith is entitled to assume that it is acting within its constitutional powers. He is entitled to assume that officers of the company who are held out by the company as particular sort of officers, are the officers of the company concerned.

In **Mahony V. East Holyford Mining Company Lord**Hatherby says, "when there are persons conducting the affairs of the company in a manner which appears to be perfectly in consonance with the articles of association, then those dealing with them externally are not to be affected by any irregularities which may take place in the internal management of the company".

In **Freeman and Lockyear V. Backhurst Park Properties (Freemans case),** the company"s articles created the position of managing director. At the material time, none had been appointed. However, one director with knowledge of the others purported to act as managing director. He engage the plaintiff, a firm of architects to work for the company. The plaintiff was not paid for the services rendered and sued the company. The company denied liability on the ground that the director was not its managing director and hence had no authority to bind. It was held that the company was liable since it represented this director as its managing director who therefore had apparent authority to bind it.

The indoor management rule protects third parties against the company in case of internal irregularities. It is justified on two grounds:

(i) It is fair to third parties to prevent the company from denying liability by relying on an internal irregularity.

(ii) It facilitates commercial transactions in that third parties are not bound to inquire whether the rules of internal management have been complied with.

However, the indoor management rule does not protect the third party in certain circumstances and the company may escape liability. These are:

The exceptions to the rule in Turquands case:

1. Public documents of the company:
   If the defect or irregularity would have been ascertained by an inspection, of the company"s public documents which the third party did not do, he is not protected by the rule. It was so held in **Irvine V. Union Bank of Australia.** This is because, the public documents are registerable and open for inspection e.g. special resolutions.

2. Knowledge of the irregularity:
   If the third party is aware of the irregularity or lack of authority, on the part of the officer dealt with, he is not deemed to be acting in good faith and cannot rely on the indoor management rule. It was so held in **B. Liggets (Liverpool) Ltd. V.Barclays Bank Ltd.** where the defendant was aware of the irregularity.

3. Suspicion:
   If circumstances are such that, they put the third party on inquiry, but the party does not inquire to ascertain the true position, he is not protected by the rule as a reasonable third party would have inquired. It was so held in **B. Liggets (Liverpool) Ltd. V Barclays Bank Ltd.**

4. Abuse of power by an officer:
   If the officer dealt with by the third party purports to exercise powers not ordinarily exercised by that sort of officer, and the third party does not inquire, it cannot rely on the indoor management rule.

5. Forged Documents
   The indoor management rule cannot protect a third party or hold the company if the document relied upon is a forgery. As such a document is a legal nullity as was held in **Ruben V. Great Fingall Consolidated.**

6. Insiders
   As a general rule, the indoor management rule cannot be relied upon by an insider. These are persons who by virtue of their position in the company, are in a position to know whether the internal regulations have been complied with e.g. directors. It was so held in **Howard V. Patent Ivory Manufacturing Co. Ltd** where the 3rd parties in question were directors. It was held that they were deemed to know of the irregularities and would not rely on the indoor management rule.
   Question has arisen as to whether directors are insiders in all cases for purposes of the indoor management rule.

   It has been observed that they are not always insiders. It all depends on the nature or character of the transaction.
   If it is so closely interwoven with the position of the director as a director of the company, he is deemed to know the circumstances affecting it and therefore deemed to be an insider. If it is not closely intertwined with his position as director, he may rely on the indoor management rule.

QUESTION SIX

The affairs of the company may be investigated by the registrar or an inspector(s) appointed by the registrar or by the court.

1. **Investigation by the Registrar:**
   The affairs of a company may be investigated by the registrar in the following circumstances:

(a) Non-compliance with the provisions of the Act:
Under Section 164(1) of the Act, if the registrar has reasonable cause to believe that the provisions of the Act are not being complied with, he may investigate the company"s affairs.

(b) Incomplete documents:
Under Section 164(1) of the Act, if on perusal of a document, submitted to him, in accordance with the provisions of the Act, the registrar is of the opinion that it does not disclose a full and fair statement of the matters it relates to.

In both cases the investigation is initiated by a written order calling upon the company to produce the books or to furnish information or explanation as the order may specify. The same must be produced or furnished within the duration prescribed by the order. It is the duty of the officers of the company to produce the books or furnish information or explanation. If after examining the books, and considering the information, and explanation and unsatisfactory state of affairs is disclosed, the registrar must make a written report to the court.

(c) Investigation of ownership of shares and debentures:
Under Section 174(1), if there is good, the registrar is empowered to investigate the ownership of shares or debentures of a company by requiring persons who may have been interested in the securities or who have acted as agents or advocates for interested parties, to provide information in relation to them as they reasonably can. Failure to provide such information renders, the person in default liable to imprisonment for a term not exceeding 6 months or a fine not exceeding Sh.10,000 or both.

(II) **Investigation by an inspector appointed by the registrar:**
Under section 173(1) of the Act, if there is good reason, the registrar is empowered to appoint one or more competent inspectors to investigate and report on the membership of a company for purposes of determining the two persons who:

(a) Are or have been financially interested in the success or failure of the company
(b) Control the company
(c) Materially influence the policy of the company.

The registrar is empowered to define the scope of the investigation. The registrar may appoint an inspector or inspectors under this section upon application by members.

(III) **Investigation by Inspector(s) appointed by the court:**
The High Court may appoint an inspector or inspectors in the following circumstances:

(i) Application by members:
Under Section 165(1) of the Act, the High Court may appoint an inspector(s) to investigate a company"s affairs upon application by members. The application may be made by:

- Not less than 200 members
- Holders of not less than 1/10 of the issued shares
- Not less than 1/5 of the number of members of the company

The application must be supported by sufficient evidence to justify an investigation.

(ii) Special resolution:

Under Section 166(a) of the Act, the High Court must appoint one or more competent inspectors to investigate a company"s affairs if the company has by special resolution resolved that its affairs be so investigated.

(iii) Registrars report:
Under Section 166(b) of the Act, the court may appoint one or more competent inspectors to investigate a company"s affairs if on the basis of the registrar"s report made pursuant to Section 164, it appears to the court that:

It is desirable to do so.
Members have not been given all the information respecting the company"s affairs which they reasonably expect.
Persons concerned with the formation or management of the company have been guilty of fraud, misfeasance or misconduct towards the company or its members.
The company"s business has been conducted:

With intent to defraud its creditors or creditors of any other
person. For a fraudulent purpose
For an unlawful purpose
In a manner oppressive to any part of the members
The company was formed to pursue a fraudulent or unlawful purpose.

QUESTION SEVEN

Courts have interpreted Section 22(1) to mean that when he articles are registered, there comes into being a contract between the company one on one hand and its members on the other. This contract confers rights and imposed obligations on the parties therefore. The company and its members are obliged to observe the provisions of the articles and either party may sue the other for non compliance with the articles. The existence of this contract was first acknowledged in **WeltonV. Saferry (1892)**where Lord Herschell observed, "It isquite true that the articles constitute a contract between each member and the company".

In **Hickman V. Kent (1915)**article 49 of the company"s articles provided that any dispute between a company and any of its members be referred to arbitration. A dispute arose between Mr. Hickman who was a member and the company secretary. Hickman sued the company. The company applied for a stay of the proceedings for the dispute to be referred to arbitration in accordance with the articles. The court granted a stay on the grounds that the articles constituted a contract between the company and its members.

Nature of the Contract:
The contract created by Section 22(1) in relation to the articles has certain special characteristics of which are laid down by Ashbury J in **Hickman V. Kent.**

1. It is a contract between the company and its members only. In the words of the Judge, "no articles can constitute a contract between the company and third persons".

2. The contract confers rights and imposes obligations on the company and its members.

3. The rights conferred by the contract can only be enforced by members in their capacity as members. In the words of the judge, "No right merely purporting to the conferred by the articles to a person in a capacity other than that of a member e.g. director, promoter can be enforced against the company".

In **Eley V. Positive Govt. Life Assurance Co. Ltd.** The articles of the defendant company provided that Mr. Eley be employed as company solicitor to transact all the company"s legal

business at a fee. He could only be removed from office for misconduct. After incorporation, Eley was appointed solicitor and transacted the company"s legal business for some time. He then bought shares and became a member of the company. After some time, the company ceased to employ him preferring other solicitors. It was held that the article was unenforceable since Eley was an outsider. Though he was a member, he was suing to enjoy rights accruing to him in a capacity other than that of a member.

A similar holding was made in **Bealfie V. Bealfie Ltd. (1938)** where it was held that the article in question would not be given effect since it referred to directors in their capacity as directors. In **Rayfields V. Hands (1960)** article 11 of the articles provided that any member wishing to transfer the shares had to inform the directors who were to take up the shares equally between them at a fair value. Rayfields who held 725 share sinformed the directors of his intention to transfer the shares. The directors who were also members refused to take up the shares. Rayfields sued to enforce article 11. It was held that the article was enforceable since it referred to the category of directors who are members of the company.
In the words of Vaisey J., "In my judgement, the relationship here is between the plaintiff as a member and the defendants not as directors but as members.

4. The contract created by the articles must be consistent with the provisions of the memorandum and the Companies act.

5. The terms of the contract created by the articles keep on changing from time to time whenever the company alters the articles in exercise of powers conferred upon it by Section 13(1) of the Act.

Obiter

Courts have observed as a by the way that when the articles are registered another contract comes into existence. The second contract is between members themselves i.e. members interse. In the words of **Starling J in Wood V. Odessa Works Co.,**"The articles of association constitute a contract not merely between the shareholders and the company but between each individual shareholder and every other. Words to that effect were expressed in **Quinn and Axtens Ltd. V. Salmon.** The so called contract is generally unenforceable, amember cannot use another to enforce the articles. However, the contract may be enforced:

(a) By the liquidator in the course of winding up
(b) By a shareholder under the exceptions to the rule in **Foss V. Harbottle (1843).**

QUESTION EIGHT

(a) Loans and other payments to directors:

Under Section 19(1) of the Act, it is generally unlawful for a company to make a loan to its directors or a director of its holding company or enter into any guarantee or provide security in connection with a loan made to such person. However, a company may make a loan to a director or effect a payment in the following circumstances:

- If the company is for the time being private;
- If the lending company is a subsidiary and the director is its holding company
- If the lending company is part of the ordinary business of the company and the same is lent in the ordinary course of such business
- If the funds are necessary to meet expenditure incurred or to be incurred by the director for purposes of the company or to enable him properly perform his duties as an officer of the company.

The funds given to the director under this exception must be authorized by members in general meeting. A payment without such authority renders the directors liable to indemnify the company the amount.

(b) Compensation to directors for loss of office:

Under Section 192(1) of the Act, it is unlawful for a company to make to any director any payment by way of compensation for loss of office or as consideration for or connection with his retirement from office unless:

Particulars of the proposed payment including the amount ahs been disclosed to members of the company.

The payment is approved by the company in general meeting.

Under Section 192(2), a payment made to a director in contravention of this provision is illegal and the director receives the amount in trust for the company.

(c) Appointment of directors:

Under Article 75 of Table A, the number of directors and the first directors is determined in writing by the subscribers to the memorandum or a majority of them failing which the subscribers become the first directors. Directors are appointed by an ordinary resolution of members in general meeting. Under Section 184(1), directors are appointed to office individually. However, two or more directors may be voted in together if a motion to that effect has been agreed to by the meeting without any vote against it.

However, in private companies, directors may be voted in together. A company may by its articles adopt the retirement of directors by rotation. At the 1st AGM, all directors retire from office. However, a retiring director is eligible for re-election. At subsequent AGM"s⅓ of the longest serving directors retire. However, a serving managing director is not subject to retirement by rotation. Under Article 95 of Table A, directors have the power to appoint any person to be a director either to fill a casual vacancy or as an addition to existing directors. Such a director holds office until the conclusion of the next AGM.

REVISION PAPER FOUR

QUESTION ONE

(i) Duties and powers of an inspector appointed by the court:

Duties

- Under Section 169(1) of the Act, once an inspector is appointed by the court, he must enter upon his obligations/duties without undue delay.
- And if required by the terms of the appointment, make an interim report, on the conclusion of the investigation, he must make a final report to the court which must be written or printed if the court so directs. A copy of the report is forwarded to the registrar by the court. It is deemed to be opinion evidence in legal proceedings. The court may direct that the report be printed and published.

Powers:

1. Under Section 167 of the Act, he is empowered to investigate related companies i.e. the holding or subsidiary if such investigation is necessary.

2. To administer oath.

3. To examine officers and agents of the company on oath.

4. To demand the production of books, documents and other information by officers of the company.

5. To apply to the court for persons to give evidence there in for purposes of their investigation.

(ii) Causes of action or proceedings on the inspectors report:

Under Section 170(1), if it appears from the inspectors report, that further action ought to be taken in relation to persons or the company investigated, a copy of the report must be delivered to the Attorney General who may take any of the following actions:

1. Initiate criminal proceedings against any person implicated in the report.
   The Attorney General must be satisfied that there is sufficient evidence to sustain the case. Officers and agents of the company are bound to assist the Attorney General in the prosecution.

2. If the Attorney General is satisfied that proceedings ought to be instituted, in the public interest by the company so as to recover damages in respect of fraud misfeasance or misconduct in relation to the formation or promotion of the company or its management or for the recovery of any property of the company misapplied or retained by a person, the Attorney General may institute the proceedings in the name of the company.

3. If the Attorney General is satisfied that the company ought to be wound up, he may petition for winding up pursuant to Section 219(f) i.e the company be wound up if the court is of the opinion that its just and equitable that the company should be wound up.

(iii) Costs and expenses of investigation:

Under Section 171(1) of the Companies Act, the expenses of and incidental to an investigation by an inspector appointed by the court must in the first instance be made good by the registrar. However, the following persons are liable to repay the registrar:

1. Any person convicted on a prosecution instituted by the Attorney General on the basis of the report.

2. Any person held liable in damages or ordered to restore any property in proceedings instituted on the basis of the report.

3. The body corporate in whose name proceedings are instituted.

4. The body corporate dealt with by the report.

5. Applicants for the investigation if an inspector was appointed pursuant to Section 165(1).

QUESTION TWO

As a general rule, companies ought to be managed in a democratic manner in accordance with the articles and the law. As a general rule, the majority will prevail and courts of law only interfere by exception.

If for example, the decision is arrived at in contravention of the law or articles or in bad faith company law attempts to safeguard minority interest through judicial propositions and statutory provisions.

Minority Protection at Common Law:

Courts of law have not gone far enough to champion minority interest. However, they will interfere with a majority decision in certain circumstances e.g.:

1. If a decision is arrived at in contravention of the articles or law.
2. If the majority decision is made in bad faith.
3. If the majority has exercised its voting power to:

Benefit at the expense of the minority
Expropriate corporate assets etc.

Minority Protection by Statute:

Minority protection has for the most part been realized through statutory provisions. The Companies Act contains numerous provisions which expressly safeguard minority interest:

1. Alteration of the objects clause:

Under Section 8(1) of the Act, a company may by special resolution alter the objects clause of its memorandum. However, the alteration may be objected to by:

(a) Holders of not less than 15% of nominal value of the company"s issued share capital
(b) Holders of not less than 15% of any class of shares of the company.
(c) Not less than 15% of the number of members of a company.

The court may cancel the proposed alteration.

2. Variation of class rights:

Under Section 74(1) of the Act, a company whose share capital has been divided into different classes of shares e.g. ordinary, preference, deferred etc may if authorized by its

articles or memorandum, vary the rights attached to any class of the shares either by a special resolution or written consent of holders of not less than ¾ of that class of shares.

However, holders of not less than 15% may within 30 days of the consent or resolution, apply to the court for the variation to be cancelled.

3. Convention of an AGM in cases of default:

Under Section 13(2) of the Act, if a company fails to hold an AGM, pursuant to Section 131(1), any members of the company may petition the registrar to convene or direct the convention of an AGM. Such an AGM, is duly constituted by 1 member present in person or by proxy.

4. Requisitioning of an Extraordinary General Meeting:

- Under Section 132(1) of the Act, holders of not less than 1/10 of the paid up capital or total voting rights of the company, may requisition an extra-ordinary General Meeting by depositing a requisition with the company.

- If directors do not convene a meeting, within 21 days of the deposit, the requisitionists or not less than 1/12 of them may convene the meeting.

5. Convention of General Meeting:

Under Section 135(1) of the Act, if for any reason, it is impracticable to call a company meeting or conduct a meeting in the manner prescribed by the articles or by the Act, the court may either on its own motion or upon application, by a director or a member entitled to attend and vote, direct convention or conduct of a meeting in accordance with the Act or Articles. Such a meeting is duly constituted by 1 member present in person or by proxy.

6. Investigation of company affairs by inspectors:

Under Section 165(1) of the Act, shareholders may instigate the appointment of one or more competent inspectors to investigate the affairs of the company. The investigation is made by an application to the court by:

(a) Not less than 200 members
(b) Holders of not less than 1/10 of the issued shares.
(c) Not less than 1/5 of the number of members in the register.

The applicants must furnish the court with sufficient evidence to justify the appointment.

7. Take-over Bid:

Under Section 210(1) of the Act, if a scheme involving, the transfer of shares or any class of shares in a company to another is proposed, and within 4 months of the offers, holders of not less than 90% of the shares or class there of have accepted the offer, the offering company may at any time within 2 months after the 4 months notify the dissentient shareholders of the offering company its intention to acquire their shares compulsorily. The dissentient shareholders may at any time within 1 month of the notice apply to the court seeking cancellation of the takeover bid and the court may disallow the same as was the case in **re Buggle Press Ltd** where the majority shareholders had formed a new company to enable them acquire the minority interest in their other company by the use of Section 210. The take over bid was disallowed.

8. Winding up under the Just and Equitable Ground:

Under Section 219(f) of the Act, a company may be wound up by the court if the court is of the opinion that it is just and equitable that the company should be wound up. The minority may have a company wound up on this ground in case of oppression or where they have justifiably lost confidence in the management of the company.

QUESTION THREE

(a) Section 218 of the Act confers upon the High court, jurisdiction to wind up companies registered in Kenya. Winding up by the court is by petition.

- The petitioner must establish his case for a winding up order to be granted.
- A winding up petition must be based on certain grounds and Section 219 of the Act sets out the circumstances in which a company may be wound up by the courts.

These are the grounds under compulsory winding up.

Under Section 219 of the Act, a company may be wound up by the Court if:

1. Members have by special resolution resolved that the company be wound up by the court.
2. Failure to hold the statutory meeting by the company pursuant to Section 130(1).
3. The company has failed to deliver the statutory report to the registrar for registration.
4. The company has failed to commence business within a year of incorporation.
5. The company has suspended its business for a whole year.
6. The number of members has fallen below the statutory minimum.
7. The company is unable to pay its debts i.e. insolvent.
8. The court is of the opinion that it is just and equitable that the company be wound up.
9. Winding up proceedings have been commenced outside Kenya in respect of a company incorporate outside Kenya but carrying on business in Kenya.

(b) Winding up subject to the supervision of the court.

Under Section 304 of the Act, if a company has passed a resolution for voluntary winding up, the court may on application of the official receiver or other person order that the winding up continue, voluntary but subject to the courts supervision.

Under Section 305 a petition for the continuance of a voluntary winding up subject to the supervision of the court is deemed to be a petition of winding up by the court. A winding up subject to supervision by the court has 2 advantages:

(a) The court may while making the order or by a subsequent order appoint an additional liquidator for the company. The liquidator so appointed has the same

powers and subject to the same obligations as one appointed in a voluntary winding up and the court is empowered to remove him from office and fill any vacancy occasioned by his death, removal or resignation.

(b) Creditors and contributories have the liberty to apply to the court for any orders necessary for beneficial winding up. Under Section 308(1) of the Act, where an order is made for winding up subject to the courts supervision, the liquidator may subject to any restrictions imposed by the court exercise all the powers without the sanction or intervention of the court in the same manner as if the company were being wound up voluntarily.

QUESTION FOUR

(a) (i)Powers of the chairman of the Board;

- To call meetings to order
- To determine who to speak and for how long
- To adjourn the meeting with consent of members
- To close discussion on an issue after reasonable debate
- To demand voting by poll
- To declare results of any vote of show of hands or by poll.
- To make decisions on points of order.
- To close the meeting
- To vote again or have a casting vote in the case of a tie.

(ii) Functions of the Managing Director;

Under Section 109 of Table A, directors may entrust and confer upon a Managing Director any or the powers exercisable by them on such terms and conditions and with such restrictions as they deem fit.

Such powers are exercisable with the board or its exclusion.

However, the board may from time to time revoke, withdraw, after or vary all or any of the powers conferred upon the managing director as was the case in **Holdsworth v. Eaddies**where the managing director‟s powers, were exercisable in relation to the company and its subsidiaries as determined by the board.

After 1 year, the board resolved that he should confine his attention to one of the subsidiaries only.

(b) (i)A poll vote:

This is voting on the basis of shares held. Under Article 62 of Table A, in a poll vote, one share is one vote. Voting by poll is by demand and the demand may be made by:

The chairman of the meeting

Not less than 5 members present in person or by proxy

A member or members present in person or by proxy holding not less than 1/10 of the paid up capital.

A member or members present in person or by proxy holding not less than 1/10 of the total voting rights.

The demand for a poll may be withdrawn before it is taken. However, voting by poll is conducted in accordance with the wishes of the chairman and the outcome becomes the decision of the meeting on the matter.

Under Section 138 of the Act, in a voting by poll, a member entitled to more than one vote is not bound to use all his votes in the same way.

(ii) A proxy vote:

At common law, a shareholder has a right to attend general meetings of the company in person or by proxy. A proxy is a person appointed by a shareholder to attend and vote in general meeting on behalf of the member. A proxy need not be a member of the company.

Under Section 136(1) of the Act, any member of a company entitled to alter and vote at a meeting of the company is entitled to appoint another person whether a member or not to attend and vote instead of him. The appointment is affected by completion and submission to the company of the proxy form.

A proxy form, conferred upon the proxy certain rights:

The right to attend the meeting
The right to vote by poll if any
The right to join other members or proxies to demand voting by poll
In the case of a private company meting, the right to speak at the meeting.

QUESTION FIVE

Gratuitous payments are gifts or donations and charities made by companies gratuitously. At common law, gratuitous payments are invalid unless made for the benefit of the company.

In **Huton V. West Cork Railway Co. (1883),** the company had disposed off its entire undertaking and only existed for purposes of winding up. Shareholders in general meeting solved to spend some of the purchase money to compensate salaried employees at the company and to pay directors for past services. A dissatisfied shareholder challenged the resolution and it was held that the proposed payments were invalid. Bawel L. J. observed,

"The law does not say that there are to be cakes and ale, but there to be no cakes and ale except such as are required for „the benefit of the company". Cases decided after this held that all gratuitous payments were invalid even if provided for in the objects clause. The courts were of the view that the payments are a wastage of the corporate assets.

For example in **Parke V. Daily News Ltd** and in **Re Roith** where the objects clause empowered the companies to make gratuitous payments. It was held that the payments were invalid since they were not made for the benefit of the company.

In **re Behrens Co. Ltd (1932).** It was held that the gratuitous payments. It was held that the payments were invalid since they were not made for the benefit of the company.

In re **Lee Behrens Co. Ltd. (1932).** It was held that the gratuitous payments proposed by the company was invalidity of gratuitous payments.

1. Is the transaction reasonably incidental to the carrying of the company"s business?
2. Is it a bonafide transaction?
3. Is it for the benefit and to promote prosperity of the company?

This test was disqualified by the court of Appeal in **Rolled Steel case (1980).** However, English law has since changed and a company may be incorporated for the purpose of making gratuitous payments.

In **re Horsley and Weight Ltd** the court of appeal observed, "The objects of a company need not be commercial, they can be charitable or philanthropic, indeed they can be whatever the original incorporators wish provided that they are legal".

In the **Horsley and Weight Ltd** the court of appeal observed, "The objects of a company need not be commercial, they can be charitable or philanthropic, indeed they can be whatever the original incorporators wish provided that they are legal".

The common law relating to gratuitous payments though made applicable by Section 3(11)(c) of the Judicature Act, does not apply in Kenya since the circumstances of Kenya encourage donations by companies and individuals to worthy causes.

QUESTION SIX

(a) "Body Corporate"

Under Section 16(2) of the Companies Act, from the date of Incorporation mentioned in the certificate of incorporation the subscribers to the memorandum together with such other persons as may from time to time become members of the company shall be a BODY CORPORATE.

The most fundamental attribute of incorporation is that the company becomes a legal person distinct and separate from its members. Other consequences or effects of incorporation are based on these facts. The Salomons Case Lord MacNaghten stated that "the company is at law a different person altogether from the subscribers to the memorandum". The principle of legal or corporate personality manifests itself in various ways. The legal personality created by incorporation has several characteristics or attributes:

- Limited liability
- Perpetual succession
- Sue or be sued
- Capacity to contract
- Owning of property
- Common seal

(b) Merits of a corporation as a business entity:

Upon incorporation a company becomes a legal person distinct and separate from its members. The registered company is the most advanced form of business association. This is because the merits of a company outweigh the shortcomings by far:

Limited liability: Members are generally not liable for debts and other obligations of the company since their liability is limited by shares or guarantee.

Wide capital base: compared to other forms or business association, companies generally have more capital by reason of wide spectrum of membership.

Perpetual succession: The fact that a registered company has capacity to exist in perpetuity encourages longterm investment.

Qualified or specialized management: Under Section 177 of the Act, every public company must have at least 2 directors and every private company must have at least one. Directors

are elected by members in general meeting. Members have an opportunity to elect qualified persons as directors.

Owning property and capacity to contract: The fact that a registered company can own or hold property and enter into contractual relationships means that it has capacity to invest to enhance profitability.

Sue or be sued: Shareholders are not obliged to sue to remedy wrongs done to the company and generally cannot be sued for the wrongs of the company.

Transferability of shares: Shares in public and private companies are transferable, however, they are really transferable in public companies.

Borrowing by floating charge: Registered companies can utilize the facility of floating charge to borrow. This is an equitable charge securing a debenture on the assets of a going concern but which remain dormant until crystalisation. A registered company may therefore use the goods it deals with in the ordinary course of business as security for a loan.

Shortcomings of a corporation as a business entity:

Formalities: Companies are characterized by formalities from incorporation to winding up. Formation of a registered company is subject to the provisions of the Companies Act. During its existence, it must file annual returns with the registrar, hold general meetings etc.

Publicity: Companies are subject to undue publicity. Promoters must notify the registrar of the name of the intended company. A company"s public documents e.g. memorandum, articles, special resolutions etc are open to scrutiny by the public. A public company must publish annual accounts and the winding up of a company is conducted in the public eye.

Expenses: The registered company is the most expensive form of business association to form, maintain and wind up. Formation expenses include: legal fees, registration fees, stamp duty. A company must have directors, auditors and board meetings. The winding up of a company is an expensive exercise.

Corporation tax: This tax payable by registered companies is comparatively higher than Income tax. It reduces the amount of profit distributable to members by way of dividend.

Ultra vires/inflexibility: They do not enjoy as wide contractual capacity as partnerships or sole proprietorships. They cannot change the nature of business at will. A company"s capacity is restricted to transactions set forth in the objects and those that are reasonably incidental to the attainment or pursuit of the express/such object. Other transactions are ultra vires the company and null and void.

Participation in management: Members other than directors do not participate in the day to day management of a company"s affairs.

QUESTION SEVEN

Distribution of assets in the winding up of an insolvent company:

1. Under Section 302 of the Companies Act, all costs, charges and expenses property incurred in the winding up including the liquidators remuneration are payable out of the assets of the company in priority to other claims.

2. Under Section 311(1) of the Act, the following payments must be made in priority to other debts.

All taxes and local rates due from the company is payable within 12 months before the commencement of winding up.
All government rents not more than one year in arrears
All wages and salaries due to any clerk or servant other than directors for services rendered during four months preceding commencement of winding up.
Any amounts payable under the NSSF and NHIF Act.

3. Secured creditors.

4. Unsecured creditors

5. Other creditors if any

6. The balance is distributed among

members. Secured Creditors:

A secured creditors may:

1. Realise his security and prove as an unsecured creditor for the balance if any of his debt.
2. Value of the security and prove for any balance. In this case, the liquidator may redeem the security at the creditors value or require it to be sold.
3. Relay on his security and not prove at all. The liquidator may then redeem by payment in full.
4. Surrender his security and prove for the whole debt.

QUESTION EIGHT

Company secretary:

The office of the company secretary is created by the provision of the Companies Act. Under Section 178(1) of the Act, every company must have a secretary. However, if the office is vacant, its functions may be discharged by a deputy or assistant secretary if any or a delegate of the board.

Appointment of the Secretary:

Under article 110 of Table A, the Secretary is appointed by the board for such term at such remuneration and such conditions as the board may deem fit. The board is additionally empowered to remove the secretary from office. To qualify for appointment, one must either:

1. Be an advocate of the High court
2. Hold the Certified Public Secretaries certificate
3. Hold such other qualification which qualify him for appointment.

However, the following persons must not act as secretary:

1. The sole auditor of the company
2. A corporation which is the sole director of the company.

Under Section 180 of the Act, if a thing can only be done by or to a director and the secretary, such a thing is not deemed to have been done if done by or to the same person acting as director and the secretary.

Legal position of the secretary:

He stands in a fiduciary position in relation to the company. He owes it the basic fiduciary obligations.

Status of the Company Secretary:

During the 19th Century, the company secretary was regarded as a mere servant with no authority to bind the company. In **Haise and Bunnet V. South London Trumways** Lord Esther stated, „A secretary is a mere servant. His position is that he is to do what he is told and no person can assume that he has any authority to represent anything at all". The secretary"s position has since changed and he is now regarded as the chief administrative officer of the company with extensive powers.

In **Panorama Developments V. Fidelis Furnishing Fabrics (1971)** where a company secretary hire vehicles for his own personal use but on the pretext that it was not necessary for purposes of the company and failed to pay the hiring charges where upon the company was sued. It was held that the company was liable for the hiring charges since the secretary had authority to hire the motor vehicles. In the words of Lord Denning, "But the times have changed, a company secretary is a much more important person than he was in 1887. He is an officer of the company with extensive duties and responsibilities. He is no longer a mere clerk".

Duties/obligations of the secretary:

His duties generally depend on the size of the company and his contract with the company. His principle obligation is to ensure that the affairs of the company are conduced in accordance with the memorandum, articles, the Companies Act and the general law. However, his specific obligations include:

(i) Filing the annual return.
(ii) Issuing share and debenture certificates
(iii) Registering charges
(iv) Publishing the company"s name as appropriate
(v) Taking minutes in general and board meetings
(vi) Issuing notices to members
(vii) Certifying transfers.
(viii) Maintaining the various registers of the company
(ix) Facilitating inspection of registers
(x) Custodian of the company"s common seal.
(xi) Makes the declaration necessary for commencement of business.

Liability of the Secretary:

1. As a fiduciary, he is liable for breach of his fiduciary obligations to the company.

2. His office is liable (at criminal law):

For failure to register charges or publish the company"s name
Refusal to facilitate inspection of registers
Failure to maintain registers
Failure to publish directors names in official documents.