

**MAKERERE UNIVERSITY BUSINESS SCHOOL
FACULTY OF COMMERCE
BUSINESS LAW DEPARTMENT**

**BUSINESS LAW II
YEAR TWO
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BUSINESS LAW II NOTES 2022

Business Forms

There are a number of business organisations, which *include a private limited liability company, Public Limited liability company, partnership, cooperative society, unregistered associations such as clubs and trusts*. All these named business organisations have advantages and disadvantages.

Definition of a Company

The Companies Act 2012 defines a company as "a company formed and registered the Companies Act, 2012, or an existing company, or a re-registered company under the new Act of 2012. (Sec. 2)

However, a company in simple terms can be defined as one where one or more persons come up with resources to form a business, which is a legal entity/person distinct/separate from those who formed it.

A corporation is owned by shareholders, who profit from the company's gains. **A partnership** is owned by two or more people who divide the business' profits. **A sole proprietorship** is owned by one person who alone is responsible for losses and reaps profits. A corporation is the most complex form of business and involves the most paperwork and expenses to set up, but it can offer certain rewards that other forms of business do not.

But of all many a comparison shall be made between Corporations/Companies and Partnerships, as illustrated below;

Section 2(1) of the Partnership Act of 2010 defines a partnership as a relation which; subsists between persons carrying on a business in common with a view of profits.

This statutory definition is fortified in a celebrated English case by Lord Justice Herman in **Keith Spicer Ltd. v Mansell [1970] 1 WLR 333** who defined – partnership in the same words. In **W v Comm. Of Taxes 1969(1) ALR Comm. 91** held that there are 4 elements of a partnership ***(a) Each partner must pool something to the business i.e. money, asset, labour (b) Business must be carried on for the joint benefit of all partners (c) Object must be to make a profit (d) the business must be legal.***

- **The principal difference between a company and a partnership**, is that the former is a co-operate entity while the latter isn't. It is therefore important to note therefore that a partnership **does not enjoy rights and remedies distinct from those of its individual members.**
- Partnership cannot own property on its own; the firm's property belongs to the partners jointly. Persons who deal with the partnership contract with the parties jointly.
- Action for a firm debt may be taken against anyone of the partners.
- The death of a partner usually puts an end to the existence of the firm.
- The survival and progress of a partnership business does not outlive its partners unlike corporations.
- A partnership business is mostly left out when it comes to multi-national mega transactions, instances of bidding for big tenders. This is because partnerships are generally viewed as small and mid-sized scale business operations, save for a few that change their operation models, which in Uganda are very few.

However, the partnership has a number of advantages.

- In the 1st place the operation of partnership is **flexible as compared to the strict control of organisations like companies.**
- Unlike companies whose objects clauses are restricted and difficult to alter, partnership deeds are **freely alterable in anyway agreed among all the partners.**

- Partnerships are not only easy to form and manage due to the few numbers, but also easy to dissolve. No legal formalities are thus required in its formation. For example, **Sect. 3 of Business Names Registration Act** requires registration of business name if the true surnames of the parties are not used. This is easier on partnership because they use the true surnames of the parties.

Further still, under taxation, partners (ITA Sect 75) are taxed individually including their share from. The partnership returns. Companies on the other hand are taxed at a corporate tax rate and the individual shareholders are also taxed.

The Key Pointers that make Corporations the best over Partnerships:

Whereas a partnership may on face of it appear to be the ideal option of a business organization, the reality may seem to offer a different side, due to the following distinctions;

Liability Protection

The biggest benefit a corporation offers over other business structures is liability protection. Shareholders do not risk losing personal assets because of a company's debts, because corporations are considered separate legal entities from the people who own them. Owners of partnerships, on the other hand, are held responsible for all company debts and legal responsibilities. They are subject to losing personal assets if the company goes bankrupt or is caught up in costly legal situations as discussed earlier above. To this therefore it is recommended that for avoidance of gross liability that can easily bring down a business organization, a corporation is more suitable because by law and practice, individuals are more insulated from liabilities, save in a few exceptional circumstances.

Access to Funds

Corporations can more easily raise funds than other forms of businesses, according to the U.R.S.B Data base report on Small Business Administration, of 2011. Corporations can sell stock to raise money for business expenses or cover debts. Partnerships and

business partners, on the other hand, must try to come up with funds on their own or turn to loans or credit programs to raise money. It takes less time and effort to sell stocks than it does to apply for loans or seek out investors for a business.

Tax Benefits

Corporations enjoy some tax benefits that sole proprietorships and partnerships do not. Corporations must file taxes separately from the shareholders. Owners of corporations pay taxes on any salaries, bonuses and dividends they earn from the corporation.

According to the **Income Tax Act** for example, a corporation is not required to pay tax on earnings paid as compensation to employees or shareholders, and it can deduct the payments as a business expense. Also, the corporate tax rate is usually lower than the personal income tax rate. The owners of sole proprietorships and partnerships pay income taxes at regular rates on the profits they earn from their companies.

In conclusion, the best business organization for the medical practitioners is A Company, because of the above discussed merits and demerits of both business organizations.

NB: Do extensive research on other various business forms showing the advantages they enjoy over the rest and show the best business form Eg. Clubs and Societies- Bakibinga pp 26-27; Trusts: Trustees Incorporations Act; Bakibinga pp 29-30; Co-operative Societies: Cooperative Societies Act; Bakibinga pp 28-29; NGO: Non-Governmental Organisations Registration Act; NGO Registration (Amendment) Act, Companies Act.

COMPANY LAW

Definition of a Company

A company is a legal entity separate and set apart from its members or shareholders. This legal personality is an artificial one, which is distinguishable from natural personality.

Types of Companies

Under the Companies Act 2012, provision is made for the different types of companies that can be lawfully formed in Uganda. The different types of companies can be divided into several categories.

A) Private Companies

Characteristics of Private Companies

- ❖ The transfer of shares is restricted
- ❖ Secondly, it limits the number of members to 100 excluding past and present employees. Therefore the maximum number of members in a private company is 100 Members.
- ❖ Thirdly, a private company prohibits any invitations to the public to subscribe for any shares or debentures of the company (investment in the company). This means that it cannot advertise to the public inviting members of the general public to come and buy its shares.
- ❖ Fourthly, only one director is required in the case of a private company. This means that for such company to commence business, there must be a minimum of at least one director.
- ❖ A private company requires a quorum of 2 members at a general meeting for any valid business of the meeting to be conducted.

Where a private company does not comply with the above requirements, then it loses exemptions and privileges conferred on a private company. This failure can only be remedied upon showing court that it was caused by accident or some other sufficient cause.

Single Member Company

A private company may also be registered as a single member company. This is inferred from several provisions of the companies Act.

For first, **Section 4(1)** provides that any one or more persons can for a lawful purpose form a company. This means that one person can form a company called a single member company.

Section **186** of the companies Act 2012 provides that a single member company shall have two nominee directors one of whom shall become nominee director in case of death of the single member and the other shall become alternate nominee director to work as nominee director in case of non-availability of the nominee director.

Section **187(3)** provides that a single member company is not obliged to have a secretary.

Section 87 allows a single member company to convert into a private company not being a single member company. This is done by passing a special resolution to change status from a single member company to a private company

B) Public Companies

Characteristics of Public Companies

- ❖ The Companies Act 2012 defines a public company as one which is not a private company. As such, there is no limitation on the membership of a public company.
- ❖ A public company requires a minimum of 2 directors. There must always be a minimum of 2 directors for such company to legally operate.
- ❖ Shares in a public company are freely transferable.
- ❖ The quorum at general meetings in such company is 3 members
- ❖ A public company can issue a prospectus to the public encouraging them to acquire shares in their company. Thus, the decisive advantage of a public company over a private company is its rights to raise capital from the public.

A company whether private or public may be:

- i) limited by shares
- ii) limited by guarantee
- iii) Unlimited.

A Company Limited by Shares

This is one where the memorandum of association limits the liability of its members to the amount; if any, unpaid on their shares for instance where a shareholder has been allotted 100 shares of 1/- each and he pays for only 50 shares and the other 50 shares are not paid for, he will be required to pay for the remaining 50 shares. (Section 4)

A Company Limited by Guarantee

This is one where the liability of its members is limited to such amount as they may have undertaken to contribute to the company assets in the event of winding up. Such a company is not allowed to distribute its funds as dividends, which means that they are not useful for carrying on commercial ventures, which are profit motivated. Companies limited by guarantee are not profit motivated and are commonly charitable organisations,

religious institutions and research institutions. In essences, they are referred to as NGO's. For such companies, it must be stated in the memorandum of association that the members undertake to pay a specified amount of money on winding up of the company in the event that the assets of the company available are not sufficient to meet the debts of the company. **(Section 4)**

Unlimited Companies

These are companies where the liability of members for the debts of the company is unlimited. This means that if it happens that upon winding up of the company, the company's assets are not enough to meet its debts, the members' personal property can be sold to meet such debts because their liability is unlimited.

A private company can be re-registered as a public company by passing a special resolution. The special resolution has to alter the company's memorandum so that it no longer states that the company is no longer private. **NOTE** that a public company can also reregister as a private company in the same way.

C) Other Corporate Bodies

Statutory Bodies

These are formed by Acts of Parliament and ***do not go through the process of incorporation as stipulated under the Companies Act***. Parliament seats and enacts a law which brings into existence such company. The said law provides for the objects of the company, its management, appointment among others. Such companies are normally intended to provide social amenities. e.g. National Water and Sewerage Corporation, Uganda Railways, etc.

D) Corporation Sole

These consist of one human member at a time being the holder of an office. They are mostly created by the Acts of Parliament but may also be created by the constitution or common law e.g. the offices of a Bishop created by common law, the office the Kabaka created by the Constitution and the Administrator created by the Acts of Parliament.

HOLDING AND SUBSIDIARY COMPANIES

A company may only hold shares of another company if, and or without prejudice to the foregoing.

- If one company has a major shareholding in another, they may stand in the relationship of holding company and subsidiary company.

Example: A is the holding company of B if:

- 1 It is a member i.e. the registered holder of at least 1 share of B and also controls the Board of Directors of B;
- 2 On the basis that A's shareholding gives it more than half the voting power exercisable at the General Meeting of B, or
- 3 When A & B empowers A to appoint directors of B (i.e. without obtaining the consent of another person) appoint, remove or even constitute the majority directors of B.

NB. The subsidiary- Holding company relationship is of much commercial importance. Since large business enterprises find it convenient to operate through a structure of a holding or 'parent' company and subsidiaries, wholly or less partly owned. Subsidiary status may have been acquired by purchase or takeovers. **Section 154.**

Draw practical examples from Uchumi Kenya which was a Holding Company of Uchumi Uganda, and Uchumi Uganda was a subsidiary of Uchumi Kenya, Nakumatt Uganda and Nakumatt Kenya.

PROMOTION AND FORMATION OF THE COMPANY

Promotion:

A business cannot come into existence unless someone thinks of the idea and attempts to translate it into business. The process of conceiving and translating the business opportunity is what is called promotion.

Definition of Promoters:

A promoter is defined in **TWYXCROSS VS GRANT (1877)** as "any person who undertakes to form a company, or who, with regard to a proposed newly formed company, undertakes part in raising capital for it. A person is prima facie a promoter of the company, if he has taken part in setting a company formed with reference to a given object."

Thus a promoter is someone whose profession it is to take part in setting up a company. A typical example would be a village grocer who converts his business into a limited company. He of course is in no sense a professional company promoter but he would be the promoter of his little company and the difference between him and a professional promoter is basically one of degree rather than of kind. Both create or help to create the company. The only difference is that the grocer is less likely than the professional to abuse his position since he will probably continue to be the majority shareholder in his company whereas the promoter if a shareholder at all, will intend to offload his holdings on to others as soon as possible.

Thus the expression “promoter” covers a wide range of persons. Both the professional promoter and the village grocer are promoters to the fullest extent, in that each undertakes to form the company with reference to a specific object and to set it going and takes the necessary steps to accomplish that purpose. Thus, a person may be a promoter though he has taken a comparatively minor part in the promoting proceedings. However those who act in their professional capacity such as solicitors and accountants will not be classified as promoters because they undertake their normal professional duties.

Therefore, who constitutes a promoter in any case is therefore a question of fact.

Duties of a Promoter:

1. A promoter stands in a fiduciary relationship to the company and consequently owes it certain fiduciary duties i.e. duties of disclosure and accounting and this implies that they must not make any secret profit out of the promotion without disclosing it to the company. This was illustrated in the case of **ERLANGER VS NEW SOMBRERO CO LTD (1978) 3AC 1218**. Members in a syndicate bought the lease of an island containing a phosphate mine at £55,000. The members of the syndicate then promoted a company and appointed themselves its directors. They sold the lease to the company for £110,000. This was unfortunately not revealed in the prospectus inviting the public to subscribe for its shares but was subsequently discovered. The company instituted an action to recover profits from the promoters who in turn argued that they had made a disclosure of their profits to a board of directors. Nevertheless, the BOD was: -

- i. Appointed by the promoters themselves,
- ii. The first director could not attend meetings because of his state in life (ill health)
- iii. The second director was not present when the profits of the promoters were approved.
- iv. The third director was one of the promoters themselves.
- v. The fourth and fifth directors were ignorant of the subject matter.

The issue was whether there was a disclosure. It was held that the company was entitled to rescind the contract. That the promoters must repay the purchase price and the company in turn must convene the lease to the promoters so as to restore the status quo (original position)

A promoter cannot escape liability by disclosing to a few friends who constitute the initial members of the company especially if their intention is to float the company to the public and hoodwink shareholders. This was illustrated in the case of **GLUCKSTEIN Vs BARNES (1900) AC 240** Lord Harlsbury stated that: “it is too absurd to suggest that a disclosure to the parties to this transaction is a disclosure to the company.”

Thus a disclosure must be made to the company either by making it to an entirely independent board or to the existing and potential members as a whole. If the first

method is employed the promoter will be under no further liability to the company although the directors will be liable to the shareholders if the information has not been passed on in the invitation to subscribe (prospectus) and if the promoter is a party to the invitation to subscribe he too will be liable. If the second method is employed, the veil of incorporation will be ignored and disclosure must be made in the prospectus, articles so that those who are or become members have full information regarding the promoters' transactions. A partial or incomplete disclosure will not do, the disclosure must be full or explicit.

2. Duty of skill and care: In the process of promotion, a promoter must carry out his work with great care and skill and due diligence expected of a reasonable man.

3. Duty to act in the best interests of the company.

Consequently, a promoter may do any one or more of the following activities: -

- Solicit capital
- Prepare a prospectus
- Solicit directors for the company.
- Arrange the preparation of the Memorandum and Articles of Association
- Obtain premises
- Obtain whatever equipment is necessary for the running of the business

Remedies for Breach of Duty:

1. A promoter can be made to account for any secret profit made.
2. Damages for misrepresentation where the promoter has made an actual misrepresentation and cannot prove that he had reasonable ground to believe and did believe up to the time the contract was made the facts represented were true.
3. Damages for failure to disclose
4. Rescission: Since the promoter owes a duty of disclosure to the company, the primary remedy against him in the event of breach is for the company to bring proceedings of rescission (termination) of any contract with him.
5. Damages for negligence in allowing the company to purchase property at an excessive price since they are to act with skill and care.

Remuneration of a Promoter:

Promoters do not possess an automatic right to receive remuneration from the company for their services from the company unless there is a valid contract enabling him to do so between him and the company. Without such a contract, he is not even entitled to recover his preliminary expenses. This is so because until a company is

formed, it cannot enter into a valid contract and the promoter has to expend the money without any guarantee that he will be repaid.

However, in practice, the company's articles may allow directors to pay preliminary expenses from the company's funds.

However, the promoter will not be content merely to recover his expenses and if he is a professional promoter, he will expect to be handsomely remunerated. In the case of **TOUCHE Vs METROPOLITAN RAILWAY WAREHOUSING COMPANY (1871) LR 6 CH.APP 671** Lord Hatherly said: "the services of a promoter are very peculiar, great skill, energy and ingenuity may be employed in constructing a plan and in bringing it out to the best advantages."

Hence, it is perfectly proper for the promoter to be rewarded provided he fully discloses to the company the rewards which he obtains. The remuneration must be fully disclosed not only by the promoter to the company but also by the company in the prospectus.

Pre-incorporation Contracts.

In promoting a company, promoters usually enter into contracts with third parties and when they do so, they purport to do so on behalf of the unincorporated company. Such contracts are not binding on the company because it is not yet in existence and consequently has no capacity to contract. However, such contracts bind the promoter and can be adopted by the company once it is incorporated. Upon adoption by the company, the liability of the promoter ceases. **(S. 54 of the Companies Act 2012)**

Formation of a Company

A company is formed by registering it with the registrar of companies in Kampala and obtaining a certificate of incorporation. **(S. 22)** To register a company, a number of procedures and documents must be presented and these include;

1) Propose a desired Company name.

A promoter should have fronted the proposed desired names. This is because the business is still in the idea form and it must get identity and members come up with various options desirable and he picks the best 4 names for reservation.

2) Reservation of a name.

The promoters forming the company or their advocate must write to the Registrar of companies requesting him to search the register of companies and reserve its name. **S.36)**

The search is aimed at ensuring that there is no other name already registered that is similar to that of the company. However for the registrar to reserve the said name, the following must be satisfied. The name will be reserved if;

- i) It has not already been registered previously
- ii) It desirable
- iii) It is not identical with the one that has already been registered so as to confuse the public.
- iv) It is not illegal or has abusive connotations.
- v) Its not misleading

3) Memorandum of association.

This is the most important document of a company because it determines the powers of the company, i.e, it lays out the various activities or nature of businesses the company has been formed to engage in.

In ***Guinness V Land Corporation of Ireland (1882) 22 Ch. D 349***, it was established that the Memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors and the outside public as well as the shareholders.

It also mentions several other aspects which define the company as shown hereunder;

- i) Name of the company. Where it is a limited liability company, the name of the company must end with the word "Limited".
- ii) Situation/location of registered office of the company. It must state that the registered office of the company is situated in Uganda.
- iii) The actual address of the company must be communicated to the registrar within 14days after incorporation or from the day it starts business whichever is earlier
- iv) Objects clause; this entails the objectives or activities the company has been set out to deal in.
- v) A statement as to the nature of the company (whether it is a private / public or any other kind of company) **Note that** the inclusion of the objects clause in the Memorandum is discretionary according to S.7 (1)(C).
- vi) If the company is limited by shares, the amount of share capital and division thereof must be stated.
- vii) If the company is limited by guarantee, the amount each member undertakes to contribute to the assets of the company in the event of winding up must be stated.
- viii) The names, addresses and descriptions of the subscribers who must be at least 2 for a private company and 7 for a public company.
- ix) It must bear stamp duty.i.e, a tax called stamp duty must be paid.
- x) It must be signed by each subscriber/member in the presence of at least a witness who must attest to the signature.

OBJECTS CLAUSE

This is the clause/term which lays out the objectives/powers or activities the company has been formed to engage in. The objects must be lawful and should include all the activities which the company is likely to pursue.

According to section 7(1)(C), the insertion objects clause in the memorandum of association is discretionary. This means that a company may or may not include an objects clause in its memorandum of association.

More importantly, section 51 of the Companies Act provides that the memorandum of association does not limit the capacity of a company. As such, a company is bound to honour a transaction entered into even if it is not authorised to enter into such transaction by the memorandum of association.

In case a company intends to deal in general commercial business, the companies Act 2012 provides for a general object; that is, "the object of the company is to carry on any trade or business whatsoever and the company has power to do all things incidental to carrying on any business by it".

LIABILITY OF MEMBERS

- i) If the company is limited by shares, the memorandum of association should state so.
- ii) If limited by guarantee, it should state how much each member intends to contribute to the debts of the company in the event of winding up of the company.
- iii) If unlimited, the members act as guarantors in respect of the company's obligations. While a creditor has no right of action against the member himself, his action being against the company, he in turn looks to the members to discharge its debts by providing the necessary funds.

Alteration of the memorandum (S.10)

A company may by special resolution alter the provisions in its memorandum to enable it,

- i) carry on business more economically or more efficiently
- ii) enlarge or change the local area of its operations
- iii) attain any of its objects by new or improved means
- iv) carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company.
- v) Restrict or abandon any of the objects specified in the memo
- vi) Sell or dispose of the whole or any part of the undertaking of the company.
- vii) Amalgamate with any other company or body of persons.

Note;

The memorandum of association is a public document; therefore any person who wishes to deal with the company must first look at the document to acquaint himself with the major details of the company particularly the nature objects of the company, the liability of the members among others.

The statutory form of memorandum of association is provided for in Tables B, C and D of the 3rd Schedule to the Act.

Articles of Association (S.11)

These contain regulations for managing the internal affairs of the company. They are applied and interpreted subject to the memorandum of association in that they cannot confer wider powers on the company than those stipulated in the memo.

According to section 12 of the Act, in the case of an unlimited company, the articles must state the number of members with which the company proposes to be registered and, if the company has a share capital, the amount of share capital with which the company proposes to be registered.

In the case of a company limited by guarantee, the articles must state the number of members with which the company proposes to be registered.

Where an unlimited company or a company limited by guarantee has increased the number of its members beyond the registered number, it shall, within fourteen days after the increase was resolved on or took place, give to the registrar notice of the increase and the registrar shall record the increase.

Section 13 of the Companies Act provides that the articles of association of a company may adopt all or part of the regulations contained in Table A of the Act

According to section 14, a public company upon registration must adopt the code of corporate governance provided for in Table F of the companies Act. A private company may or may not adopt Table F

A company may by special resolution alter or add to its articles. A special resolution which is passed by majority of not less than three-fourths of such members, as being entitled to write in person, or where proxies are allowed, by proxy at a general meeting of which not less than 21 days notice specifying the intention to propose the resolution as a special one has been given. **(S.16)**

For an unlimited company and a company limited by guarantee, it is a requirement to register this document. But for a company limited by shares, it is optional. If such company does not register one, the Articles contained in Table 'A' of the Companies Act are presumed to apply as the Articles of Association of the company.

NB: The statutory Declaration of Compliance is no longer a legal requirement in practice for company registration.

Statement of Nominal Capital

This is the document in which the directors of the company state the capital of the company with which the company is starting to operate with upon its registration and the amounts into which it is to be divided.

For a public company, the following additional documents must be presented

List of Names and Particulars of Directors and Secretary

In this document, the names of all the directors and secretary must be stated as well as their occupations, addresses etc. the document must also contain an undertaking by the directors to take and pay for their qualification shares in the company in case the director is required to hold such. However, it is not a must for a private company to file this document on its formation. It can file it even long after the company has been formed. However for a public company to be incorporated, this document must be filed together with the other documents.

Prospectus

This is a document setting out the nature and objects of a company and inviting the public to buy or subscribe for its shares. It sets out the numbers of founders of the company, share qualification of director, names, description and addresses of directors, number of shares offered to the public for subscription, company property etc. The purpose of the prospectus is to provide the essential information about the position of the company when its being launched so that those interested in investing in the company can decide whether or not to invest. This document is only a requirement for public companies and private companies do not file it because they are not allowed under the law to invite members of the general public to come and buy its shares.

Stamp Duty Must Be Paid

The higher the figure of nominal capital registered, the higher the charge for stamp duty, which stamp duty normally varies as a given percentage of the nominal capital.

Registration Fees

The necessary registration fees must also be paid to the registrar on presenting the documents for registration.

Registration form

Section 18 provides that a company is registered by filling in the particulars contained in the registration form in the second schedule to this Act.

Effect of registration and the role of Registrar (S 22)

If the Registrar is satisfied that the documents are in order and that stamp duties and fees have been paid, he enters the name of the company in the register of companies and issues a certificate of incorporation. The issue of the certificate of incorporation is conclusive evidence that all registration requirements have been complied with and that the association is a company authorized to be registered and is duly registered under the Act. The basic role of registrars is to ensure that business entities are not formed without proper documents, ensure compliance with the law in the process of registration and thereafter. Where the registrar is not satisfied with the documentation, he/she can decline to register the business/company. However, where he declines without a reasonable excuse, an order of **Mandamus** can be obtained from the High Court compelling him/her to perform the duty.

The issue of a certificate of incorporation is conclusive evidence that all the registration requirements have been complied with and that the company is duly registered under the Act. It is then that the company comes into existence and the certificate of incorporation is deemed to be the birth certificate of the company. The company then enjoys the characteristic of being a legal person i.e, it becomes a separate legal entity from its members capable of enjoying various advantages like a natural person (consequences of incorporation).

THE CONTRACTUAL EFFECT OF THE MEMORANDUM AND ARTICLES OF ASSOCIATION

S.21 (1) of the Companies Act provides that subject to the provisions of this Act, the memorandum and articles shall when registered bind the company and the members thereof to the same extent as if they respectively had been signed and sealed by each member and contain the warranty on the part of each member to observe all the provisions of the memorandum and articles.

Thus, registration gives a legal effect i.e. the company is now bound by the provisions of the memorandum and articles in other words a contract is created between the company and the members of the company. A member need not have signed the document but once they become members then they are deemed to have signed the contract and therefore they have to observe all the provisions of the memorandum and articles i.e. it's the memorandum and articles that form the terms of the contract. The memorandum and articles form three contracts and these are:

1. The memorandum and articles constitute a **contract between the company and each member**. S. 21 (1) provides expressly that the contract is subject to the provisions of the companies' Act and the companies' Act include sections which permit

alterations of the memorandum and articles by way of special resolution. Thus, the shareholder is making a contract on terms which are alterable by the other party (the company) by a special majority voting at a general meeting.

2. Secondly, the contract under S.21 (1) is **between the members inter se (members themselves)**. Thus, a direct action between members is possible where one of the members breaches the contract in the memorandum and articles. This was illustrated in the case of **A. O. OBIKOYA Vs EZEWA & ORS (1964) 2 ALL NLR 133** the applicant and respondents were the permanent directors of a limited liability company by virtue of Article 28 of their company articles. Article 32 of their Act provided that a permanent director shall not vote for the removal from office of another permanent director. In breach of both articles 28 & 32, the respondents purported to alter article 28 by a special resolution and inserted article 86 of Table A which voted for the removal of the applicant from office as director of the company and the applicant sued for damages against the respondents personally and for breach of the contract in article 32 and for an injunction to restrain the respondents from further preventing the applicant from acting as director of the company. Held that when the 3 members of the company who are also the 3 permanent directors agreed by virtue of article 32 not to vote for the removal of each other from office, they were agreeing between themselves as members in which capacity they exercised their voting rights not to vote. A contract did exist between them and the applicant was within his right to sue because the respondents were in breach of articles 28 & 32.

3. Thirdly, S.21 (1) creates a contract a **contract between the company and the members only in their capacity as member and not in some other special capacity**. If therefore an article provides that someone shall be the company's solicitor, he can not rely on that as a contract to enforce his right to be the solicitor, even if he is in fact also a member, for the article concerns him in his capacity as an outsider not as member. Nor will a provision that disputes between the company and its members must be referred to arbitration avail a person whose dispute is between the company and himself as a director, even though he happens also to be a member. This was illustrated in the case of **HICKMAN Vs KENT (1915) 1 CH 881** Ashbury J stated that: " an outsider to whom rights purport to be given by the articles in his capacity as such outsider, whether he is or subsequently becomes a member, can not sue on those articles treating them as contracts between himself and the company to enforce those rights...No right merely purporting to be given by an article to a person whether a member or not, in a capacity other than that of a member as for instance as solicitor, promoter, director, can be enforced against the company..."

Membership:

Sec.47 of the Companies Act defines a member as a person who has signed the Memorandum.

Any person who agrees to become a member of a company and his name is entered on the register of members also becomes a member

In **MAWOGOLA COFFEE FACTORY VS KAYANJA**, it was held that to be a member of a company, there must have been a valid allotment of shares to the person and his name entered on the register. It was further observed that a certificate of allotment of shares is the best evidence but in its absence, the register of members shall suffice.

A minor can become a shareholder but he incurs no liability until he obtains the majority age and fails to repudiate the contract within a reasonable time.

COMMENCEMENT OF BUSINESS

A private company may commence business and execute all its powers as soon as it is incorporated. However, the power to make contracts is normally vested in the directors. Thus, there must be at least one meeting of the directors or a general meeting. The Company must also acquire all the relevant trading licenses before it can commence business.

THE CONCEPT OF CORPORATE PERSONALITY

Sect 22 of the Companies Act stipulates that once the memorandum of association is registered the company is incorporated. Upon incorporation;

- ❖ the subscribers to the Memorandum of Association become a body corporate
- ❖ the company acquires the ability and power to hold property, to have perpetual succession and to have a common seal. ¹
- ❖ The members acquire limited liability but under certain circumstances to contribute to the assets of the company in the event of its winding up. Under perpetual succession, a company can also die i.e. only when the company is voluntarily wound up or wound up under a Court Order. The only time when the members can be called upon to pay the debts of the company is when they remain with the balance not paid on the shares owned (contributories).

The concept of corporate personality is what distinguishes a company from other forms of business organisations. Simply put, it means that companies have separate legal entities distinct from their members (i.e., they have "corporate personality" and are "corporate persons") while others are not. In the celebrated English case of ***Salomon V. Salomon & Co. Ltd. (1897) A.C. 22***,

Mr. Salmon, formerly a wealthy man dealing as a boot and shoe manufacturer trading on his own sole account under the prosperous firm of "A Salomon & Co.", brought a suit as a

¹See the Ugandan case of KABIRE & ANOR V. ABDI & SONS TRANSPORTERS LTD (1989) KA LR 156

pauper. He was undoubtedly in good credit and repute but his woes began when he involved his wife, five sons and a daughter and turned the business into a limited liability company under the Companies Act, 1862. The Memorandum of ASSOCIATION fixed the capital of #40,000 in 40,000 shares of #1 each. There were articles of association providing for the usual machinery for conducting the business. The company was intended from the beginning to be a private limited company and it remained so to the end. No prospectus was issued; no invitation to take shares was ever addressed to the public. The subscribers met and approved Mr. Salomon and his two elder sons as directors. The directors then proceeded to carry out the proposed transfer of the business to the company and signed a contract with Mr. Salmon to that effect. The price fixed by the contract was duly paid. The price on paper was extravagant. It amounted to over #39,000- a price which represented the sanguine expectations of a fond owner rather than anything that can be called a businesslike or reasonable estimate of value. A sum of #20,000 was paid to Mr. Salomon and then immediately returned to the company in exchange of fully paid up shares. The sum of #10,000 was paid in debentures for the like amount. The balance went to discharge his business liabilities at the time of the transfer. In the result, he received for his business about #1,000 in cash, #10,000 in debentures, and half the nominal capital of the company in fully paid shares for what they were worth. The rest got seven shares. Shortly after incorporation, the business runs into financial crisis. He got his debentures cancelled and reissued to a Mr. Boderip, who advanced him #5,000, which he immediately loaned to the company. Mr. Boderip's interest was not paid when it became due and he sued and got a receiver appointed. During liquidation and the forced sale of the company's assets, they realised enough to pay Mr. Boderip, but not enough to pay the debentures in full: and the unsecured creditors were left in the cold. The liquidator disputed the validity of the debentures on the ground of fraud, claimed rescission of the contract for the transfer of the business, cancellation of the debentures, and repayment by Mr. Salomon of the balance of the purchase money or payment for the shares, arguing that nothing had been paid for them.

The trial judge, Vaughan Williams J., suggested that the company had a right of indemnity against Mr. Salmon and that the signatories to the Memorandum of Association were nominees of Mr. Salomon- mere dummies. The company was Mr. Salomon in another form. He used the name of the company as an *alias*. He employed the company as his agent; so the company, he thought, was entitled to indemnify against its principal.

The House of Lords reversed that view, holding that;

- ❖ the judge's order was a misconception of the scope and effect of the companies Act 1884. That in order to form a company ltd by shares the Act requires that the Memorandum of Association should be signed by 7 persons when each are to take one share.
- ❖ there is nothing in the Act requiring that the subscribers be independent or unrelated or that they or anyone of them should take a substantial interest in the under taking or that they should have a mind or will of their own or that there should be anything like a balance in the constitution of the company. If the conditions of the Act are complied with, it does not matter whether the signatories are strangers or relations.

- ❖ where the Memorandum of Association is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate (capable forth with) of exercising all the functions of an incorporated company. That the company attains maternity on its birth. There is no period of minority or interval of incapacity.
- ❖ a body corporate cannot lose its individuality by insuring the bulk of its capital to one person, whether he be a subscriber to the Memorandum of Association or not.
- ❖ the company is at law a different person altogether from the subscribers to the Memorandum of Association and though it may be that after the incorporation, the business is precisely the same as it was before and the same persons are managers and the same persons receive profits, the company is not in law the agent of subscribers or trustees for them nor are subscribers as members liable in any form or shape except to the extent and in the manner provided by the Act.

The doctrine of corporate personality as seen in the case above developed at a time when the capitalist system was emerging and continues to support it. Among the principal reasons which induce persons to form private companies are:-

- The desire to avoid the risk of bankruptcy.
- The used facility afforded for borrowing money.
- A trade can be carried out with limited liability and without exposing the persons interested in it in the event of failure to the harsh provisions of the bankruptcy law.
- A company too can raise money on debentures with an ordinary person cannot do.

Any member of a Company acting in good faith is as much entitled to take and hold the company's debentures as any outside creditor. Every creditor is entitled to get and hold the best security the law allows him to take. If the shares are fully paid up, it does not matter whether they are in the hands of one or many. This principle was also stated in the case of ***Lee V Lee & Air Farming Co. Ltd (1961) A.C 12.***

Lee formed an air farming company in NewZealand holding 90% and being the sole director of the company. The company was formed with the objective of spraying chemicals to kill pests. He was the only pilot employed by the company. He later died in a plane crash where upon his wife demanded compensation. Legally, the widow would only be entitled to compensation if only her late husband had been employed by any person. Counsel for the defendant claimed that Lee was not an employee. The NewZealand Court of Appeal was faced with the dilemma of deciding on who could have made the contract under which the husband was employed as the director.

The Privy Council held that he was an employee in one capacity and therefore should receive compensation. That once a company has been incorporated, there is no limitation for it to make any decision less it is *ultra vires*. That it is well established that the mere fact that

someone is a director of a company is no impediment to his entering into a contract to serve the company.

Furthermore, in the case of ***Macaura Vs Northern Assurance Co. Ltd (1925) AC 619***, Macaura had 99% shareholdings on a company that was involved in timber business and he took out an insurance policy against fire. Fire later destroyed the company's insured property and the assurance company refused to indemnify Macaura on the grounds that the property was for the company. Master J held that no shareholder has any right to any item of the property owned by the company for he has no legal or equitable interest therein. That he is House of Lords - England courts. entitled to a share in the profits while the company continues to carry on business and a share in the distribution of surplus assets when the company is wound up. This holding based on the insurance principle that when you are insuring thing, you must have an insurable interest in it i.e. an economic interest.

In the case of ***Katate -Vs-Nyakatukura (1956) 7 U.L.R 47***, the issue was whether a ltd liabilities company whose shareholders are Africans can be said to be African. It was held that a limited liability company is a body corporate and as such it has an existence which is distinct from its shareholders. Being a distinct legal entity and abstract in nature, it is not capable of having racial attributes.

Last but not least, in the case of ***Wani -Vs-Uganda Timber & Joiners Ltd, (Civil Suit No 989/1972)*** Katende. Pp.143, there was an application for a warrant of arrest to be issued against the managing director of the defendant company in order that he may be called upon to show cause why he should not furnish security for his company at the hearing of this suit. It was based on the fact that the Ugandan government had decreed that all the British Asians must leave the country (i.e. declared *persona non-grata*). It was held by Kiwanuka J.R that, "they had arrested a wrong man because the defendant was a company. The Managing Director was a mere officer and therefore should not be molested. That it is well to say that he is the managing director of the defendant company but a managing director is not the company and even if he were, the company records do not show him as a defendant."

CONSEQUENCES OF INCORPORATION

1. LIABILITY

The Company, being a distinct legal entity is liable for all its debts and obligations. The liability of the members or shareholders is limited to the amount remaining unpaid on the shares in the case of a Company limited by shares. In the case of a Company limited by guarantee, the liability is limited to the amount that the members guaranteed to pay. In the case of a Company that is unlimited, the members liability is unlimited i.e. their property will be encroached upon to pay the debtors of the Company. In the case of ***Sentamu Vs UCB (1983) H.CB 59*** it was held that individual members of the Company are not liable for the Company's debts.

2. PROPERTY

An incorporated Company is able to own property separately from its members. The advantage of this is that members can not directly interfere with the Company's property.

3. LEGAL PROCEEDINGS

As a legal person, a Company can take action to enforce its legal rights or be sued for breach of its duties. However, the action for or against the Company must be instituted in the Company's registered name. In the case of ***Dennis Njemanze Vs Shell B.P. Harcourt [1966] ALL NLR 8*** it was held that an action against a Company must be instituted in the Company's registered name. That it is not enough to institute the action in the name of an officer of the Company on behalf of the Company except where he has been authorised to do so.

4. PERPETUAL SUCCESSION

A company on its formation enjoys perpetual succession. This means that changes in the membership arising from bankruptcy or death of one of the members of the Company does not affect the existence of the Company. The life of the Company can only be brought to an end by a legal process known as winding up, striking off the Company from the register, amalgamation and reconstruction.

5. TRANSFER OF SHARES

A share constitutes an item of property, which is freely transferable except in the case of private Companies.

6. BORROWING

A Company can borrow money and provide security in the form of a floating charge. A floating charge is said to float like a cloud over the whole assets of the Company at any given time.

7. ABILITY TO CONTRACT

As an artificial person, a Company is able to enter into contracts like any other natural person. In the case of ***Lee Vs Lee's Air Farming(1960) 3 ALLER 420*** Lee who founded Lee's Air Farming limited was the controlling shareholder and governing director of the Company that had been established to kill pests. He was employed, as it's chief pilot. While piloting an aircraft of the Company in the course of it's business, he was killed. The issue arose in the course of litigation as to whether he was a worker. The NewZealand Court of Appeal held that he was not an employee. Upon Privy Council, it was held that he was a worker. LORD Morris stated that: "...the relationship came about because the deceased as one legal person was willing to work for and or make a contract with the Company which was another legal entity.

Disadvantages of incorporation

1. Formalities have to be followed
2. The exercise is too expensive.

LIFTING THE VEIL OF INCORPORATION

Ever since the case of Salomon, Courts of law continue to uphold the doctrine of corporate personality i.e that a company once formed becomes a separate legal entity from its members which can sue and be sued in its own name, it can contract in its own name, is liable for its own debts among others. ***Nevertheless, the application of the doctrine has in certain instances led to injustice and the courts have disregarded it.*** In certain situations the legal personality of a company may be disregarded in certain circumstances by a device known as lifting the veil or the mask of incorporation.

The companies Act in section 1 defines lifting the corporate veil to mean disregarding the corporate personality of a company in order to apportion liability to a person who carries out any act

In such a situation, the law looks at the people behind the company rather than the cloak of incorporation (company). The legal technique of lifting the veil is recognised under two heads i.e;

- i) lifting the veil under statute
- ii) Lifting the veil under case law

Statutory lifting of the veil

a) Where the number of members falls below the legal minimum

Under the S.20 of the Companies Act in case of a company other than a single member company, the membership is reduced below the statutory minimum the High court of Uganda may lift the corporate veil of such company. The section does not destroy the separate legal entity or personality of the company. It still remains an existing entity although the shareholders fall short of the minimum.

b) Where the company is not mentioned in the Bill of Exchange

Under the Act, an officer of the company is personally liable if he signs a bill of exchange eg a cheque on behalf of the company without mentioning the company's name on it in clear characters.

c) Holding and Subsidiary companies

Under the Act, where companies are in a relationship of holding and subsidiary companies, group accounts should be presented before the holding company in a general meeting. In this regard, the holding company and subsidiary companies are regarded as one for accounting purposes, and the separate nature of the subsidiary company is ignored.

d) Investigation into related companies

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

e) Taxation

The veil of incorporation may also be lifted to ascertain where the control and management of the company is exercised in order to determine where it is "a Ugandan company" for income tax purposes or where the company is involved in tax evasion. (S. 20)

f) Fraud

Under the S.20 of the Companies Act, the corporate veil of corporation may be lifted if the company is involved in fraudulent practices.

Lifting the veil under Case Law

a) Where the company acts as an agent of the shareholders

Where the shareholders of a company use the company as an agent, they will be liable for the debts of the company. Thus in *Re F.G (Fils) Ltd*, an American company provided all the funds for producing a film, which it sought to register as a British film on the ground that the film was produced by arrangement with a British Company of which the American company owned GBP90 of the GBP100 capital. It was held that the British company was no more than a nominee or agent of the American company which was the true maker of the film.

b) Where a company is deemed trustee of the shareholders

The courts are prepared in some cases to hold that the company holds property in trust for the shareholders. In ***Abbey, Malvern Wells Ltd Vs Ministry of Local Government & Planning***, all the shares of the company were held on charitable trusts. The articles of association provided that the relevant trustees would be the governing body of the company. It was held that the company held all its assets on charitable trusts.

c) Where there has been fraud or improper conduct

The veil of incorporation may be lifted where the corporate personality is used as a mask for fraud or illegality. In ***Gilford Motor Co. Vs Horne***, the defendant was the Plaintiff's former employee. He agreed not to solicit its customers when he left the employment. He then formed a company which solicited the customers. Both the company and the defendant were held liable for breach of covenant not to solicit. The company the defendant formed was described as a "mere cloak or sham for the purpose of enabling him to commit a breach of the covenant!"

d) Ratifying corporate acts

Under the law, a company is bound only by resolution of its organs such as the board of directors or a duly constituted general meeting, or duly authorised agents. The issue therefore arises as to whether a resolution which I passed by members without a properly convened meeting of the board or members binds the company. In ***Re George Newman Ltd***, Lindley L.J indicated thus; *individual assents given separately may preclude those who have given them from complaining of what they have sanctioned, but for the purpose of binding a company in its corporate capacity, individual assents given separately are not equivalent to the assent of a meeting.*

However, in subsequent cases it appears to have been recognised that individual assents of all members given separately are equivalent to the assent of a general meeting, irrespective of a formally convened meeting.

e) Determination of Residence

The court may look behind the veil or façade of the company and its place of registration in order to determine its residence. The test for determining residence is normally the place of its "central management and control". Usually, this is the place where the board of directors operate. However, it might also be the place of business of the managing director where he holds a controlling interest, or that of the parent company.

MANAGEMENT OF A COMPANY

There are basically two organs that are responsible for the management of a company and these include:

1. The share holders through company meetings
2. The Board of Directors through the Board of Directors meetings.

THE SHAREHOLDERS AND COMPANY MEETINGS

The shareholders have an opportunity of influencing the company's management through the company meetings. There are different types of meetings through which the shareholders can participate in the affairs of the company and these include:

1. STATUTORY MEETINGS

This is provided for under S.137 of the Companies Act 2012 which requires every company limited by shares or limited by guarantee having share capital to hold such type of meeting within 1-3 months from the date of commencement of business. The section has three features:

- (a) The meeting is only required of companies limited by shares and companies limited by guarantee which have share capital.
- (b) The meeting is held once in the company's life and can never be held ever again.

- (c) It must be held within 1-3 months from the date the company commenced business. The company must send a statutory report to all the members of the company at least 14 days before the meeting. This report must be certified by at least 2 directors of the company.

CONTENTS OF THE REPORT

- (i) Shares allotted
- (ii) Whether the shares are paid up or not.
- (iii) Cash received by the company from the sale of shares
- (iv) The nature of consideration for the issue of shares
- (v) Any payments made by the company
- (vi) Particulars (names, addresses, etc) of the directors, managers, auditors and secretary of the company
- (vii) Names, addresses and occupations of shareholders
- (viii) Particulars of major contracts requiring approval of the meeting, etc
- (ix) A copy of the statutory report must also be sent to the registrar in addition to the copies sent to the members (S.130(5)).

In case of failure to comply with the provisions regarding a statutory meeting, every director is supposed to pay a fine of 1000/= further, failure to hold such meeting is a ground for the winding up of the company. (S.222 (b))

2. ANNUAL GENERAL MEETING (AGM) (S.138)

Every public company is required to have an annual general meeting (AGM) this meeting is held every year and not more than fifteen months should elapse between the date of one annual general meeting of a company and that of the next.

A private company may at the request of a member hold an annual general meeting.

If a company does not convene such a meeting there are two consequences that arise:

- (i) The registrar may himself convene that meeting or order that the meeting be convened and in extreme cases, he may further order that any one shareholder of the company present in person or by proxy may be deemed to constitute the meeting.
- (ii) Every director who is in default of convening that meeting as well as the company and every officer responsible are liable to a default fine not exceeding 25 currency points

The 1st AGM must be held within 18 months from the date of its incorporation and thereafter within every 12 months.

The matters discussed in such meeting include:

- (i) Appointment of auditors and directors of the company
- (ii) Fixing their remuneration
- (iii) Declaration of dividends
- (iv) Consideration of the Accounts and balance sheets of the company
- (v) Consideration of the report of the directors and auditors of the company
- (vi) Election of new directors to replace those retiring
- (vii) Any special or other business

3. EXTRA-ORDINARY GENERAL MEETING (S.139)

This extra-ordinary general meeting is required by S.139 of the companies Act. This meeting may be held in case of emergencies or special matter which cannot wait until the next AGM.

The directors may whenever they think fit convene such meeting. However, such meeting may also be requisitioned by the shareholders themselves.

If at any time there are not within Uganda, sufficient directors capable of acting to form a quorum, any director or any two members of the company may convene an extra ordinary-general meeting in the same manner as nearly as possible as this meeting may be convened by the directors.

This meeting:

- (i) Is held as a result of a requisition by the shareholders or at the instance of the directors upon the emergence of an urgent or special matter.
- (ii) Not every shareholder can requisition for such meeting. In a company limited by shares, it is requisitioned by a member or members who hold not less than 10% of the shares in a company and those requisitioning for the meeting must represent at least 10% of the total voting rights.
- (iii) The meeting must be held within 21 days after the requisition has been received.

4. GENERAL MEETING CONVENED UNDER COURT ORDERS (S.142)

This type of meeting occurs as a result of an aggrieved shareholder or member applying to court for an Annual General Meeting to be held in instances in case it not practicable to hold a meeting in any of the above described ways. Court can also on its own motion also order a company to conduct a meeting.

Under such circumstances, court may where it thinks fit order a one person meeting. In the case of **RE SOMBRERO LTD (1958) CH 980**, one member was allowed by court to constitute a meeting. The court pointed out that the circumstances of each particular

case must be examined and that in the instant case, if the meeting was refused, it would be depriving the applicant of his statutory right which through the company he is entitled to exercise and remove the respondents as directors.

That there is a clear statutory duty on directors to call this meeting whether or not the consideration which is only one of the matters to be dealt with at the Annual General Meeting is ready or not.

In ***UGANDA EYEDDEMBE PUBLICATIONS LTD (1975)(Companies Cause No. 9 of 1979)***

In this case there were three shareholders, two of whom were chased from Uganda in 1972. The third member became the sole director, signatory and used to constitute all general meetings and the court later allowed it.

In the case of ***RE AIR RIP INTERNATIONAL LTD (Companies cause NO.3 of 1984)***. There were only two shareholders and one complained that his co-shareholder had never stepped into the companies premises for the previous two years. The court asked him to make an application requesting to be allowed to convene a general meeting which he duly did and it was granted.

NOTICES OF COMPANY MEETINGS

The law insists on the need for directors to give shareholders full information and detailed disclosures of what is likely to be discussed in the meeting. In the case of ***HENDERSON V BANK OF AUSTRA-ASIA (1890) 45 CH 330***, court held that the shareholders must be given full and sufficient information as to what is likely to be discussed in the meeting.

The notices convening meetings must be sent to the members within the time prescribed by the company's Act, that is 21 days before the meeting and every notice must be in writing or otherwise the notice is void. **(S. 140)**

However if a shorter notice is given and all the members attend the meeting is valid.

A number of cases have considered the issue of self interests where the directors have not fully disclosed the matters of discussion. In the case of ***KAYE V CROYDON TRAMWAYS CO. (1898) 1 CH 358***, one of the issues to be discussed at the company's meeting was whether or not to approve a particular agreement in which the directors stood to gain. The secretary sent out a vague circular for the meeting and the members asked the secretary to provide further information as to how the directors stood to benefit but this was not complied with. The issue was whether the meeting and the agreement adopted were valid. ***Court held*** that the notice was insufficient and therefore the

agreement adopted at the meeting could not be valid until sanctioned by a proper company's meeting duly convened for that purpose.

In the case of ***TIESSEN VS ANDERSON (1899)1 CH 86***, the meeting of the company was to consider alternative schemes of reconstructing a company which was in financial difficulties. The scheme adopted, was one in which one of the directors had a strong interest which was not disclosed in the notice.

One of the shareholders applied to court to have the resolution set aside. ***Court held*** that "a shareholder after investing his money in a company which is now in financial difficulties has to consider whether or not the scheme proposed is the best scheme."

The notice convening the meeting must thus be sufficient, full and specific to enable the shareholder receiving it to decide whether to attend or not. It must give fair warning and fair chance.

The court in this case concluded that it is not protecting decedents (a shareholder who isn't interested) but a shareholder who is absent as a result of having received a notice but concludes that he will not oppose the matter for discussion leaving it for the majority to decide.

PROCEDURE, ATTENDANCE AND VOTING AT MEETINGS

Unless the company's articles provide otherwise, any two or more members holding at least 10% of the capital and paid up capital may call a company's meeting (Provided under S.141 (b) of the company's Act.)

QUORUM

This term refers to the number of members of any body of persons whose presence at the meetings is required in order that business may be validly transacted. Where the articles of the company are silent, the company's Act provides that ***"In case of a private company, two members present in person, and in case of any other company, three members personally present constitute a quorum."s.141(c)***

However, one member may constitute a quorum where the court under S.142 declares that a quorum of one person is sufficient for a meeting. See **RE: UGANDA EYEDDEMBE PUBLICATIONS LTD (1975)** Company's cause of No. 9 of 1979

DUTY OF THE CHAIRMAN

The Chairperson of a meeting may be elected by members present at the meeting (S. 141(c)). The articles of association (AOA) usually stipulate who shall be the chairman at meetings for instance **Table A** under **articles 55-56** indicate that the chairman of the

Board of Directors if present and willing shall be the chair and in case he is absent, or if the members so wish, a chair may be elected by the members present from among themselves.

The chairman's duties include:

1. Ensuring proper and orderly conduct of the business at the meeting.
2. Regulating the proceedings and
3. Time keeping.

Article 60 of Table A gives the chairman the casting vote at the meeting. In the case of ***NATIONAL DWELLING SOCIETY (1894) 3 CH 159*** the court held that it is unquestionably the duty of the chairman to preserve order and to take care that the proceedings are conducted in a proper manner and that the sense of the meeting is properly ascertained with regard to any question before the meeting.

The court further said that the chairman has no power to take into his own hands decisions which the meeting has competence to decide.

VOTING AT MEETINGS

Unless the articles of the company provide otherwise, each member has one vote and voting is by show of hands irrespective of the number of shares held by each.

Under S.144 poll may be demanded before or by the show of hands. Where the articles provide that voting shall be by poll, in a company with a share capital, each member has one vote in respect of his shares. Thus, a shareholder with a higher number of shares has a higher vote.

The AOA can not exclude the right to demand a poll or require a specific percentage of members with a specified number of shares to demand for it.

Under S.144, it is stated that either 5 members entitled to vote or shareholders with at least 10% of the voting rights, can demand a vote by poll. The rationale behind voting by poll is the presumption that, those who are likely to demand the poll are the members with the highest stake in the company. Accordingly, if an important matter relating to the company's policy is before the meeting, such people must be given a chance to direct the company.

Any provision in the AOA which tends to exclude the right to demand a poll is invalid.

The courts may however sometimes invalidate a member's voting if it wasn't done in good faith. ***RE: CLEMENS V CLEMENS LTD (1976) 2, ALL ER 268*** an Auntie who framed resolutions attempted to get the plaintiff out of any control of the company and the court set the resolutions aside on the ground that it wasn't done in good faith.

PROXY

A proxy in company law is a document which authorizes somebody to attend a meeting on behalf of a shareholder. The person appointed may or may not be a shareholder of the company.

Under S.143 a person holding a proxy can vote on a poll. A person appointed as a proxy has the same rights as the person appointing him.

The notice calling the meeting must specify that the member is free to appoint a proxy.

OFFICERS AND MEMBERS OF THE COMPANY

1. THE BOARD OF DIRECTORS (BOD)

This is the other organ that is charged with the management of a company. There is no definition of a director in the Company's Act or even under case law. Nevertheless, S.1 of the Act states that "a director includes any person occupying the position of a director by whatever name he may be called".

According to S.185 a public company must have at least two directors but a private company can have one director. However, where a private company has one director, such director cannot at the same time act simultaneously as the secretary of the company.

According to section 186, a single member company is required to nominate two nominees, one of whom becomes nominee director in case of death of the single member and the other becomes alternate nominee director to work as nominee director in case of non-availability of the nominee director

QUALIFICATIONS OF DIRECTORS

1. S.193 of the company's act provides that before a person can be appointed a director of a company with a share capital, he must have signed and delivered for registration his consent to act as a director.
2. According to S.196, a person is not eligible for appointment as a director unless such person has attained the age of 18 and above.
3. S.200 disqualifies an undischarged bankrupt from becoming a director and where such person acts as such, then he will be liable to a fine not exceeding 10,000 or imprisonment of two years or both.

4. Under S.201, the court is empowered to prohibit any person from taking part in the management of the company for a period of five years if that person is convicted of an offence relating to the promotion, formation, management or winding up of the company.

However, the acts of persons who act as directors when they are not qualified are not necessarily invalid. In the case of ***R V CAMPS (1962) EA 403***. In this case the articles required every director to hold in his own right at least one fully paid up share in the capital of the company camps didn't satisfy this requirement but continued to act as a director.

When he was charged with failing to keep proper books of accounts, and failing to hold an AGM and also failing to produce accounts and the balance sheets, he argued that he wasn't even qualified to be a director.

The trial court held that since camps never acquired his qualification shares, his appointment was invalid and the case was dismissed. The state appealed and the supreme court of Kenya agreed with the trial court and held that camps could not be held to be a director since with the enactment of the section which made it an offence to act as a director when unqualified, the legislature did not intend to include such persons as camps.

The state appealed further and it was held that "Camps had been validly appointed a de jure director (that he wasn't a director as a matter of law) but he continued to act as a de facto one. (As if he was in fact a director) and therefore he was liable."

The court pointed out that any person who performs the functions of a director, though not duly qualified is occupying the position of the director that to hold otherwise would be to defeat the object of the penal sanctions relating to liability of directors.

PAYMENT/REMUNERATION OF DIRECTORS

Payment to the directors is not provided for under the Companies Act. In the case of ***RE GEORGE NEWMAN & CO***. the chairman of the company spent large sums of the company's funds on improving on his private residence to uplift the social image he held as a chairman. On liquidation of the company, the liquidators wanted the chairman to refund the company monies that he had spent personally.

Court held that directors have no right to be paid for their services and cannot pay themselves or each other or make presents to themselves out of the company's assets unless authorized by the instrument regulating the company (the Articles of Association (AOA) or by the share holders at a properly convened meeting (through a resolution).

Accordingly, the legal position is that unless authorized by the AOA or the general meeting, directors are not legally entitled to pay themselves salaries for the services

rendered by them to the company. However, Table A, article 76 provides for payment for directors for professional services they may have rendered to the company.

However, a major question arises that where payment for directors is provided for in the AOA; can a director who is not a member or shareholder of the company enforce his right to payment on the basis of the AOA? *The AOA is a contract between the shareholders and the company as well as between the shareholders themselves. So it is only the shareholders who can enforce a right provided for in the articles.* Therefore a director who is not a shareholder/member of the company cannot enforce his right to payment on the basis of the AOA even if it is in the AOA where payment for the directors is provided for. This is because he is not privy or party to the AOA which is a contract between the shareholders and the company as well as between the shareholders themselves.

However, where payment is provided for in the AOA, a director who is also a member of the company can enforce his right to payment for his services as a director on the basis of the AOA because he is privy to the AOA which is a contract between the members and the company and between the members themselves.

It is therefore important that where a director is not a shareholder of the company he must insist that the company through the shareholders meetings makes a resolution regarding his payment for his services as a director.

THE CONSTITUTION AND CONDUCT OF DIRECTORS'S MEETINGS

Since the BOD is entrusted with the management and administration of the company, its affairs must be conducted with reasonable formality. Decisions of the Board of Directors will govern internal matters e.g. capital expenditure and personnel policy. The Board of Directors resolutions also constitute the authority for dealings with 3rd Parties e.g. opening of Accounts, entering into specific transactions, engaging employees etc.

Accordingly, the Companies Act provides that "*subject to the provisions of the AOA, the directors may regulate their proceedings as they think fit.*"

This term "as they think fit" was discussed in the case of ***RE PORTUGUESE CONSOLIDATED MINES LTD (1889) 42 CH 160***, In this case, an application was made for shares in the company and the same day there was a meeting of two out of four directors. The other two were not given sufficient notice for the meeting. The meeting resolved that the two should form a quorum and allotted shares. They adjourned the meeting until the next day. On that day, the allottee withdrew his application and the meeting was again adjourned to the following day. On this 3rd occasion three directors

were present. One of those who had been previously absent approved the resolution relating to the quorum and confirmed the allotment.

The 4th director on the same day wrote approving the quorum and his letter was received the next day.

The court of appeal held that as there had been no notice to the original meeting, none of the subsequent meetings was valid and the allotment was bad in law.

This case is authority for the rule that; In general, the only way in which directors can exercise their powers in the management of the company is at or under the authority of a meeting if a proper notice is given to all the directors.

However, a Board of Directors meeting can be held under informal circumstances i.e. casual meetings."

However, casual meetings of two directors unless in exceptional circumstances cannot be treated as a Board of Directors meeting if the meeting is held at the option of one director against the will and intention of the other. This was laid out in the case of ***BARROW V PORTER (1914) 1 CH 895***, This company consisted of two directors Barrow and Porter and they failed to agree as to the conduct of the company's business and they refused to meet each other in Board of Director meetings. Barrow requisitioned a general meeting for the purpose of approving resolutions removing Mr Porter from the Board of Directors and for appointing another director. The day before the general meeting, Porter met Barrow coming off a train and proposed that certain persons be appointed directors of the company. Barrow replied that he had nothing to say and continued towards a taxi. There and then, Porter as chairman of the company gave his casting vote and declared the resolution passed. Realising that this was not good enough, he went to Barrow's office before the meeting and proposed other directors. Again Barrow made a non-committal answer and Porter again exercised his casting vote and declared them appointed. The issue was whether these meetings were valid and ***court held*** that these were not meetings.

This however is not to suggest that informal BOD meetings are not valid for it depends on the circumstances of each particular case.

Directors must also act as a body and the courts of law will intervene where a director is improperly excluded from BOD meetings by fellow directors. An excluded director can apply to court for an injunction to restrain the other directors from continuing to exclude him from taking part in the BOD meetings.

However, where the shareholders do not wish a particular director to continue acting as a member of the BOD, then the court will not grant the injunction.

CONFLICT BETWEEN SHAREHOLDERS AND DIRECTORS OF THE COMPANY

Who has more power?

The issue as to which of the two wields the real power is very important at that level. Article 80 of Table A which is adopted by most companies is to the effect that, ***"A part from those powers as may have been expressly reserved for the general meeting by the Act and the AOA, directors are to manage the companies business and to exercise all powers as are not reserved for the general meeting."***

Article 80(2) of Table A of the companies Act allows the shareholders in a general meeting to invalidate any decision made by the board of directors that they consider is not in the best interests of the company.

DISMISSAL OF DIRECTORS

According to S.195 of the Companies Act, A director can be removed by an ordinary resolution before the expiry of his tenure of office even if the AOA or the contract between himself and the company provide otherwise. However, before such director is dismissed, he must be given a notice of dismissal of 28 days and within that period, the director is free to make/set the record straight.

LIABILITY OF A COMPANY FOR THE ACTS OF ITS DIRECTORS/OFFICER

Whereas a natural person is fully responsible for his acts carried out in his normal mental capacity, the situation is slightly different and complicated when it comes to company matters.

The law regarding liability of a company was laid out in the case of ***LENNARDS CURRYING CO Vs ASIATIC PETROLEUM (1915) AC 705***; In this case, the issue was whether a company could admit actual fault or privity in the loss of a ship, which is an abstract with neither a mind nor a body of its own. ***Court held*** that ***"active and directing will must be seen to exist in the person of somebody who for some purposes may be called an agent but who is really the directing will and mind of the company"***. Such person may be acting under the direction of the general meeting or the Board of Directors or some person authorized under the AOA provided he's appointed by the company's general meeting.

It must be noted that not any type of officer will make the company liable for his acts. The courts have identified the categories of persons whose acts will bind the company in the case of ***BOLTON ENGINEERING CO. LTD V GRAHAMS & SONS LTD***, In this case Lord Denning held that: ***"Although a company may often be linked to a human body in so far as he has a brain, a nerve centre which control what he does as well as having***

hands which hold the tools to do a particular act, never the less, some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind and will of the company. But there are others as directors and managers who represent the directing mind and will of the company and therefore control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such. Where the law requires personal fault as a condition of liability, the fault of the managers or directors is the fault of the company"

In the case of **SMITHFIELD BUTCHERY V R**, in this case, the appellant company had been indicted for contravening by-laws relating to the sale of meat. And the court accepted the contention/argument that wrongful acts by subordinate staff of the company would not in ordinary circumstances be sufficient to affix or prefer criminal responsibility as such but since the selling of such meat was within the knowledge of at least one responsible agent of the company, the company was liable.

THE INDOOR MANAGEMENT RULE (THE RULE IN TURQUAND)

The courts have attempted to reconcile the interests of the company with the interests of those who deal with the company in the indoor management rule which emerged in the case of **LOYAL BRITISH BANK V TURQUANDS (1865) 119 ER 886**; In this case, the company's deed of settlement (AOA) authorized directors to borrow on behalf of the company on bond only such sums as authorized by a general resolution of the company. Contrary to this, two directors and the company's secretary borrowed €2000 on bond from the plaintiff bank without authority of the general meeting. The bank made a demand for payment from the company and the company said it wasn't liable since the officers who carried out the transaction did not abide with the regulations.

Court held "that those who deal with an incorporated company are bound to look at the AOA but once a person looks at the AOA and MOA he is not bound to do more than that (ie he is not bound to look beyond the MOA & AOA)

Therefore the court held that the bank had a right to infer that a resolution by the company had been given for the money borrowed. It should be noted that the rule on this matter is "While a person dealing with the company is fixed within notice of the contents in the MOA & AOA, and once he has looked at these documents and found that there's authority for a particular officer to enter into a transaction on behalf of the company and that the transaction is intra vires the company, one isn't bound to investigate further in the absence of any facts putting one on such inquiry investigation."

The rationale for this rule according to Gower in his book, Principles of Modern Company Law page 184 was to enhance business convenience since business could not be carried

out effectively if everybody was dealing with the company had to examine its internal machinery in order to ensure that there was actual authority.

The Indoor Management Rule is over ruled by the companies Act (S.51,52 &53) in as far as it provides that:

- 1. The capacity of a company cannot be limited by the memorandum of association**
- 2. The power of the board of directors to bind the company is not limited by the memorandum of association**
- 3. A person dealing with the company has no duty to enquire as to capacity of a company or authority of directors.**

As such, any person dealing with a company has absolutely no duty to enquire as to whether a transaction done by the company is intra vires the company or the power of directors to bind the company in that particular transaction whether or not they authorized by the memorandum

DUTIES OF OFFICERS AND MEMBERS OF THE COMPANY

1. DIRECTORS

It should be noted that although directors are important to the company, their role was not all that emphasized until 1883 in the case of ***RE DENHAMS & CO (1883) CH 752*** where the court held that a director who was a company gentleman and never attended most of the BOD meetings for 4 years, who was unskilled in business matters and trusted other directors to run the company affairs wasn't liable in negligence for the acts of his colleagues who had wrongly declared the payment of dividends.

KATENDE in his book *"The Law of Business Organizations in East and Central Africa"* on the question of the standard of duty expected of a director stated that; *"Since directors are not professional men, the standard of duty expected of them was not clear."*

In the case of ***Cook V Deeks (1916) AC 514*** Lord Buckmaster stated that: *"Since directors were not professional men, the standard of duty expected of them was difficult to judge."*

Gower in his book *Principles of Modern company Law* pg.603 stated that "the courts have moved with less assurance among complicated problems of economics and business administration with the result that they are reluctant to interfere with the director's business judgment.

However, the company being a vital instrument in the conceptualization and maintenance of capital, it was necessary in the interest of all those interested in the

company to set minimum standards in a way for the directors and its now an established principle that a director owes a company definite duties i.e

The duties of the directors are provided for in S. 198 of the companies Act to include the following:—

1. Act in a manner that promotes the success of the business of the company;
2. Exercise a degree of skill and care as a reasonable person would do looking after their own business;
 - a) Act in good faith in the interests of the company as a whole, and this shall include:—Treating all shareholders equally;
 - b) Avoiding conflicts of interest;
 - c) Declaring any conflicts of interest;
 - d) Not making personal profits at the company's expense;
 - e) Not accepting benefits that will compromise him or her from third parties; and
3. Ensure compliance with this Act and any other law.

1. THE DUTY OF SKILL AND CARE

There is no criterion for measuring the standard of the duty of skill and care expected of a director and consequently this will depend on the circumstances of each case. Never the less the courts have tried to set some guidelines as to what this duty entails.

In the case of ***RE: CITY EQUITABLE FIRE INSURANCE CO LTD (1925) CH 407***, on the question of liability of directors of an Insurance Company who had left the management of the company affairs to its managing director, owing to the latter's fraud, a large amount of the company's assets disappeared. Some items appeared in the balance sheet under the heading "Loans at call" or "At short notice" and "Cash at bank or in hand", but the directors never inquired as to how such items were made up. If they had done so, they would have discovered that the loans were actually made to the Managing Director and the general manager.

The court in holding the directors liable for breach of the duty of skill and care on the ground that they were negligent, also laid down two criteria against which the standard of the duty of skill and care of a director must be measured. These include:

- (a) The court pointed out that there's need to look at the nature of the company's business. Where such a company is a small concern, the standard of the duty expected of a director is not as high as that expected of a director within a big company.
- (b) The mode with which the company's work is distributed among various officers has to be determined. Where the company's operations are divided among many directors, the duty of skill and care is higher.

The court in this case laid down the general preposition of law in this area which is to the effect that while a director need not exhibit a greater degree of skill in the performance of his duties than may be reasonably expected of a person with similar knowledge and experience, he must act honestly and for the benefit of the company while at the same time exercising some degree of skill and care.

ROMER J in the same case state that; "A director is not bound to give continuous attention to the affairs of a company as long as he attends the Board of Directors and Committee meetings whenever called upon."

2. THE DUTY OF GOOD FAITH

In determining whether or not a director or any other officer has breached the duty of good faith to the company, it must always be remembered that the officer stands in a fiduciary relationship to the company.

Whenever a party has an upper hand in any relationship, e.g. a lawyer and a client, Doctor-patient, Trustee-Beneficiary etc in any commercial transaction, we term this party's position as a fiduciary position and any cheating by this party may be challenged in courts of law.

In formulating the rules governing a director in respect of this duty of good faith, the courts have been more elaborate compared to the duty of skill and care.

The duty of good faith is sub divided in about 5 components;

i) The duty to exercise director's powers with good faith and for proper purposes. The directors must always put the company's interests first and in the exercise of their powers they must take into account the paramount interests of the company. Therefore the Board of Directors as a body has an equitable duty to act bonafide (act in good faith). In the case of **PURCIVAL V WRIGHT (1902) 2 CH 421**, the court stated that the principle or the duty of good faith is owed to the company and not individual share holders.

a) When dealing with company's property; When dealing with the company's property, the duty of good faith requires that a director should take care to protect the company's property. In the case of **RE: GEORGE NEWMAN & CO.**, where directors made resents to themselves out of money borrowed by the company for its business, **court held** that the company's assets are its property and not for the shareholders and if directors misapply such assets, they will be held liable for misapplication.

WHAT CONSTITUTES COMPANY PROPERTY?

The term company property is defined widely to cover contracts which such company may be entitled to. In **Cooks V Deeks (1916)1 AC 554**, 2 directors who were in

conflict with a 3rd director wanted to appropriate to themselves a contract to which the company was entitled. They negotiated the contract on their own behalf but using exactly the same procedure as they had always used while acting on behalf of the company. ***The Privy Council held***, the directors liable for appropriation and the court emphasized the fact that directors who assume the control of the company's business are not at liberty to sacrifice the interests of the company which they are bound to protect and consequently they should not divert to themselves any business which property belongs to the company.

Therefore, directors have a duty to protect the company's property and not to expend them anyhow. If they do so, they will be liable for breach of the duty of good faith and will have to make good, the loss i.e. compensate the loss.

(iii) Making secret profits out of the company

In the discharge of his duties, a director is expected to avoid making secret profits at the expense of the company. Under the law, if a director uses his position to make secret profits this is regarded as a breach of the duty of good faith and the law is quite strict in this respect as observed in the case of ***ABERDEEN RAIL CO. V BLAKE BROTHERS (1943) ALLER 249***; In this case, the house of Lords stated that a director was in a position of a trustee when there's a likelihood of using his position as a director to make profits from a company's contract especially where he has an interest in the contract.

That a director as an agent has a fiduciary duty towards his principal and this is a rule of universal application i.e. *"No one having such duties to discharge shall be allowed to enter into engagements in which he has a personal interest which is in conflict with the interests of the company."*

The court further pointed out that this principle was so strict that a defense of fairness of the contract would not be allowed.

The rule in ***Blaike's case*** has been slightly modified since it was never regarded fair. S.200 of the Companies Act modifies the rule and allows a director to make a profit out of the transaction provided he has disclosed matters relating to his personal interest in such contract to the BOD.

In the case of ***HALLY HUTCHINSON V BRAY-HEAD LTD***, court held that failure to disclose such interest does not necessarily render such contract void but voidable.

It should be understood that it is the duty of directors of companies to use their best exertions for the benefit of those whose interests are committed to their charge and that they should disregard their own private interests of/whenever a regard to them conflicts to the discharge of their duties.

The following tests must be satisfied before directors are made liable for breach of the duty of good faith.

1. Need to prove that the transaction into which the director entered was so related to the affairs of the company to the extent that it can properly be said to have been done in the course of neutralization of his opportunities and special knowledge of a director.
2. It must be proved that what the particular director did resulted in a profit to him self

(iv) Insider trading (trading in securities of the company)

This is where a well-positioned officer in the company uses sensitive and important information about that company to his benefit. This is more common in deals concerning securities and capital markets.

Directors of companies are free to acquire shares in the companies. And if a director has shares in this company, he is taken to be an insider although at times even if one has no shares but is actively involved in the day-to-day management of the company, then for all intents and purposes he is an insider.

A director being deep inside the company is placed in a position to utilize sensitive information regarding the value of shares and also the company as a whole. In the case of **PURCIVAL V WRIGHT (1902) 1 CH** the plaintiffs owned shares per value of £10 in a company whose shares neither had a market price nor were they quoted on the stock exchange and were only transferable with the director's approval. Through their solicitors, the plaintiffs inquired from the company if anybody was willing to purchase their shares at £12.55 a price based on independent valuation. The chairman of the BOD agreed to take up the shares at £12.10. During the transaction the chairman informed the plaintiffs that two other directors were interested in buying the shares in question. Later on, the plaintiffs learnt that before and during the negotiations, the chairman had been approached by a party who wanted to buy all the company shares at a price over and above £12.10, but the negotiations did not materialize and the plaintiffs in this case sued to set aside the sale of the shares on the ground that the BOD owed them a duty to disclose the info about the unfruitful negotiations and that the directors were in a fiduciary duty as trustees for the individual share holders.

The issue was whether

1. The directors owed a duty to the shareholders to disclose information regarding the unfruitful negotiations
2. The directors owe the duty of good faith to the shareholders

The court rejected the argument of the shareholders and pointed out that the plaintiff shareholders were fixed with knowledge of the powers of directors and therefore had no

basis to assume that such directors were not exercising their powers properly. That the directors owe a fiduciary duty to the company and not the individual shareholders.

Court further said that there was need to protect directors from disclosing pre-mature transactions since pre-mature disclosure might well be against the best interests of the company. This case laid down the preposition that the duty of good faith by directors is owed to the company as a whole and not the individual shareholders.

ENFORCEMENT OF MEMBERS' RIGHTS

Sealy in his book **"Cases and Materials in Company Law" (1971)** at page 452-453 stated that the minority shareholders of a company in principle must accept the decisions of the majority shareholders and must acknowledge that the powers enjoyed by their brethren/ brothers bring about change in the company by persuasion, lobbying and publicity.

The frustration of the minority shareholders in such a situation can only be resolved by the protection of the law as provided under common law and the Companies Act.

Accordingly, a shareholder who is aggrieved by the actions, omissions or decisions of the majority shareholders has rights and remedies generally based on contract. This contract emanates from the Companies Act which is to the effect that once the MOA and AOA have been signed, they constitute a contract between a particular signatory and his co-signatories as well as between himself and the company. Thus, such a minority shareholder can sue in court basing on breach of this contract. However, one has to be a member or shareholder to sue or benefit from this contract in question (AOA).

The instances when such a contract may be breached are many and include among others:

- (i) Where a shareholder is denied his dividend that has already been declared
- (ii) Where a director has embezzled and misappropriated the company's property and funds
- (iii) Where it is obvious that the majority shareholders are expropriating the minority shareholder's share
- (iv) Where the majority shareholders are varying the rights of a minority shareholder without the latter's consent or are infringing them in one way or another.

It should be noted that whether or not a minority shareholder will be able to maintain any of these actions in his name would depend on the procedure laid down by the law.

ENFORCEMENT OF MEMBERS' RIGHTS AT COMMON LAW

The issue as to whether or not a shareholder can maintain a personal action for wrongs in his company is in common law governed by the rule in **FOSS V HARBOTTLE (1843)**.

In this case, the plaintiff complained inter alia that the directors of the company had sold their own land to such company at a price quite in excess of the true value of the land i.e. they had benefited from the sale. The court found as a fact that even if the act of the directors was wrong and true, it was not an injury to the plaintiff but to the company as a whole and the court dismissed the action observing that; ***"in such cases where the company has also been injured it is the company to sue for such wrong unless factors exist to justify a departure from this procedure."***

The court propounded the rule to the effect that

"In a case where something injurious has been done to the company, the proper plaintiff to sue for that wrong is not an individual or a group of share holders but the company itself".

Rationale (reason behind) of the rule in Foss Vs Harbottle

The rule in **Foss & Harbottle** was an aid before courts to curb unnecessary potential litigation.

In the case of **MAC DOUGH V GARDINER (1871) Ch 13**, the court pointed out that if every dispute about the internal management of companies had to be brought to courts, the courts would be overwhelmed with cases.

In the case of **MAYRILLE V WHITLEY (1896), Ch 788**, court said that the rule serves the purpose of preventing the company from being torn to pieces by litigation.

In **CAREN V DRURY (1812)** the court stated in principle that ***"this court is not to be required from every occasion to take the management of any play house and brew house in the kingdom."***

EXCEPTIONS TO THE RULE IN FOSS & HARBOTTLE

Although the rule in **Foss & Harbottle** is a general rule, it has many exceptions. The case in Foss in providing for the rule also provides for a situation where one may depart from the general rule and this is where the court states in the holding:

"... that unless factors exist to justify a departure from that procedure."

Consequently and over time, a number of exceptions have been formulated with a view of bringing in line the rule in Foss & Harbottle with the realities of changing times.

1. Infringement of a personal right of a shareholder

Once the individual rights of a shareholder have been infringed or are about to be infringed, the aggrieved shareholder can maintain a personal action notwithstanding the fact that his company may also have been infringed in the process. In the case of **MISANGO V MUSINGIRE (1966) EA 390**, the plaintiff argued that a meeting of his company by a resolution altered the AOA of the company to his detriment. He further argued that non-shareholders attended the meeting and voted for such resolution. Sir Udo-Udoma **held** that the suit was maintained in law by the plaintiff in his own right, since there had been an injury done to him personally by the directors and other members of the company.

3. Where the directors involve the company in illegal transactions

If there's a fraudulent act being carried out in the company and those committing the act are the people in control as majority shareholders, an individual shareholder can maintain a personal action notwithstanding the rule **in Foss & Harbottle**.

In the case of **BROWN Vs BRITISH APPREHENSIVE WHEEL Co. (1919) CH 290**, the defendant majority shareholders having failed to persuade the minority for the latter to sell to them their shares, attempted to add to the company's AOA a clause requiring any shareholder to transfer compulsorily his shares if required in writing by an order of at least 90% of the company's issued capital. Acting under the new article, the defendants holding 98% of the shares asked the plaintiff to transfer his shares to them upon which the plaintiff brought an application to court challenging this new article.

The court declared the resolution for the new article invalid as it amounted to expropriation of the plaintiff's shares.

The term "**fraud on the minority**" has been broadly interpreted to cover even instances where the company's property is being expropriated.

In the case of **EDWARDS V HADWELL (1950)**, Jenkins L.J laid down the tests where the rule in Foss & Harbottle may be departed from i.e.

- (i) where the company shareholders are acting or are about to act ultra vires
- (ii) when the act complained of though not ultravires is illegal and could be effectively resolved by a mere simple majority vote.
- (iii) Where its alleged that the personal rights of the plaintiff's shareholders have been infringed or are about to be infringed
- (iv) Where those who control the company are perpetuating a fraud on a minority shareholder.

In **DANIELS V DANIELS (1972) 2 WLR 73**; court held that fraud on the minority covers more than fraud in the strict sense and an action would be allowed in respect of any fault without fraud.

4. Breach of the Articles of Association

These articles constitute a contract between the shareholders and the company as well as between the shareholders themselves and therefore any shareholder can institute an action in his name where the articles have been breached.

5. Need to by-pass the rule in Foss & Harbottle in the interest of Justice

In the case of **HEYTING V DUPONT (1964), WLR 843**, the court held that the category of exceptions to the rule in F & H could not be closed since under certain instances the interests of justice may demand that the rule be by-passed by a minority shareholder

In **DANIELS Vs DANIELS** a share holder complained that the defendants who were the majority shareholders as well as the directors of the company acted negligently in selling the company property (land), to one of the directors for £4,250 and that director resold the land four years later at £120,000.

The issue was whether the plaintiff's action could succeed in light of the rule in F & H in the absence of any fraud. **Court held** that there's no reason why it cannot succeed where the action of the majority and the directors although without fraud had conferred some direct benefits to themselves.

The court said that ***"to put up with directors is one thing and to put up with directors who are so foolish that they make a profit of that magnitude at the expense of the company's is something entirely different."***

6. Derivative actions

This is a relatively recently developed action which a shareholder who cannot proceed under common law because of the rule in F & H or under statute can take a complaint to court for the wrongs committed in his company. The plaintiff in such action is seen not to be suing on his own but on behalf of and for the company.

However, there are limitations on derivative actions, that is:

- (i) The plaintiff must have clean hands i.e. he must not have connived with the company members.
- (ii) It must be proved that it is impracticable for the company to sue by itself.

A derivative action differs from a personal action in the sense that although a shareholder is allowed to sue, he is not suing on his own behalf but on behalf of the company because the company itself is unable to sue for that wrong.

The rationale behind the principle is that when the people who have committed the wrong are the same people who are supposed to sue, they may not do it.

However, the courts have insisted that a derivative action should not be utilized as a means of side stepping the rule in F & H therefore the following conditions must be satisfied:

- (i) The action must allege a fraud on the minority.
- (ii) That the company is being controlled by those who have committed the wrong and therefore are unable to sue for it.
- (iii) That the plaintiff is not suing on his own behalf or on behalf of the others but rather on behalf of the company.

7. Protection of members against prejudicial conduct.

A member of a company may apply to the court by petition for an order under this Part on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members including at least himself or herself or that any actual or proposed act or omission of the company including an act or omission on its behalf is or would be so prejudicial.

B. ENFORCEMENT OF MEMBERS' RIGHTS UNDER STATUTORY LAW

1. Winding up the Company Under the Just and Equitable Clause

A company can be wound up if it is just and equitable to do so. Before the shareholder can have the matter entertained under this section, he must satisfy the following conditions:

- a. He must petition the court that the company be wound up for just and equitable reasons.
- b. The petitioner must be a contributory. That is, he must be a shareholder who is liable to contribute to the assets of the company during its winding up.
- c. He must satisfy the court that although there is another remedy open to him, he is not acting unreasonably in not seeking that other remedy instead of winding up the company.
- d. The petitioner must satisfy the court that after the winding up, there will still be something tangible for sharing among shareholders - if the company is heavily indebted (insolvent) then S. 222 cannot be invoked.

What kind of Wrongs can be Entertained Under the Just and Equitable Clause?

The following have been accepted as major grounds for winding up the company under the Just and Equitable Clause:

a. Deadlock between Directors who are also the only Shareholders:

In Reyenidje Tobacco Co Ltd (1916) 2 Ch.426; two directors who were also the only shareholders only communicated through a secretary. The directors hated each other such so much that the company had to be wound up.

b. Loss of substratum of the company (i.e. object for which the company was formed):

Where a company was formed for an illegal or fraudulent purpose, it can be wound up under the just and equitable laws.

2. The Oppression Section

Where one of the members of the company is oppressed, the member can complain to the registrar under the oppression section, S. 247. Here, the petitioner may be complaining about oppression not only to himself but also to other shareholders. In the case of Elder Vs Elder and Watson (1952) S.C 491, the court defined oppression as a visible departure from the standards of fair dealing and the violation of the conditions of fair play on which every shareholder is entitled to rely.

For one to rely on the plea of oppression, he must satisfy the following grounds:

a. That although the facts justify the winding up of the company, such winding up would be unfair to him.

b. Where the registrar is satisfied with the petition, he may make an order directing how the company's affairs are to be conducted in future or an order that the petitioner be bought out of the company. The order is for the petitioner only to be bought out but not other oppressed members.

c. The Petitioner must prove that the act being complained of is not an isolated event but a continuing process.

d. He must satisfy the registrar that the oppression is not only limited to himself but that also the affairs of the company are being conducted in an oppressive manner.

In Re H.R. Hammer Ltd (1959) IWL 62, a father who gave gifts of shares to sons continued to run the company as his own and to disregard wishes of other shareholders and company directors and even resolutions of the Board of Directors. It was held that *oppression amounts to a conduct by the majority which is harsh, burdensome and wrongful.*

3. INSPECTIONS AND INVESTIGATIONS

These can be initiated either by the registrar or the members themselves.

a. Investigations by members may be initiated in 2 instances:

i. Applying to the registrar to carry out the Investigations under S.173.

They must also prove that they are not malicious. The application will not be entertained if there are other remedies available. See the case of Re Elyeza Bwambale Co. Ltd (1969) E.A 243

ii. Using a Special Resolution

A special resolution may be passed that a court appoints competent inspectors to investigate the affairs of the company.

b. Investigations by the Registrar.

S. 172 - Where the registrar:

a. Believes that the Company's Act's provisions have not complied with.

b. Believes that the books and documents of the company supposed to be filed do not reasonably disclose what they ought to disclose;

He may direct through a written order for the company to produce all relevant books and documents for investigation and inspection and if he feels dissatisfied he can make a report to court.

c. Investigations by Court

Court may order for the appointment of inspectors to look into the affairs of the company if from the registrar's report either:

i. The company's business is conducted in a fraudulent or unlawful or oppressive manner or members have not given all the information they are entitled to.

ii. Promoters or management are guilty of misfeasance.

D. MISFEASANCE PROCEEDINGS

This is another remedy open to a shareholder who wants to enforce a company's rights. He is not enforcing his own rights. A shareholder who is also a contributory can apply to court for an order to examine the conduct of promoters, directors, managers, liquidators and/or any company's officer or a member who has been guilty of misfeasance or breach of trust to the company.

There are 3 important limitations:-

- a. The proceedings are only invoked during the winding up of the company.
- b. The section deals with only the wrongs involving misappropriation of funds or property (pecuniary claims).

Where the proceedings are successful, the guilty officer may be ordered to pay/replace the funds/property or to contribute such sums of money as the company deems fit to the assets of the company. Such officer may also be liable to criminal proceedings. However, the officer concerned may be excused by relying on the defence that "an officer may be excused from breach of duty or negligence if he pleads that he was acting reasonably and honestly in the circumstances.

RAISING THE CAPITAL OF THE COMPANY

Companies are time and time again faced with the challenge of raising capital for the growth of the company. For an existing company, new capital for such a company can be raised through ploughing back profits without declaring any dividends. Alternatively, the company may decide to offer its securities to the public, by floating new shares. Also, the company may decide to borrow from the bank or the government or insurance companies or finance houses.

RAISING CAPITAL THROUGH SELLING SHARES TO THE PUBLIC

Companies can raise capital by inviting members of the public to subscribe for shares in the company. This is done through the issuing of a prospectus.

THE PROSPECTUS

According to S.2, a prospectus means any document, prospectus, notice, circular, advertisement or other invitation or offering to the public for subscription of the securities of a company.

The definition in S.2 is very vague and consequently the courts have come up with some guidelines to be employed in determining whether an invitation amounts to a prospectus or not. Firstly, according to ***Nash Vs Lynd (1929) AC 158***, for a document to amount to a prospectus, not only must it be delivered but also there must be some publicity with

the aim of inducing subscription e.g. if a thief stole the document and publicized the issue of shares which the public purport to buy, the document does not amount to a prospectus.

Legal Aspects of a Prospectus

The prospectus must be approved by the Capital Markets Authority and must be delivered to the registrar for registration, when it is signed by every person who is named in the prospectus as a director, S. 60. If these requirements are contravened, the company and any officer responsible for that prospectus are liable to a fine.

STATEMENT IN LIEU OF A PROSPECTUS

If a public company is not issuing a prospectus on its formation, it then must file a statement in lieu of prospectus with the registrar of the companies. A statement in lieu of prospectus is defined as a public document prepared by every such public company which doesn't issue a prospectus on its formation with the registrar before allotment and is signed by every person who is named therein.

A statement in lieu of prospectus gives practically the same information as a prospectus and is signed by all the directors or proposed directors. In case, the company has not filed a statement in lieu of prospectus with the registrar, it is then not allowed to allot any of its shares or debentures.

A statement in lieu of the prospectus contains the following information:

- 1- Name of the company
- 2- Statement of capital
- 3- Description of the business
4. Names, addresses, and occupation of directors
- 5- Estimated initial expenses
- 6- Names of vendors and details of property
- 7- Material contracts
- 8- Director's interest
- 9- Minimum subscription

METHODS OF ISSUE OF SHARES TO THE PUBLIC

There are different ways of inviting the public to subscribe for shares in a company.

1. Placings (private)
2. Offer by tender.
3. Rights issue
4. Bonus Issue
5. Offers for sale
6. Direct offers e.g. by issuing prospectus

Placings

These take place in the issuing house. *A company issues securities, placing them in the issuing house for purposes of the issuing house selling them to its clients.* The issuing house (may purchase securities and place them with clients) or may not place them with the clients. When it purchases the securities, then it ceases to be an agent of the company.

Offers by Tender

This is a new innovation in the developed world by which the company will make a tender to the public for the purchase of its shares. All the shares that have been tendered are sold to the highest bidder.

Rights issue/script issue

The company invites its own shareholders to subscribe for new shares or debentures. As an incentive, such securities are sold at a lower price than what they would normally obtain in the new market.

Bonus issue

Like the rights issue, the bonus issue method is an internal affair of the company concerned. Under this method, instead of the company paying to shareholders a dividend it may have declared, it holds on to those funds by issuing shares to the shareholders.

Offer for sale

The company concerned issues its securities in an issuing house and the issuing house sells them to the public at a higher price. This method has a number of advantages to this company:

1. The company is not responsible for unsuccessful issue to the public.
2. It is the issuing house which bears the responsibility for the prospectus.
3. Unlike the method of placings, the company does not pay anything since the issuing house pays itself a commission, the difference of the price at which he sells and the price which he bought.

Direct issue

The company itself deals with the public without an intervention of the issuing house. This method is cumbersome for a number of reasons.

1. The company has to use a prospectus i.e. legal liability are conferred upon a company.
2. The company bears a risk of unsuccessful issue.
3. Although it may protect itself against unsuccessful issue by underwriting such issue, the underwriters have to be paid a commission for that issue. The commission must not exceed 10% of the price at which the shares are issued and that there must be

authority from the Articles to pay that commission. This means that a company cannot transact with underwriters who demand more than 10% of the price. If the Articles authorise more than 10%, the company cannot exceed such figure. And such payment must be disclosed in the prospectus.

ALLOTMENT OF SHARES

Allotment of shares refers to the distribution of shares to the share holders, following payment for the same. It is generally the process through which a potential shareholder or subscriber is given the number of shares which he has successfully applied for.

1. Allotment Under Private Companies.

Private companies restrict the issue of new shares by requiring that:-

- a private company is not entitled to invite the public to subscribe to any of its securities.
- a private company must in its Articles of Association contain a clause restricting the right of transferability of its securities as far as its shares are concerned.

Such clauses are called pre-emptive clauses. Lack of such a pre-emptive clause automatically makes the company a public ltd company.

2. Allotment Under Public Companies.

Allotment of shares in public companies is the process through which the company distributes the shares to successful applicants from the public. *Generally once a company has gone through issuing a prospectus or filing a statement in lieu of a prospectus, then allotment of shares can proceed.*

If however a company is making its first allotment, it's not to allot the shares unless the minimum subscription requirements have been satisfied. A minimum subscription is that minimum amount which the directors think or deem must be raised by the issue of share capital for the following purposes:-

- i. The purchase price of any property bought if the price of such property is to be paid out of the issue of securities.
- ii. The preliminary expenses payable by the company and any commission payable by the company to persons who have agreed to subscribe or to induce subscriptions for the company's securities.
- iii. The working capital - there must be enough resources from the minimum subscriptions for the day to day running of the business on the short run.
- iv. At least 5% of the total nominal amount must have been paid for in respect of each share applied for.

Where the above limitations are contravened for 60 days after the prospectus has been issued, then the company becomes liable to repay the money to the applicants without interest. If 75 days elapse before payment of such money, after issue of the prospectus, then the directors become jointly liable to pay the money with interests at the rate of 5% p.a. Any allotment which may have been made is voidable at the instance of the applicant.

*Whenever a private company allots shares, it must within 60 days deliver to the registrar for registration its **return of allotment** stating the number and nominal amount of shares in the allotment, names and addresses and descriptions of the allottees and amount paid,*
S. 61

SHARE CERTIFICATES

This is a document that shows one's ownership of shares in a company. S. 82 states that 60 days after the allotment or after the transfer of the shares, the company must deliver to the owners share certificates. Non-compliance with this:-

- i. Makes the company and the directors liable to a default fine.
- ii. The aggrieved allottee can serve the company with a note to give him his certificate. If the company still fails, then he can apply to court for such an order.

A share certificate with a company seal is *prima facie* evidence that the owner has title to the shares. Prima facie evidence is evidence, which on the face of it, cannot be challenged.

Legal Effect of Share Certificates

1. It is *prima facie* evidence that the holder is the owner of the shares, s. 92.
2. It estops the company from denying that the person to whom it is granted was at the date of the issue of the certificate the registered owner of the shares issued.
3. It estops the company from denying that the company shares are paid up as indicated in the certificate. Therefore if a third party detrimentally alters his position on the basis of that certificate, he cannot be defeated by the company's denial of the certificate unless it was forged.

SHARE WARRANTS

A company can choose to issue either share certificates or share warrants. S. 95 provides that if the Articles of Association authorise, a company may instead of issuing a share certificate, *issue a share warrant in respect of any fully paid shares. A share warrant is thus a document of title to shares which is issued only against fully paid up shares only.*

A share warrant is a negotiable document and is easily transferable by mere delivery to another person. The holder of the share warrant is entitled to receive dividend as decided by the company.

Conditions for the issue of a share warrant

1. They can only be issued by companies limited by shares.
2. There must be a provision in the Articles of Association regarding the issue of share warrant. If there is a provision, the company can issue a share warrant. If there is no provision in the Articles, the company cannot issue a share warrant.

There are two advantages of a warrant over a share certificate:

1. A share warrant entitles the holder to transfer its shares by mere delivery of the warrant, while for a share certificate, transfer is only effective after registration of the transfer. As such, a warrant is a share guarantee that the bearer is the owner of shares indicated while the share certificate is *prima facie* evidence that the holder is the owner of shares. Prima facie evidence can be rebutted but a company cannot deny that the bearer of a warrant is the owner. This thus makes the warrant more important.
2. A purchaser of a share warrant takes the shares concerned *free of equities*, if he is a *bonafide* purchaser, while a purchaser of a certificate must first be registered as shareholder before he can become a Legal owner of those shares. When a purchaser of a warrant physically holds the same, he has a superior interest.

TRANSFER OF SHARES

A shareholder can transfer or sell his shares to another person, because shares in a company are moveable property that can be transferred as stated in the Articles of the company, S. 84.

Where the shareholder dies, his personal representative can still transfer his shares to another person, even if the personal representative is not a member of the company, S. 86.

In a single member company, transfer on death is done by the single member company converting into a private company not being a single member company, by passing a special resolution to that effect, and altering its articles, and appointing one more director within 15 days of the special resolution, S. 87.

How is this transfer done? By passing a special resolution to that effect, stating that X number of shares are going to be transferred to Y, then a share transfer document is signed and all are registered with the registrar.

RAISING CAPITAL THROUGH LOANS

Companies can decide to raise capital through obtaining loans. The loans obtained are usually secured by company property, in the form of debentures and or charges.

A **debenture** is a paper or a document indicating an indebtedness of some kind by the company. The debenture is an acknowledgement of a distinct debt. It is a bond in form of a certificate or document that recognizes the loan of the company. A debenture entitles the holder to the amount specified in the debenture.

A private company is not allowed to raise money by borrowing from the public. As such, instead, the company may decide to create a debenture stock.

A **debenture stock** is a loan fund which is created by the company and which can be divisible among various creditors who each hold a debenture stock certificate. For example, a private company with debenture stock, can obtain money from several banks which could each hold a debenture stock certificate.

Differences between a debenture and debenture stock

1. As a general rule, debentures rank according to the time of issue. The first debenture takes priority over all other debentures on repayment. On the other hand, since a debenture stock is a fund, each beneficiary ranks in *pari passu* (equal rank) with others (no priorities).
2. Easy transferability - The debenture covers a distinct debt which is indivisible and therefore must be transferred as a whole in case the present holder wishes to get money from it. On the other hand debenture stock is divisible and a debenture stock holder can always sub-divide the fund and transfer the same to different people of his choice.

CHARGES ON COMPANY PROPERTY

Where company property is attached as security for a loan, it may be done through a charge over the company's property. A secured creditor may have his security or charge in form of a fixed charge or a floating charge.

A **fixed charge** is attributed to a creditor entitled to a particular asset as security. Eg where the company presents 2 particular company vehicles as security for a loan obtained. The specificity of this security, in addition to expressly stating that it is a fixed charge would make the security a fixed charge.

A **floating charge** is that form of charge or security which covers assets (current assets) of the same generic name but which assets are indeterminable at any given time since the

borrower has to use them during his day to day business to the extent of disposing them and replacing them with others.

Under S. 105, all charges must be registered in 42 days lest they are deemed void.

TYPES OF CAPITAL

Different types of capital can be identified in a company.

1. Share Capital

Share capital is the money invested in a company by the shareholders. It is the amount contributed by members entitling them to a dividend (payments out of profits) and/or increases in the value of the company when it is eventually sold.

It also refers to the portion of a company's equity that has been obtained (or will be obtained) by trading stock to a shareholder for cash or an equivalent item of capital value.

Types of Share Capital

a. Authorised Share Capital/ Registered Capital.

This is the total of the share capital which a limited company is allowed (authorized) to issue to its shareholders. It presents the upper boundary for the actually issued share capital (hence also 'nominal capital').

b. Issued Share Capital is the total of the share capital issued to shareholders. This may be

less than the authorized capital. It is the nominal value of shares availed for subscription and which have been allotted.

c. Subscribed Capital is the portion of the issued capital, which has been subscribed by all the investors including the public. This may be less than the issued share capital as there may be capital for which no applications have been received yet ('unsubscribed capital').

d. Called up Share Capital is the total amount of issued capital for which the shareholders are required to pay. This may be less than the subscribed capital as the company may ask shareholders to pay by instalments.

e. Paid up Share Capital is the amount of share capital paid by the shareholders. This may be less than the called up capital as payments may be in arrears ('calls-in-arrears').

f. Nominal capital.

The maximum amount of share capital that can be realised. S4 describes nominal capital as the authorized maximum amount of share capital that can be realized. If the authorized capital is not enough, the company may alter it by a special resolution if Articles allow.

g. Capital at call.

Issued capital that is not yet paid for.

h. Called up capital.

Portion of the issued capital that the company has requested for settlement. It is the portion of issued capital that the company has requested for settlement from the holder of shares that have not been fully paid for who is entitled to all benefits as if the shares were fully paid provided the Articles of association allow.

i. Reserve Capital (S.70)

Reserve capital is a portion of the issued capital which is at call but is not to be called up except in the event of winding up of the company. It is issued only by a company limited by shares or by guarantee.

2. Loan Capital.

Loan given to a company as capital. It is that returnable portion of capital that entitles interest to the creditor.

MAINTENANCE OF CAPITAL

As a general rule, a company's issued capital must not be increased unless the company's ordinary business warrants such as step. One of the reasons for this rule is the need to maintain that capital fund to which creditors rely for payment when extending capital facilities to that company. Consequently, **Article 116** of Table A provides that dividends must be paid only out of profits.

As a result, the Act has provided guidelines as to the issue of maintenance of capital;

1. A company is not to pay commission to anyone in consideration for their becoming a member to the company, except where the articles so permit, and the commission paid is less than 10% of the price of the bought shares or the rate authorised by the Articles, whichever is less, and such commission was disclosed to the public, for public companies, S.

2. The company is not to provide financial assistance to anyone to buy its shares, S. 63, save where the assistance is given in good faith in the interests of the company. This rule does not apply to private holding companies and their subsidiaries.

3. No issue of shares at a discount unless the issue has been authorised by a resolution passed at a general meeting and is approved by court. The shares must be issued within one month from the time it is approved by court, S. 67.

In ***Ooregum Gold Mining Co. of India Y Roper (1892) AC 125***, the directors sought to issue shares at a discount. It was held that shares are not to be issued at a discount and whoever takes shares in return for cash must pay the full nominal value of those shares.

4. Payment of Interest out of the Company's Capital. According to S.75, where the Articles

authorize and the registrar approves, a company may pay interest out of capital on any of its

shares which were issued to raise money for defraying the expenses of the construction of

any works which cannot be payable profitably in the short run.

- The section strictly does not talk about loans but capital raised by issuing shares for the purposes of the works. Before sanctioning, the registrar may appoint somebody to investigate the circumstances of the case.
- Secondly the period to be paid is not to extend beyond 1 year after the completion of the works.
- Thirdly the interest to be paid is not to exceed 5% p.a.
- Fourthly, the payment of that interest does not operate as a reduction of the amount for the shares out of which it is paid.

5. Company's resolution to reduce its capital. According to S. 76, any company limited by

shares or guarantee and with share capital and authorized by its Articles may pass a special resolution to reduce its capital. However, the special resolution must be confirmed by court through a petition.

If the proposed reduction of capital involves a reduction in the amount of unpaid share capital

or if its designed to be paid out of the paid up capital, every aggrieved creditor who lodges a

claim is admissible. If the company were to be wound up, he is entitled to object whereupon the court may compile a list of such creditors and their claims and hear their objections.

6. Company repurchasing its own Shares. In the case of ***Trevor Vs Whiteworth (1887) 12***

AC 409, it was held that it is illegal for a company to purchase its own shares, even if the memorandum gives express authority to do so.

DIVIDENDS

Dividends are any return paid/given to a shareholder on his investment/shareholding in a company. Unless the Articles state otherwise, a shareholder receives dividends on his shares.

The Companies Act is not helpful as to when dividends should be declared. The nearest is Article 116 of table A, where dividends are to be paid out of profits. Then, the question is what are profits?

In the case of ***Lee Vs Neuchattel Asphalt Co (1889) 41 CH.D.1***, a company had been formed for the purposes of acquiring and working out a concession in a mine. The company proposed to pay a dividend out of the profits shown on the reserve account. A shareholder challenged this on the ground that the company's assets weren't equal to its share capital and that since the mining concession was a wasting asset, dividing annual proceeds amounted to dividing the company's capital assets. The shareholders contention was rejected. Court held that:

1. There is nothing at all in the Act about how dividends are to be paid nor how profits are to be recommended. That that was left and very judiciously and properly, to the commercial world. It is not a subject of Parliament to say how accounts are to be kept, what is to be put into capital accounts, what to be put on income accounts and what to be left to the men of business.
2. Losses of capital need not be made good before the company declares a dividend.

Dividends are declared on the discretion of the directors. In ***Makidayo Oneka Vs Wines And Spirits (U) Ltd And Another (1974) HB.2***, the principle was laid that unless the articles and terms of the issue of shares confer a right upon a shareholder to compel a company to pay a dividend, it is the discretion of the directors to recommend to a general meeting that a dividend be declared.

Furthermore, where a company has an article equivalent to **Article 114** of table A, if the directors have recommended a certain sum for dividend, the general meeting has no discretion to increase that sum. However, a shareholder or a debenture holder can seek a court injunction to restrain a company from declaring a dividend.

WINDING UP AND CORPORATE RESCUE

A CASE STUDY OF LIQUIDATION

Introduction

The life of limited liability companies in Uganda starts with the registration of the company's constituting documents. The end of life of a company is depicted by dissolution.

Liquidation is the process by which a company or other type of corporation is brought to an end, in other words, a company ceases to exist as a corporate entity. The process of liquidation involves appointment of a liquidator who is tasked with closing down or selling off the corporation's business, realizing all its assets.

It should be noted that liquidation is a process that starts with winding up and ends with dissolution of a company.

NB: A company may go through liquidation, but does not go up to winding up, a case in point was Equity Bank. It follows that liquidation is a step to winding up, after a liquidator has sold off everything and paid everyone, if the company is still a going concern, then it will not go into winding up.

Therefore after the directors have decided to choose any means of winding up available to them, in our instant case a receiver was appointed.

This mode of winding up is called Voluntary winding up as provided under Section **268 of the Companies Act of 2012.**

ADVANTAGES OF LIQUIDATION

- Debt writing off/discharge.
- Execution or attachment of any kind is stopped.
- Quick recovery

Then by operation of **s.272 of the Companies Act 2012**, it allows the Insolvency Act to be used and the procedure there under.

There are three modes of liquidation:-

- Voluntary liquidation (both by members & creditors) **S.78 of the Insolvency Act.**
- Liquidation subject to supervision of court **S.87 Insolvency Act.**
- Liquidation by Court. **S.91 & 92 Insolvency Act.**

After the company has appointed a liquidator as per **S.62 (1) of the Insolvency Act** and the notice of his appointment has been advertised, then the creditors come in.

DUTIES OF A LIQUIDATOR

- The duty to take reasonable & expeditious manner, all steps necessary to collect, realize as advantageously as reasonably possible and distribute the assets or the proceeds of the assets of the company in accordance with the law. **S. 99 of the Insolvency Act.**
- Take custody & control of the company's assets. **S.100 Insolvency ACT.**
- Register his interest in land and other assets belonging to the company notwithstanding any interest
- Keep company money separate from other money held by or under the control of the liquidator.
- Keep in accordance with generally accepted accounting procedures & standards, full accounts & others records of all receipts, expenditure & other transactions relating to the liquidation, and retain the accounts & records of the liquidation and of the company for not less than six years after the liquidation ends.
- And allow those accounts and records be inspected by any creditor or shareholder where court orders.
- Duty to call the Creditor's meeting in case of insolvency. **S.65 of the Insolvency Act** is to the effect that a liquidator shall call a meeting for all the creditors and present a statement of the assets & liabilities of the company. It should be noted that failure to do so it is an offence which attracts a fine.
- Duty to call a general meeting at the end of the year under **S.66 of the Insolvency Act.** This happens if the liquidation of a company continues for more than one year, then the liquidator is required to summon a general meeting at the

end of the first year of the commencement of the liquidation and shall lay before the meeting the account of his dealings and the conduct of liquidation during the preceding year. Failure to call for this meeting it is an offence and it attracts a fine.

- Duty to call for a Final meeting and dissolution under **S.67 of the Insolvency Act**. This meeting has to be called by a notice put in a gazette as per **S.67 (2) of the Insolvency Act** and it shall be published 30 days before the meeting.
- The within 14 days after the meeting the liquidator is obliged to send a copy of the account to the registrar of companies and also make a return of the meeting and of its date to the registrar.

On expiry of 3 months from the date of registration of the return, the company shall be taken to be dissolved.

CREDITORS' INTERESTS DURING THE LIQUIDATION PROCESS

Whenever a company is faced with business difficulties, which have insolvency implications the interests of creditors and shareholders are put in prospective jeopardy. It stands to reason that these interested parties should have the right to step in at the appropriate time to protect their interests before it is too late. They should work towards seeing to it that the company is either restored to good standing or it is wound up in good time in order to salvage the residual assets and distribute them among themselves for redeployment into better paying endeavors.

Companies like, living things do fall sick and they may be cured of their maladies and resume normal profitable operations. They may, on the other hand, be deemed to be incurable and relegated into winding up. The managers of an ailing company should have the appropriate acumen to take the correct life or death decisions at the right time.

It should also be an undeniable right of creditors to opt for continued life or winding up (death) of their debtors on the basis of the balance of probabilities of beneficial survival of the debtors. Under corporate law in Uganda these rights may be exercised through

petitioning the High Court to issue an administration order or a winding up order as has been explained above.

INTERIM MEASURES AND OPTIONS TO WINDING UP THAT PROTECT THE RIGHTS OF CREDITORS.

CORPORATE RESCUE

A. Administrative Orders

Roy Goode on Principles of Corporate Insolvency (3rd Edition 2005, Sweet & Maxwell) at page 33, defines administration as a collective insolvency procedure designed to promote the rescue culture by placing the company's affairs in the hands of an administrator entrusted with the task of promoting the interest of the general of creditors.

Administration is in **S.162 of Insolvency Act**, taking place by execution of an administration deed. This is done by a company in an Extra-Ordinary General Meeting.

The company, a creditor or creditors may petition for the administration order. The effect of the petition is to put a moratorium on actions that may alter the status quo of the company's assets, enforcing security against the company's assets or repossessing goods in the company's possession under any hire purchase contract and commence any proceedings, executions or any other legal processes against the company.

B. Schemes of Arrangement

The law also provides for a scheme of arrangement between a company and its creditors. The scheme may entail reconstruction, compromise or amalgamation of any or more companies.

C. Winding Up

The creditors' right to petition for winding up is also available to protect their interests. This right to petition cannot be contracted away even if it is stated so in the Articles of Association of a company.

However this approach/option is always the last option to be considered, for it has diverse risks and consequences.

D. Protection of Assets

Insolvency legislation is generally aimed at protecting and maximizing the value of the insolvent company's assets prior to and during the winding up of the company. When the likelihood of liquidation looms the creditors who are close enough to the company to read the early signs of declining fortunes may use that advantage to rush to secure their debts to the detriment of the other creditors. In order to curtail the scramble and to prevent fraudulent transfers of assets from the company before the onset of liquidation, the legislation focuses on antecedent actions that may be crafted to give undue preference to creditors ahead of an impending winding up. In case this happens, the good news is that the law protects the interests of creditors through nullification of under-value transactions as well as fraudulent and wrongful trading and provides further protection of the assets, **(S.15 & 16 Insolvency Act)**. The Insolvency Act foresees various actions or omissions by past or present managers, directors or officers of a company, which is subsequently liquidated, which could result in either reducing the value of the assets or increasing the liabilities of that company. These safeguards to prevent the dilution of assets extend to a period of twelve months next before the commencement of the winding up.

E. Amalgamation.

This is where two or more companies amalgamate and continue as one company which may become one of the amalgamated companies or may be a new company.

CREDITOR'S CLAIMS

All creditors are required to state their claims before the liquidator.

This is done by notifying the liquidator about the claim supported with evidence.

But a creditor needs to ascertain whether he/she is secured or unsecured creditor.

This helps us to know who is to be paid first by the liquidator.

➤ **Secured Creditors.**

These are creditors who hold in respect of a debt or obligation a charge over property of the company. In simple terms they have security over a debt of the company.

They are secured because once the liquidator calls all the creditors to settle their debts, the secured creditors are paid first then later unsecured creditors.

Making a claim

S.11 of the Insolvency Act provides for the claims by the secured creditors. And the law allows them to even go ahead and realize any asset of the company, or even enter into an agreement with the liquidator and be paid partly then the balance be claimed as an unsecured creditor.

Where you lodge your claim to the liquidator as a secured creditor, the claim shall be verified by a statutory declaration and shall (a) set out in full the particulars of the claim, (b) set out in full the particulars of the charge including the date on which it was given and also (c) identify any documents that substantiate the said claim or charge. **S.11 (4)**

Insolvency Act.

Once a claim is made by the secured creditor, then the liquidator is required by law under **S.11 (5) of the Insolvency Act** to;

- (i) Meet the claim in full and redeem the charge/property/security.
- (ii) Realize the asset and pay the secured creditor lesser of the amount of the claim and the net amount realized taking into account the liquidator's reasonable remuneration; or

- (iii) Reject the claim in whole or in part.
- (iv) Notify the secured creditor to take possession of any asset.

➤ **Unsecured Creditors.**

These are creditors who do not have any charge or security interest in respect of their debts. The effect of this is that once their claim is proved, they are ranked second to be paid after the secured creditors.

Making claims by unsecured creditors.

An unsecured creditor may make a dated claim informally in writing to the liquidator stating his claim, unless when the liquidator specifies a different way of notifying. This requirement is under **S.10 (1) Insolvency Act.**

The liquidator may require the unsecured creditor to make his claim formally, once it is so required, then the claimant shall submit a claim verified by a statutory declaration;

- (a) Setting out in full the particulars of the claim, (b) and identifying any documents if any, the evidence that substantiates the said claim **S.10 (2) Insolvency Act.**

It should be noted that just like under the secured creditors, the liquidator may admit or reject the claim in whole or in part of the unsecured creditor or even subsequently revoke his decision.

WHO GETS WHAT, HOW, WHEN AND WHY?

Once the liquidator has sold off the assets or has realized the company's assets, the next step is to clear all the debts, including government taxes, compensation to its employees in case of any injury as under the Workers' Compensation Act, employees' salaries, creditors etc.

But to clear all these, he follows the order of priority of debts as required by law. He will first clear the ***preferential debts*** then later clear the ***Non-preferential debts***.

Preferential Debts. These are provided for under **S.12 (4)(5)&(6) of the Insolvency Act.** These are basically those debts that the law recognizes which have are paid first in priority to other debts, and they include;

- a) Remuneration and expenses properly incurred by the liquidator
- b) Reasonable costs of any person who has petitioned court for liquidation, **these are paid first then followed by the following preferential debts;**
- c) All wages earned by way of commission for four months,
- d) All amounts due in respect of any compensation or liability for compensation under the Worker's Compensation Act which happened before the commencement of liquidation not exceeding the prescribed amount, **after paying the above sums, the liquidator shall then pay the following debts;**
- e) URA Taxes
- f) NSSF Contributions.

Therefore the above listed debts are the preferential debts that are paid first in that order then non preferential debts are paid next as seen below;

These are provided for under **S.13** and they include all other claims/debts.

These claims shall rank equally among themselves and shall be paid in full unless the assets are insufficient to meet them, in which case they abate in equal proportions. **S.13 (2) Insolvency Act.**

It should be noted that where a creditor before the commencement of liquidation had agreed to accept a lower priority in respect of a debt than what he should have gotten, such a creditor cannot change his position and claim for the full amount, under **S.13 (3)** he is bound by what he accepted.

Surplus Assets

In case there is a surplus after making the payments above, the liquidator shall distribute the company's surplus assets in accordance with the Company's Memorandum & Articles of Association. Thus unsecured creditors are paid after the secured creditors are paid.

Procedure for Members Voluntary Winding Up

- Directors of a company investigate the affairs of the company and then form an opinion that the company pay its debts within a period of one year. **(S.271(1) Companies Act 2012)**
- The Directors make a statement of the company's assets and liabilities.
- Directors call a Board meeting to make a Statutory Declaration of Solvency. **(S.271(1) C.A) (Article 98, Table A** of C.A, the directors may meet together for the dispatch of business and regulate their meetings as they think fit.
- Quorum is 2 if not fixed
- The declaration is filed together with the Statement of Assets & Liabilities within 30 days with the Registrar of Companies. **(S.271(2)(a)(b) of C.A)**
- Notice is issued to call an Extra-Ordinary General Meeting **(S.140)**, for the purpose of winding up the company, Art. 53, Table A, Quorum is 3 members present.
- Special Resolution is passed, as per S.268 of the Companies Act. 2012
- Special resolution is registered within 7 days. S.269(2) C.A
- Then advertise the Notice of the Resolution in Gazette & News papers, S.272 operationalizes the Insolvency Act at this stage, with necessary modifications.
- Appoint a Liquidator through a meeting/board resolution.
- The Liquidator within 14 days after his appointment, must publish in the Gazette a notice of his appointment, and deliver the same to the Registrar for registration; a copy of this appointment notice is left with the Official Receiver. S.82(1) of the Insolvency Act, Regulation 98 of the Insolvency Regulations, Notice shall be in Form 12
- Where liquidation continues for more than one year, the liquidator shall summon a general meeting. S.66 Insolvency Act.
- Give notice of final meeting in the Gazette & in a newspaper of wide circulation specifying the time, place and object of the meeting, at least 30 days before the meeting. (S.67(2) Insolvency Act)
- Liquidator shall prepare an account of the liquidation showing how the liquidation was conducted. S.67 Insolvency Act.
- Liquidator calls a final meeting which is the General meeting of the Company to present the account of his acts or dealings. S.67, Insolvency Act.
- Send a copy of the account to the Registrar & make a return of the meeting & its date within 14 days.

- On expiration of 3 months from the date of registration of the returns, the company shall be taken to be dissolved.

General Considerations for Winding Up

The circumstances under which the company may be voluntarily wound up are both a creature Statute and Practice. Here a company may be wound up.

- a. When the period fixed for its duration by the articles expires or the event occurs on the occurrence of which the articles provide that the company is to be dissolved and thus a company passes a resolution in general meeting that it should be wound up voluntarily;
- b. If it resolves by special resolution that it should be wound up voluntarily;
- c. If the company resolves by special resolution that it cannot by reason of its liabilities continue its business and that it be advisable that it be wound up.

Basically the second circumstance is the most important because in practice at least the first circumstance does not arise and in the 3rd circumstance the creditors themselves will resolve that the company be wound up.

In any winding up those in need of protection are the creditors and the minority shareholders. Where it is proposed to wind up a company voluntarily. **Section 271(1) of the Companies Act 2012** requires the directors to make a declaration to the effect that they have made a full inquiry in to the affairs of the company and having so done have found the company will be able to pay its debts in full within such period not exceeding one year after the commencement of the winding up as may be specified in the declaration, as stated above in a detailed procedure. Such declaration suffices as a guarantee for the repayment of the creditors. If the directors are unable to make the declaration, then the creditors will take charge or the winding up proceedings in which case they may appoint a liquidator.

WINDING UP BY THE COURT

Winding up by court is provided for under **Sections 91&92 of the Insolvency Act.**

Winding up after an order to that effect by the court is the most common method of winding up companies
These cover situations in which

1. the company has by special resolution resolved that it be wound up by court;
2. Where default is made by the company in delivering to the registrar the statutory report or on holding the statutory meeting;
3. When the company does not commence business within one year of incorporation or suspends its business for more than one year;
4. Where the number of members is reduced in the case of a public company below 2.
5. Where the company is unable to pay its debts;
6. Where the court is of the opinion that it is just and equitable to wind up the company;
7. In the case of a company registered outside Uganda and carrying on business, the court will order the company to be wound up if winding up proceedings have been instituted against the company in the country where it is incorporated or in any other country where it has established business. (see Section 56 and Fourth Schedule of the Insolvency Act 2011)

Under the Insolvency Act an Application for winding up by an order of the court may be presented either by a creditor or a contributory. However a contributory cannot make the application unless his name has appeared on the register of members at least 6 months before the date of the application and in any event he can only petition where the number of members has fallen below the statutory minimum.

In practice the creditors will petition for a compulsory winding up where the company is unable to pay its debts. The company's inability to pay its debts under S.3 of The Insolvency Act of 2011 and Regulations is deemed in the following circumstances

1. If a creditor to whom the company is indebted in a sum exceeding the statutory amount, demands payment from the company and 3 weeks elapse before the company has paid that sum or secured it to the reasonable satisfaction of a creditor;

2. If execution issued on a judgment against the company is returned unsatisfied;
3. If it is proved by any other method that a company is unable to pay its debts.

Before a creditor can petition it must be shown as a preliminary issue that he is in fact a creditor or a company creditor. This is a condition precedent to petitioning and the insolvency of the company is a condition precedent to a winding up order.

CONSEQUENCES/EFFECTS OF LIQUIDATION

Once a company goes into liquidation, all that remains to be done is to collect the company's assets, pay its debts and distribute the balance to the members.

This has a bearing on a company as provided for **under S.270 of The Companies Act of 2012** in two ways;

1. A company ceases to carry on any business except if it is for the beneficial winding up of the Company.
2. The Corporate status and the powers of the company remain in force until it is dissolved.

Under The Insolvency Act, in a winding up by the Court, any dealing with the company's property after the commencement of the winding up is void except with the permission of the court.

The purpose is to freeze the corporate business in order to ensure that the company's assets are not wasted. Once the company has gone into liquidation, the directors become functus officio.

Thereafter a liquidator is appointed whose duty is to collect the assets, pay the debts and distribute the surplus if any. In so doing, he must always have regard to the interests of the creditors, as discussed earlier.