COMPANY LAW

PART II

SECTION 3

CPA
CS
CCP

STUDY TEXT

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PAPER NO.7 COMPANY LAW

GENERAL OBJECTIVES

This paper is intended to equip the candidate with knowledge, skills and attitudes that will enable him/her to apply and comply with the provisions of company law in relevant circumstances and environments.

LEARNING OUTCOMES

A candidate who passes this paper should be able to:

- Apply legal principles relating to formation of companies
- Evaluate the rights and obligations of members and shareholders
- Comply with the legal principles governing liquidation of corporates and restructuring
- Comply with the legal principles relating to companies incorporated outside Kenya
- Ensure books of account are prepared in compliance with the law.

SYLLABUS

7.1 Nature and classification of companies

- Nature and characteristics of a company
- Types of companies
- Principle of legal personality and veil of incorporation
- Distinction between companies and other forms of business associations, sole proprietorships, partnerships and cooperative societies.

7.2 Formation of companies

- Promoters and pre-incorporation contracts
- Process of forming a company
- Memorandum and articles of association
- Certificate of incorporation
- Effects of incorporation

7.3 Membership of a company

- Acquisition of membership
- Register of members
- Rights and liabilities of members
- Cessation of membership

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- Variation of class rights
- Share certificates

- Issue and allotment
- Transfer and transmission
- Transfer of shares under central depository system
- Mortgaging and charging of shares

7.5 Share capital
- Meaning and types of share capital
- Raising of share capital
- Prospectus/information memorandum
- Maintenance of capital
- Alteration of capital
- Dividends

7.6 Debt capital
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- Debentures
- Charges
- Registration of charges
- Remedies for debenture holders

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- Essentials of a valid meeting
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7.8 Directors
- Qualifications, appointment and disqualification
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- Disclosure of director's interest in contracts
- The rule in Turquand's case/Indoor Management rule
- Insider dealing

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- Qualification, appointment and removal
- Powers and duties of the company secretary

- Liability of the company secretary
- Register of secretaries

7.10 Auditors

- Qualification, appointment and removal
- Remuneration of auditors
- Powers and duties
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7.11 Company accounts, audit and investigation

- Books of accounts
- Form and content of accounts
- Group accounts
- Director's report
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- Annual returns
- Investigation of company affairs
- Appointment and powers of inspectors
- Inspector's report

7.12 Corporate restructuring

- Need for restructuring
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- Post merger reorganisation
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- Reconstruction

7.13 Receivership and liquidation of companies

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- Appointment and vacation of office
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- Types of liquidation
- Appointment, powers and duties of liquidators
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7.14 Companies incorporated outside the country

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- Cessation of business

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TOPIC 1

NATURE AND CLASSIFICATION OF COMPANIES

NATURE AND FORMATION OF A COMPANY

The term company is used to describe an association of a number of persons, formed for some common purpose and registered according to the law relating to companies.

Lord Justice Lindley defines a company as follows: "A company is means an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share."

Justice Marshall defines a company as an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence.

Section 2 (1) of the Companies Act (cap 486) provides that "a company means a company formed and registered under this Act or an existing company". Existing company only means a company formed and registered under any of the repealed ordinances. For the purposes of Companies Act of Kenya, a company: -

a) A registered company under the Companies Act.
b) An existing company.
c) An unregistered company covered under section 357-364of the Companies Act.
d) A produce company covered under section 388of the Companies Act..
e) A foreign company covered under section 365-381of the Companies Act..

The main objects and purpose, of statutes relating to companies are as follows:

1. Encourage investments in companies by providing certain facilities, such as limitation of liability, transferability of shares.
2. Ensure due and proper administration of the funds and assets of companies in the interest of the investing public.
3. Prevent malpractices by directors and managers.
4. Arrange for investigation into the affairs of companies and provide for effective audit in dealing with cases of dishonesty and fraud in the corporate sector.

The formation, management and winding up of a company in Kenya is governed by the Company's Act Cap 486 of the Laws of Kenya. The company legislation in Kenya owes its origin to the English company law. The Companies Act of Kenya which came into force on 1st January 1962 is based on English Companies Act of 1948.This Act is still applicable together with later amendments. The Act provides a basic legal framework for the regulation of companies in Kenya. It makes provision for the legal incorporation of companies and lays down rules for their constitution, management and winding up.

Apart from the Companies Act, there is also case law which has been developed by the courts such doctrines of ultra vires. The case law and companies practice have developed so many rules which are useful for filling in the gaps which have not been provided by the Companies Act.

CHARACTERISTICS OF A COMPANY

The principal characteristics of an incorporated company can be summarised as follows:

1. Registration
A company comes into existence only after registration under the Companies Act. However, a statutory corporation is formed and commences business as notified or stated in the Act as passed in the legislature. In case of partnership, registration is not compulsory.

2. Voluntary Association
A company is an. association of many persons on a voluntary basis. Therefore a company is formed by the choice and consent of the members.

3. Legal personality
A company is regarded by law as a single person. It has a legal personality. This rule applies even in the case of “one-man company” such as in the case of **Salomon v. Salomon & Co. Ltd**.
Salomon had a business in boot manufacture. He formed a company called Salomon & Co. (with himself, his, wife daughter and 4 sons as shareholders) and transferred to it his business. As consideration for the transfer he received the major portion of the shares of the company and debentures for £ 10,000. Later on, the company went into liquidation. Salomon, as a debenture holder, claimed to be a secured creditor and demanded priority in the payment of £ 10,000, out of the assets of the company. The unsecured creditors of the company objected on the ground that the business really belonged to Salomon and he should not be allowed to claim as a secured creditor. It was held that Solomon as an individual, was quite distinct from Salomon & Co. and he could therefore be a secured creditor of the company, even though he happened to hold the majority of the shares.

4. Contractual capacity

A shareholder of a company, in its individual capacity, cannot bind the company in any way. The shareholder of a company can enter into contract with the company and can be an employee of the company.

5. Management

A company is managed by the board of directors, whole time directors, managing director or manager. These persons are selected in the manner provided by the Act and the Articles of Association of the company. A shareholder, as such, cannot participate in the management.

6. Permanent Existence

A company has a continuous existence. Old shareholders may go and new ones may join; the death, bankruptcy or insanity of a shareholder does not affect the existence of the company. This means that its life is independent of the life of its members. The change in the membership of the company does not affect its continuity. The company continues its operations so long as it fulfills the requirements of the law under which it has been formed.

7.Registered Office

A company must have a registered office where it carries out its day to day business dealings

8. Common Seal

A company being an artificial person cannot sign documents. The law has provided for the use of a common seal, with the name of company engraved on it, as a substitute for its signature. No document issued by the company shall be binding on it unless it bears the common seal, which is duly witnessed by at least two directors of the company.

10. Limited Liability

A shareholder shall be liable to contribute towards the debts of the company during its life or during winding up only at the extent of shares taken by him and only to the balance of shares taken by him or up to the guarantee given by him or both. Members cannot be asked to pay more than what is unpaid on the shares of the company held by them even though the assets of the company are not sufficient to satisfy the claims of creditors in the event of winding up. The personal property of a shareholder cannot be attached for the debts of the company if he holds a fully paid up share.

11. Transferability

Members of public limited company are free to transfer their shares to anybody. Shares can be sold and purchased through the stock exchange. However, in a private company the articles may restrict such transfer.

12. Statutory Obligations

A company is required to comply with various statutory obligations regarding management such as filing balance sheets, maintaining proper account books and registers etc.

13. Artificial Legal Person

A company is an artificial person because it is a creation of law. It does not take birth like a natural person but it comes into existence through law. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by shareholders. It was rightly pointed out in **Bates v. Standard Land Co**. that: "The board of directors is the brains of the company, which is the body and the company can and does act only through them."

Although a company is an artificial legal person, it enjoys all the rights of a natural person. It has the right to acquire and dispose of the property, to enter into contract with third parties in its own name, and can sue and is sued in its own name.

14. Residence

A company has a residence (for taxation and other purpose). A company does not possess any fundamental rights.

15. No Fundamental Rights:

Though a company has no fundamental rights, it can challenge a law as void if the law happens to violate fundamental rights of citizens. In order to succeed, the company must prove that the impugned law is expropriatory of a citizen's property.

16. Separate Legal Entity

Companies Act provides for a separate legal existence from its shareholders. From the date of incorporation as mentioned in the certificate of incorporation, a body corporate by the name contained in the memorandum is formed. Such a body corporate is capable of having perpetual succession, power to hold land, has a common seal with liabilities of its members limited as per the provisions of the Act.

17. Capacity to Sue and be Sued

The suits of the company are suits of the company, and not of the shareholders. Therefore in case of suits for the company, the company is the proper plaintiff and where the company is sued, it is the proper defendant.

TYPES OF COMPANIES

There are different types of companies which are based on the basis of formation, liability ownership, domicile and control.

1.STypes based on the basis of formation or incorporation.

a) ***Chartered companies.***
Companies which are incorporated under special charter issued by the head of state e.g. Chartered Bank.

b) ***Statutory companies.***
Are Companies which are incorporated by a special act of parliament. The activities of such companies are governed by their respective acts and are not required to have any memorandum or articles of association.

c) ***Registered companies***
Are those companies incorporated through registration under the companies act.

2.STypes of companies based on the basis of liability

a) companies with limited liability
Are companies where capital is divided into shares and liability of members is a company limited by shares. Others are limited by guarantee where shareholders promise to pay a fixed amount to meet the liabilities of the company in the case of liquidation.

b) Companies having unlimited liability.
They do not have any limit on the liability of members as in the case of partnership.

3) Types of companies based on ownership.

a) Government companies.
Are companies where at least 51% of the paid up capital has been subscribed by the government.

b)Non-governmental companies.
If the government does not subscribe a minimum of 51% of the paid up capital, the company will be a non-governmental company.