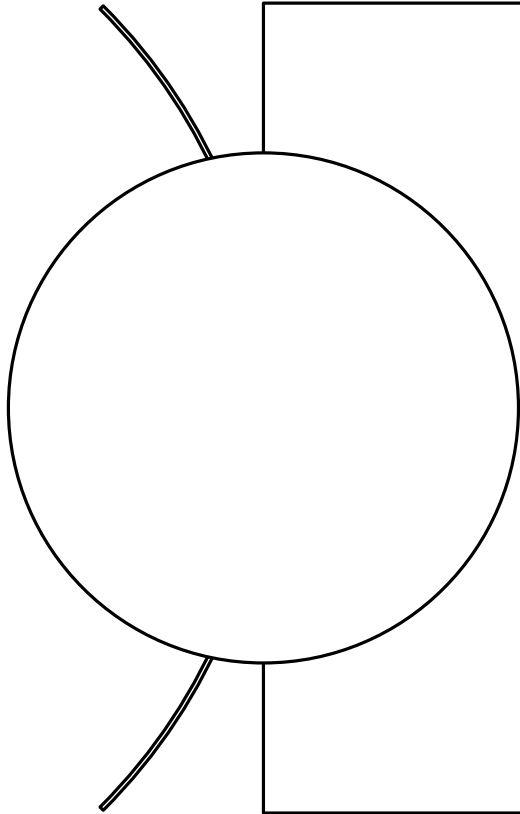


END OF CHAPTER SIX

WELCOME TO CHAPTER SEVEN
COMPANY LAW

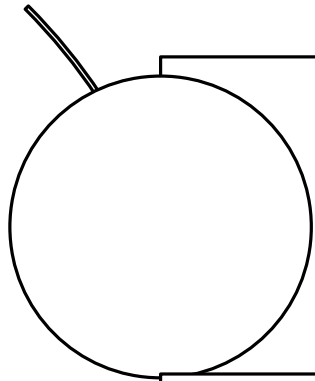
Introduction



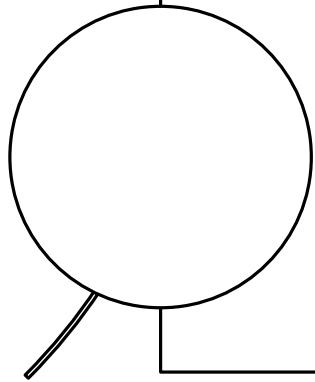
In legal theory, the term company implies an association of a number of people for a common object/purpose.

Company law, on the other hand, is the field of law concerning companies and other business organisations which include corporations, partnerships and other associations which usually carry on some form of economic, social or charitable activity.

Relevant statutes



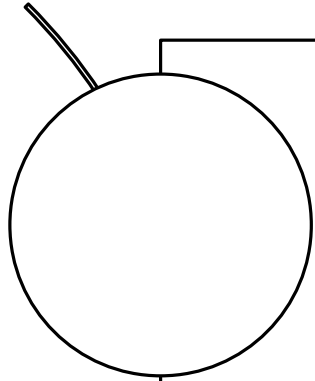
The statutory provisions which govern formation, conduct, management and winding up of companies are contained in the respective companies Acts.



Company's Act No. 17 of 2015 which repeals the Company's Act Cap. 486 of the laws of Kenya.

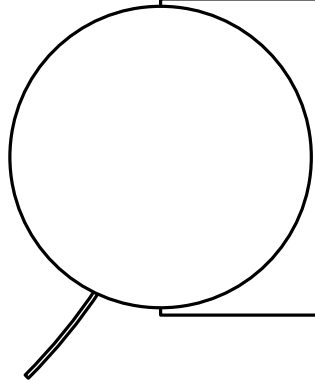
Winding up (liquidation) of companies is governed by the Insolvency Act 18 of 2015.

Legal personality



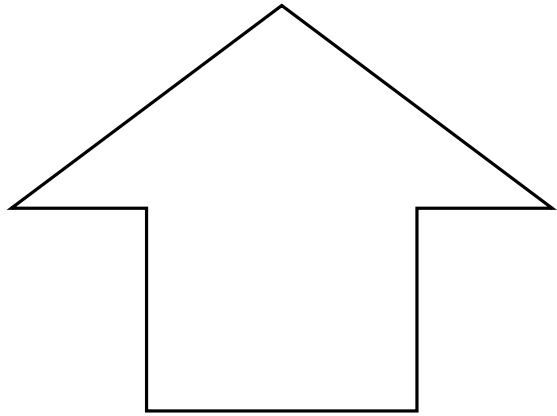
A legal person is one who the law recognises as having certain rights and duties which the courts can enforce.

Generally all persons are subject to legal rules, which protect, give rights and impose duties on them.

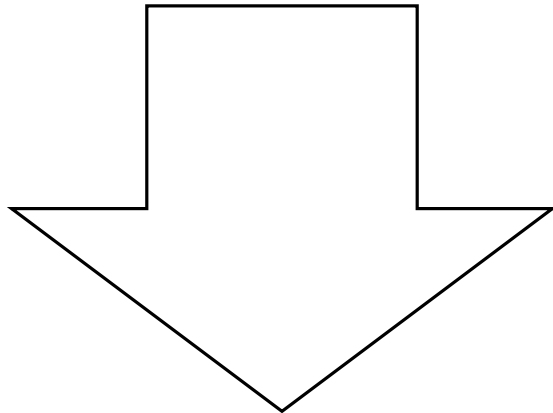


However, the law does not affect everybody in exactly the same way for example, some organisations, minors, persons of unsound mind, bankrupts and other special categories have their own particular rights and duties.

Categories of legal persons

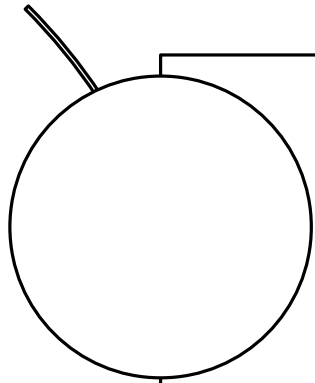


Natural legal
persons

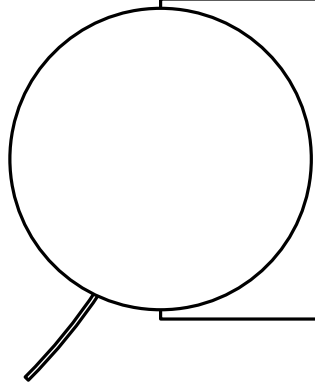


Juristic/artificial
legal persons

Natural legal persons

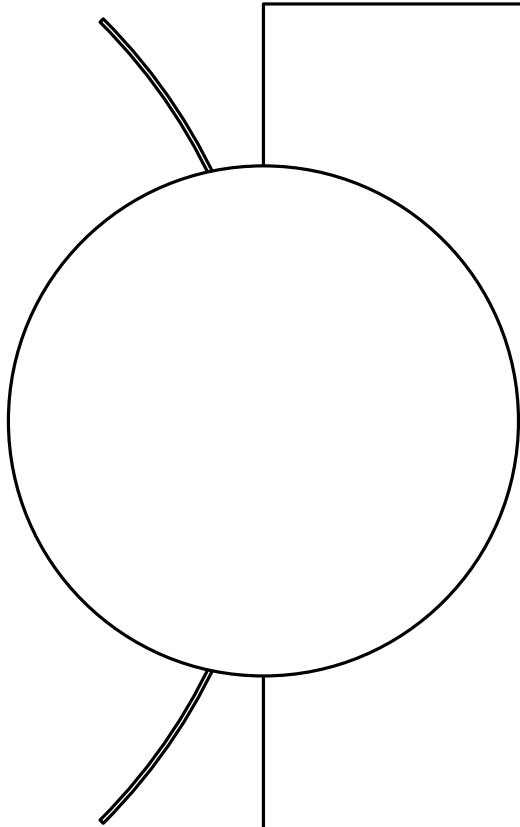


All human beings are referred to as natural legal persons. Generally the legal personality starts at birth and ends at death.



Article 26 (2) of the Kenyan Constitution provides that life begins at conception.

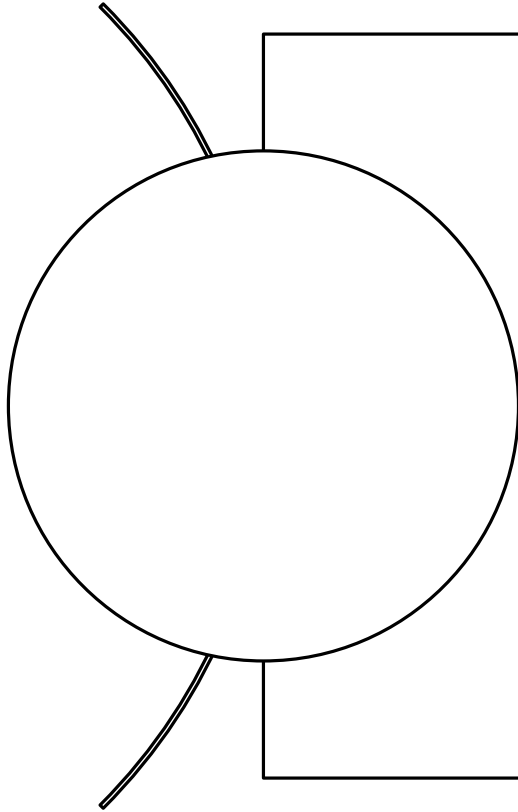
Cont'd



There are instances where one can sue for injuries sustained before birth and legal actions commenced before death can be continued after death.

The law also allows actions to be commenced on behalf of a deceased person after death.

Juristic legal persons



Juristic persons, or corporations, are non-human legal entities and are sometimes known as artificial legal persons.

They are formed by people who wish to combine their resources for a common purpose.

Corporations vary in size and complexity from vast multi-national firms to small clubs and societies.

Corporations may be classified as incorporated or unincorporated

Cont'd

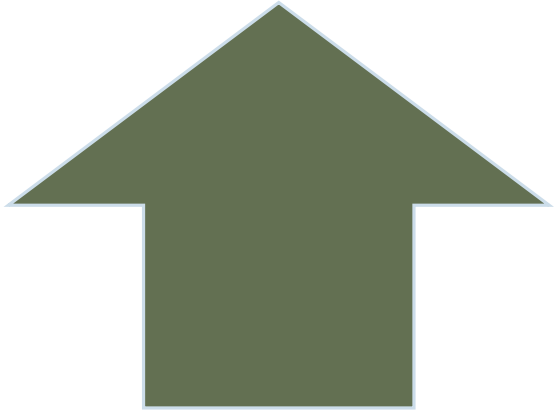
Corporations are subject to the law in much the same way as natural legal persons except where their very nature demands a different kind of treatment.



A corporation may be found guilty of some crimes

They can be fined, but not imprisoned.

Types of corporations

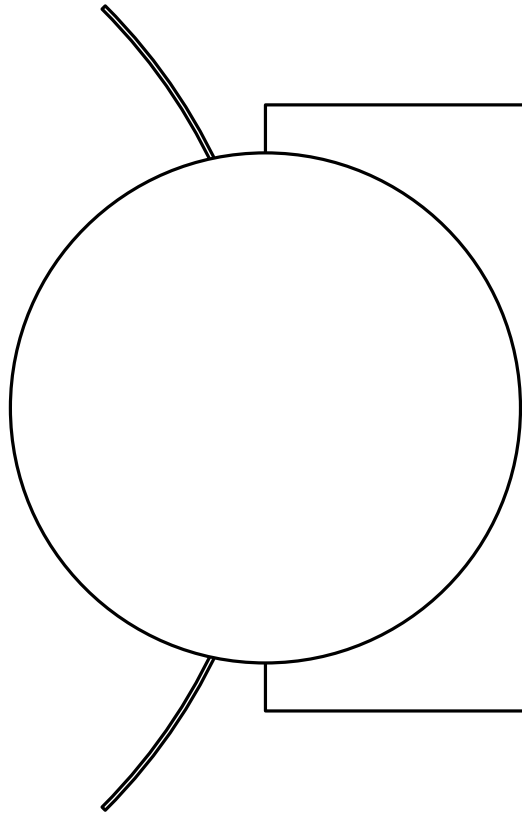


1. Corporation
sole



2. Corporation
aggregate

A corporation sole



A corporation sole is a legal person representing an official position which will be occupied by a series of different people. It is a legal entity consisting of a single "sole" incorporated office, occupied by a single "sole" natural person.

Examples



-

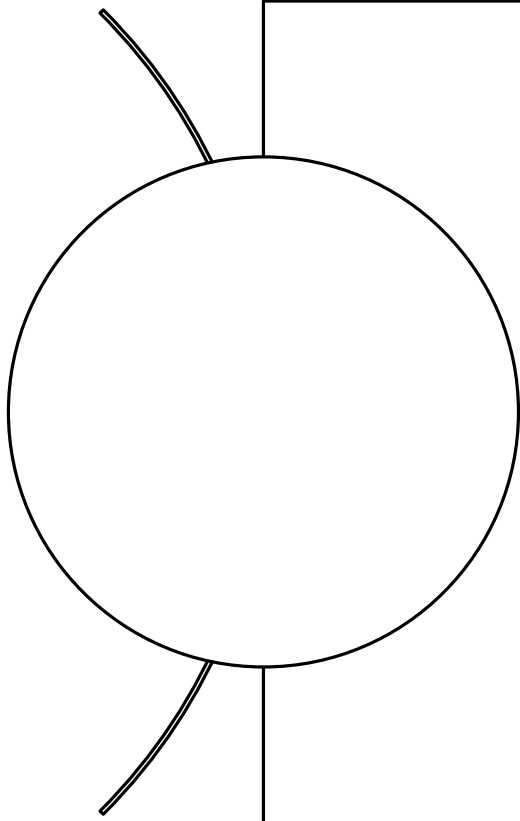
- **The president in his public capacity;**
- **The queen in her public capacity;**



-

- **The bishops and parish priests; and**
- **The Public Trustee.**

Corporations sole

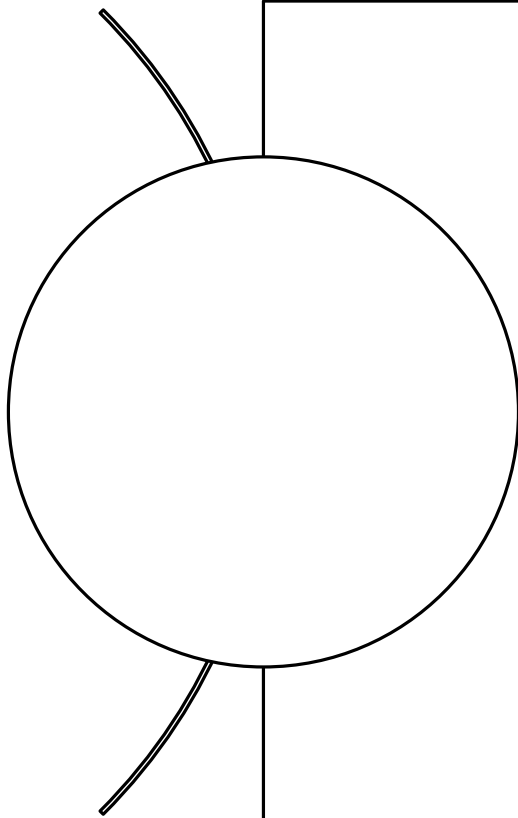


They are legal entities which are quite distinct from the people who actually hold the positions at any given time.

When a bishop for example dies, he ceases to exist as a natural legal person but the office of bishop remains.

The corporation cannot die, and regardless of when the new bishop assumes office, there is no break in its powers and its property remains vested in it.

Corporation aggregate

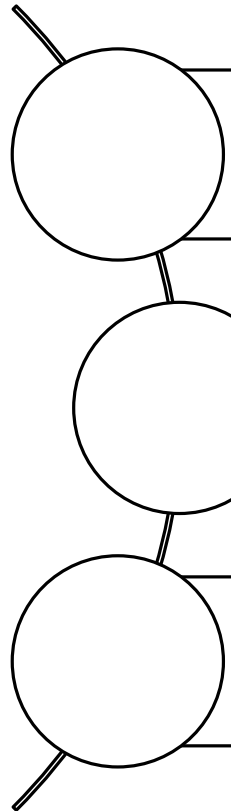


A corporation aggregate is a legal person consisting of a number of people who come together for a common purpose.

Its legal existence is quite separate from the members.

Examples are universities in Kenya whose membership is always changing because of new admissions, resignations and deaths but the corporation does not change except to the extent that its charter and bye-laws may be altered from time to time and it has the same legal rights and liabilities as a natural person.

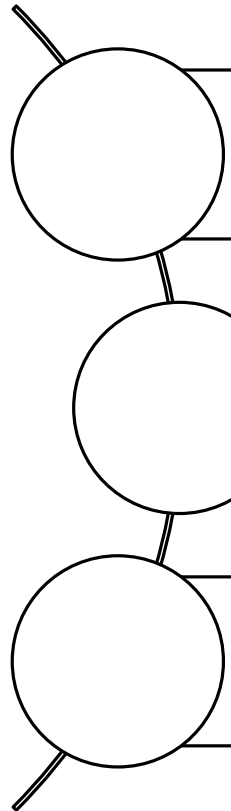
Creation of corporations aggregate

- 
1. **Charter(chartered corporations)**
 2. **Private Act of Parliament (statutory corporations)**
 3. **Registration under the Companies Acts (registered corporations).**

Forms/types of business organizations



FORMS OF BUSINESS ORGANIZATIONS

- 
1. Sole proprietorship
 2. Partnership
 3. Registered companies

Sole proprietorship

- ❖ These are also known as sole traders. They are natural persons engaged in business on their own without association with others.
- ❖ They are thus deemed to be unincorporated business (or trading) organisations.
- ❖ Generally there is no regime for the regulation as to setting up and conduct of business as a sole trader and anyone is, therefore, free to engage in any type of business activity.
- ❖ The only requirement is that where the business name is not that of the owner, the same must be registered with the Registrar of Companies within 28 days of commencement of business by virtue of the provisions of the Registration of Business Names Act (Cap 499).

Cont'd

- ❖ The main feature of the sole trader is that the owner and the business are the same i.e. the business is not a separate entity from the owner.
- ❖ The sole trader is therefore liable for the debts of the business to the full extent of their fortune.
- ❖ Sole proprietorships are the most common business structure.

Advantages of sole proprietorship

- 
- Formation
 - Regulation

- 
- Taxation
 - Personal contact with customers

- 
- Sharing of profits
 - Decision making

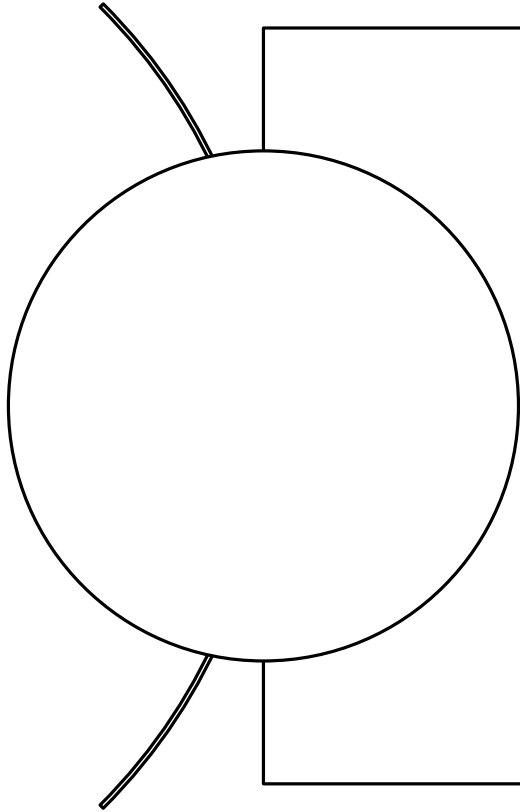
Disadvantages

- 
- Unlimited liability
 - Lack of continuity in case of death

- 
- Expansion
 - Limited expertise

- 
- Losses
 - Financing

Partnerships



A partnership is the relationship existing between two or more people carrying on business in common with a view to profit.

In Kenya, there is limited regulation for this class of business under the Partnerships Act (Cap 29).

A partnership can have up to 20 members.

Cont'd

- ❖ The partnership is not a separate legal entity and therefore the partners own all property of the firm jointly.
- ❖ A partnership is therefore merely the association of persons carrying on business together. Partnerships are not limited liability organizations and consequently the partners are liable for the debts of the business to the full extent of their fortunes.
- ❖ It is possible to have some of the partners having limited liability in which case such firm is known as a limited liability partnership. The only caveat here is that even then at least one partner must have unlimited liability. Such is known as a general partner with the other(s) being limited partners.

Cont'd

- ❖ In Kenya, the Limited Liability Act, 2012 now allows persons (individuals and body corporate) to register limited liability partnerships that are body corporate with a legal personality of their own. The Act requires such businesses to employ managers and make declarations of solvency or insolvency to the registrar of companies.
- ❖ In a partnership, each member of the firm is the agent of the other partners and is therefore liable for any wrongs committed by any of the other partners, provided they are committed in the course of business.
- ❖ Partnerships are formed by simple agreements unlike companies which require the registration of various documents – partnership deed/agreement
- ❖ A partnership is not affected by the rules of *ultra vires* and therefore can engage in any business activity.

Key features of partnerships

- ❖ Scope of activities may be changed by mutual agreement
- ❖ All partners normally play an active role in management
- ❖ Details of accounts and affairs may be kept private
- ❖ Partnership must be in business 'with a view to profit'
- ❖ All partners must agree to the appointment of a new partner
- ❖ All partners other than limited partners have unlimited liabilities for the debts of the firm

Cont'd

- ❖ Any partner can bind the partners in a contract with third parties.
- ❖ All partners are jointly and severally liable for meeting the obligation of contracts on behalf of the partnership
- ❖ No corporate existence. A partnership like a sole proprietor is not a separate legal entity like a limited company. It is the partners who are liable.
- ❖ All partners share profit according to agreement.
- ❖ The name of each partner and the business addresses must be showing clearly on business documents.

Advantages

- ❖ Raising finances
- ❖ Increased expertise - division of labour
- ❖ Sharing losses
- ❖ Formation procedure is simple
- ❖ Not subject to ultra vires rule

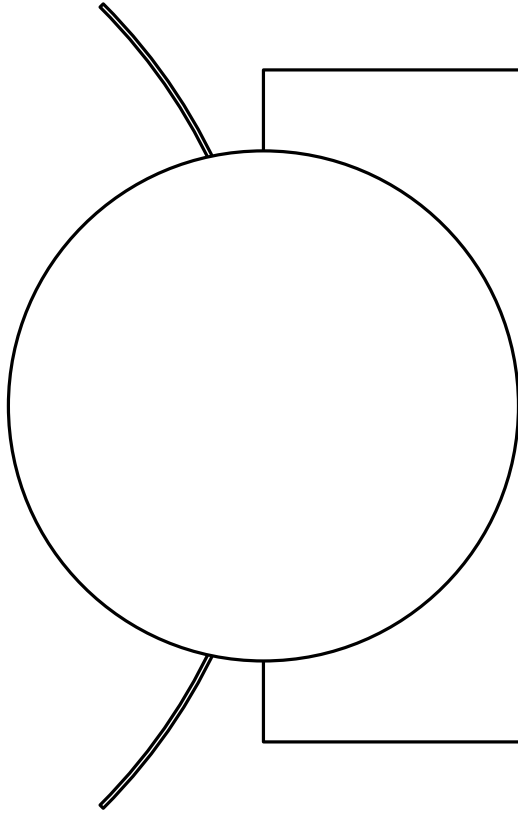
Disadvantages

- ❖ Unlimited liability
- ❖ Lack of continuity – death or withdrawal
- ❖ Sharing profits
- ❖ Slow decision making
- ❖ One partner's acts binding the others
- ❖ Disagreements in controlling the business

Features of unincorporated associations

- ❖ Unincorporated associations are groups of people which have not been incorporated through detailed legal procedures
- ❖ They range in size and importance from small social clubs and voluntary organizations with a few participants, to trade unions with memberships of a million or more.
- ❖ Unlike corporations, unincorporated associations are not generally treated as separate legal entities although there are 'quasi-corporations' which share some characteristics with corporations.
- ❖ They are simply groups of individuals, each of whom is a natural legal person with their own legal rights and responsibilities.

Contracts

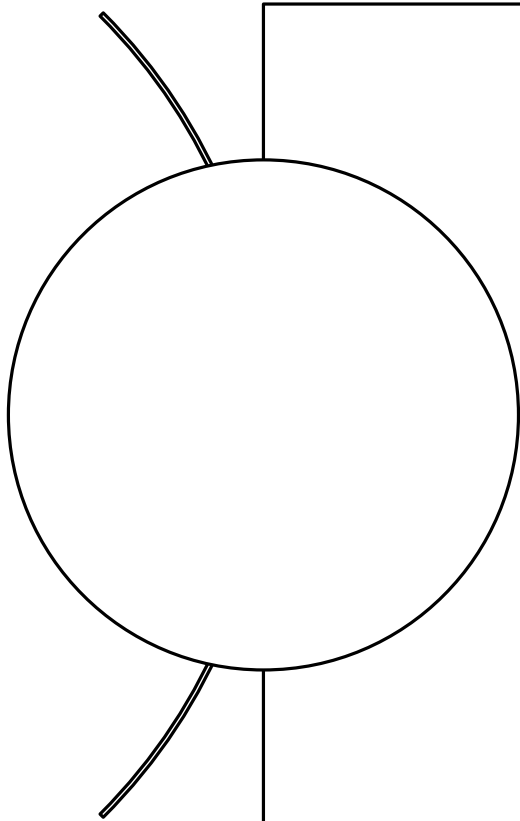


A member who makes a contract on behalf of an unincorporated association, such as a social club, is usually personally liable on the contract.

This means that a member who orders goods or supplies for the use of a club is personally liable to pay for them.

The other members of the club will be liable only if they authorize or ratify the making of the contract, which may well happen if the rules of the club provide for it

Tort

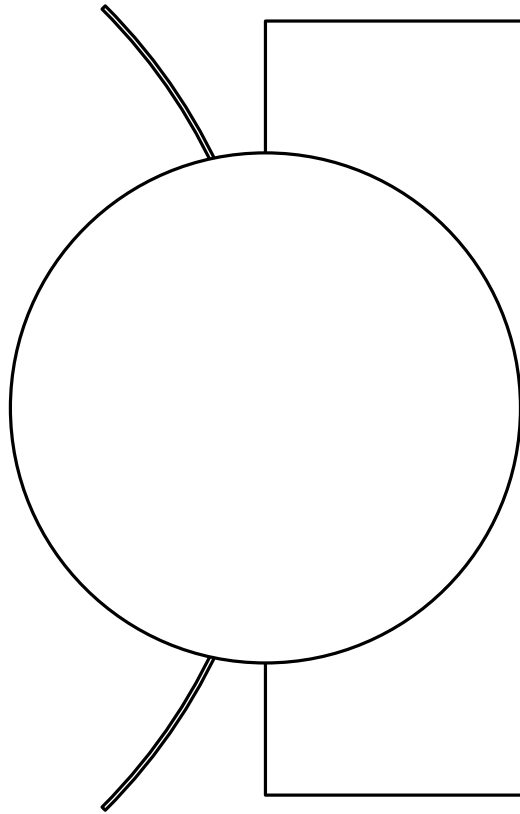


Members of unincorporated associations are generally liable for their own torts, even when they are committed in the course of the association's activities. Therefore, if one member of a club negligently injures another the former is personally liable and no other member will bear any responsibility.

However, if a person is injured as a result of the dangerous condition of the club's premises which it occupies, the committee which runs the club may in some cases be liable, depending again on the rules of the association.

Again, if a person is injured as a result of the negligence of an employee of the club the person or persons who appointed them may be vicariously liable. Vicarious liability arises where a person is held liable for a legal wrong committed by another.

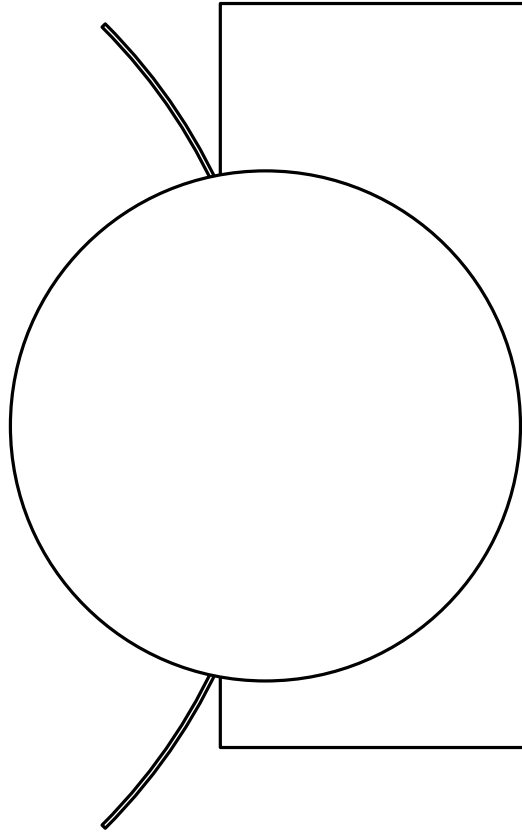
Ownership of property



Since an unincorporated association such as a club has no distinct legal existence it cannot own property, property thus belongs to the members jointly. For this reason, it is commonly arranged for club property to be held by trustees for the benefit of the association, in order to keep it separate from the members' own property.

The members may, subject to the rules of the association, call for the dissolution of the trust, in which case the property will be divided amongst them in accordance with the rules of the association. In fact, if a club is dissolved for any reason, and whether or not its property is held in trust, the club property will be divided amongst the members in this way.

Rights of members



The rights of members generally depend upon the rules of the club. Every member is deemed to be in a contractual relationship, governed by the rules, with every other member.

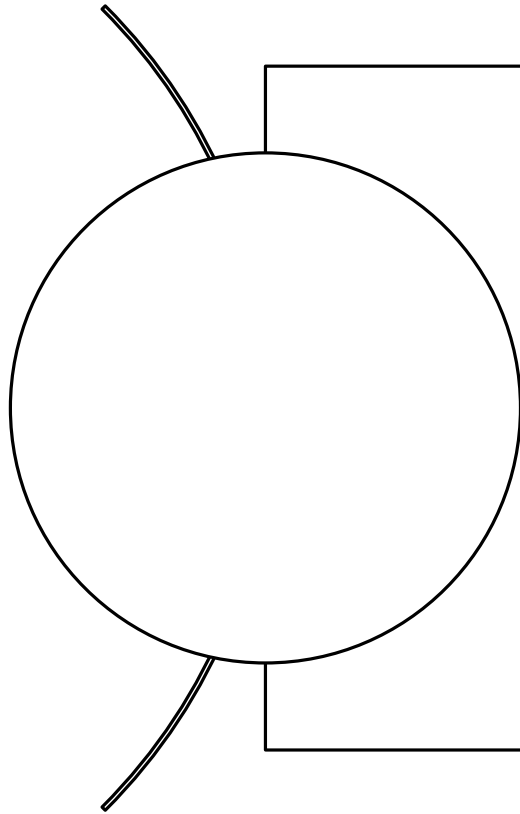
Therefore, a member who is denied rights given to them by the rules such as the right to vote or who is wrongfully expelled, may be able to sue for damages for breach of contract or for an injunction to prevent the association from acting in breach of the rules.

The action may be brought against all the members personally or, if this is impractical, the aggrieved member may apply for a representative order against a certain member or members only, such as the secretary or officers of the club.

State corporations

- ❖ Our concern are state corporations formed by the government for trading purposes under specific statutes of parliament.
- ❖ They may be formed under statutes enacted specifically to create and provide for them, e.g. the Kenya Railways Corporation, Kenya Meat Commission, Kenya Ports Authority among others.
- ❖ State corporations are regulated by the Acts by which they are established. In addition, some are subject to the provisions of the State Corporations Act.
- ❖ Like companies, they have a legal personality, can own property, can sue and be sued, have perpetual succession and limited liability.

Companies registered under the Company's Act



A company is an artificial person recognized by the law with an entity separate from its members for the purpose of preserving in perpetual succession the rights, which would fail if vested in a natural person.

In Kenya, the incorporation (by registration), regulation and winding up of companies is governed by the Companies Acts No. 17 of 2015 which repealed the Company's Act Chapter 486.

Formation of companies

- ❖ The process of forming companies is referred to as promotion of companies. Promotion is the process by which a company is incorporated or brought into existence by registration under the company's Act and established as a going concern by issue of a prospectus.
- ❖ People wishing to form a company are known as promoters. A promoter has been defined in the **case Tycross vs. Grant** as one who undertakes to form a company with reference to a given project and to set it going, and who sets the necessary steps to accomplish the purpose.
- ❖ A promoter is a person who assumes the primary responsibility to promoting a company.

Promoter to do;

- ❖ The type of company to be registered
- ❖ A suitable name for the company
- ❖ The object of the company, each member's liability and
- ❖ the registered office
- ❖ Drawing up rules for internal management
- ❖ Memorandum of association
- ❖ Directors, auditors and bankers for the company
- ❖ Printing and issuing a prospectus


File with the registrar

- ❖ Application for registration
- ❖ Memorandum of association
- ❖ Articles of association
- ❖ A statement of the nominal capital of the company
- ❖ A list of directors with their written and signed consent to be directors
- ❖ A statutory declaration by the proposed secretary that all the requirements have been complied with


Registration documents

MEMORANDUM AND ARTICLES OF ASSOCIATION


Memorandum of association – contents/clauses

- 
- Name clause
 - Registered office clause


- 
- Limitation of liability clause
 - Nominal capital clause

- 
- Objects clause
 - Guarantee clause
 - Association and subscription clause

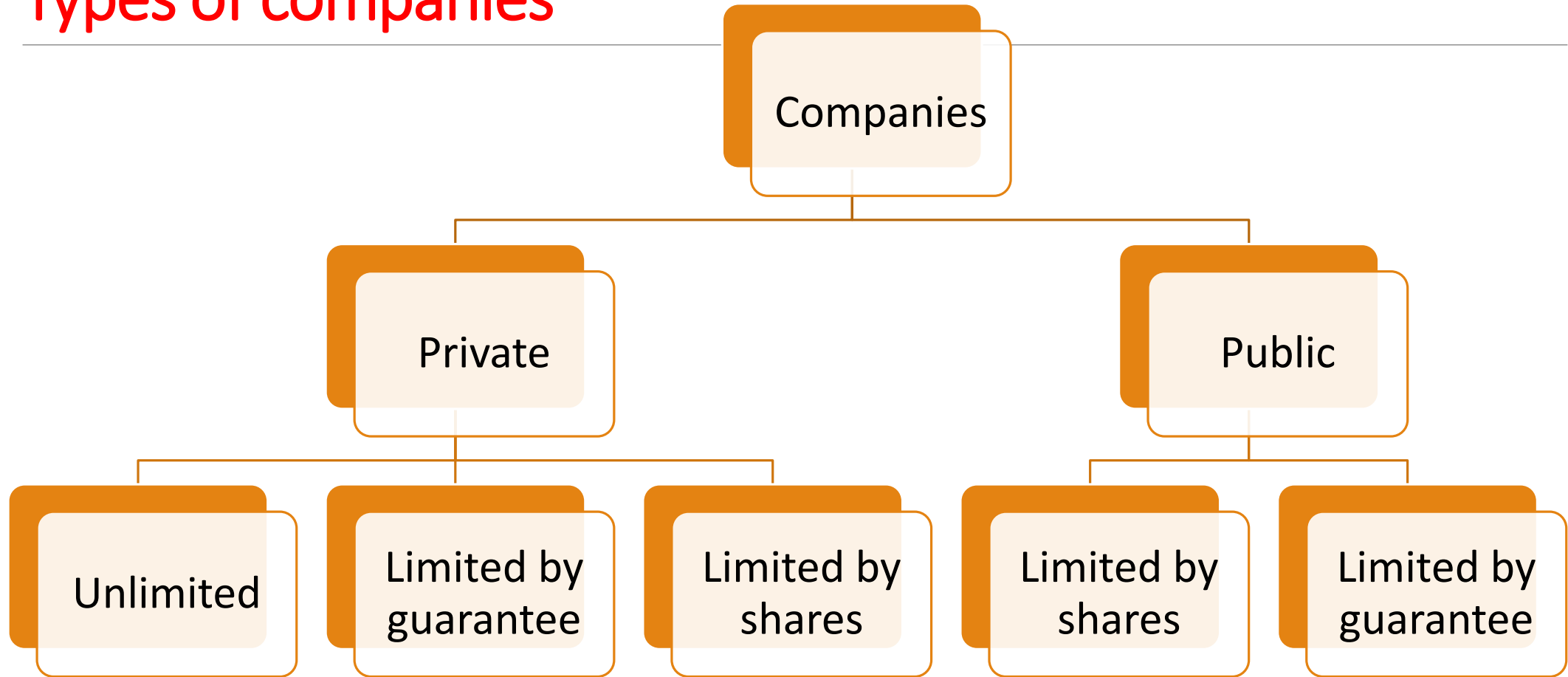
Articles of association - contents

- 
- Preliminary contracts
 - Division of capital into shares
 - Meetings

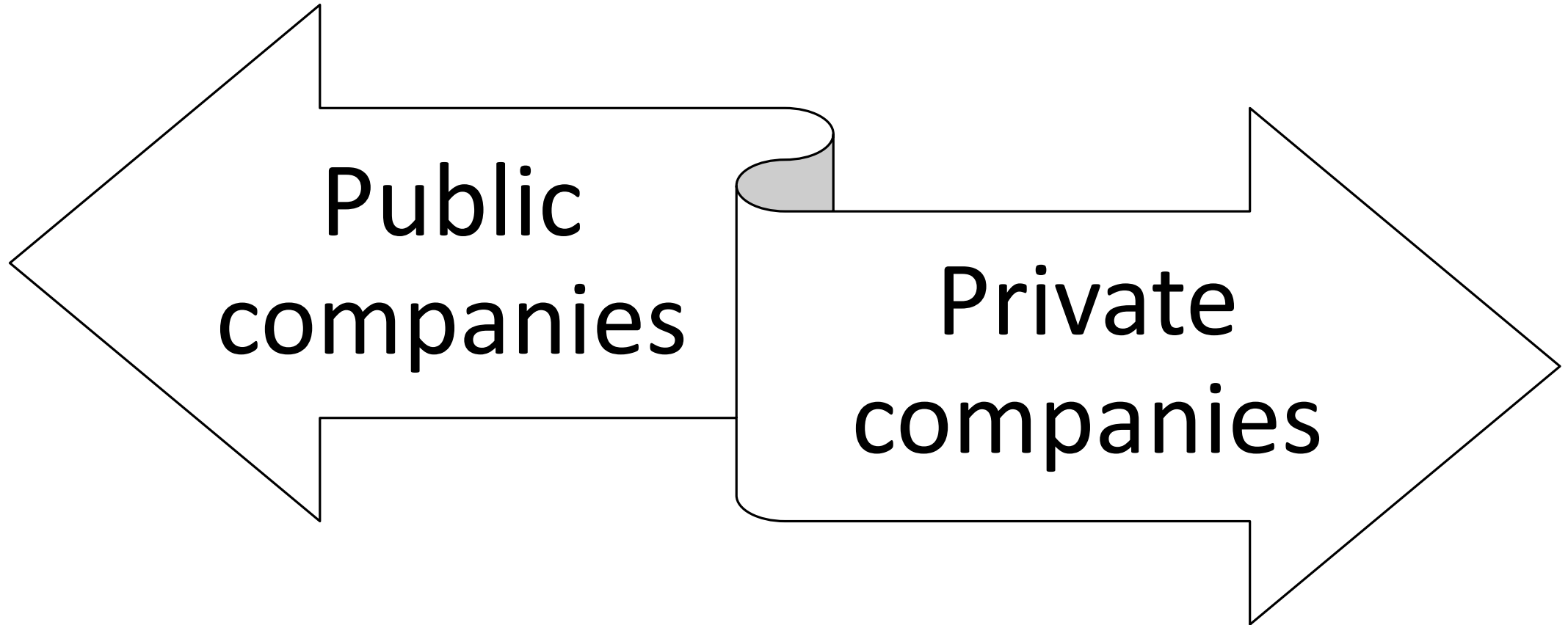
- 
- Directors
 - Registers
 - Books of account and audits

- 
- Quorum
 - Books of account
 - Winding up

Types of companies



Types of companies



Public companies vs. private companies

PRIVATE COMPANIES

- ❖ restrict the right to transfer its shares;
- ❖ limits the number of its members to fifty (excluding present and past employees); and,
- ❖ prohibits any invitation to the public to subscribe for shares in it.
- ❖ Not compulsory to hold AGMs
- ❖ A secretary compulsory if share capital exceeds KES 5 million
- ❖ Min.1 director

PUBLIC COMPANIES

- ❖ its articles allow its members the right to transfer their shares in the company;
- ❖ its articles do not prohibit invitations to the public to subscribe for shares or debentures of the company ;
- ❖ They do not have limits for membership
- ❖ its certificate of incorporation states that it is a public company.
- ❖ Must hold AGMs
- ❖ Minimum 2 directors

Characteristics/features of registered companies

- ❖ Separate legal status from members
- ❖ Activities defined in the memorandum of association
- ❖ Managed by a board of directors
- ❖ Liability of members limited
- ❖ Perpetual succession
- ❖ Subject to general law

Cont'd

- ❖ Details of accounts and other matters must be made public
- ❖ Company may or may not trade for profit
- ❖ Shares (and therefore membership) of public limited companies may be freely acquired
- ❖ Capacity to own immovable and moveable property
- ❖ A corporation once formed can sue and be sued in its own name

Advantages of companies

Limited liability –
to value of
shareholding or
guarantee

Perpetual
existence

Professional
management

Expansion
potential

Transferability of
shares

Diffusion of risk

Disadvantages of companies

Lack of secrecy

Restrictions in
legal
requirements

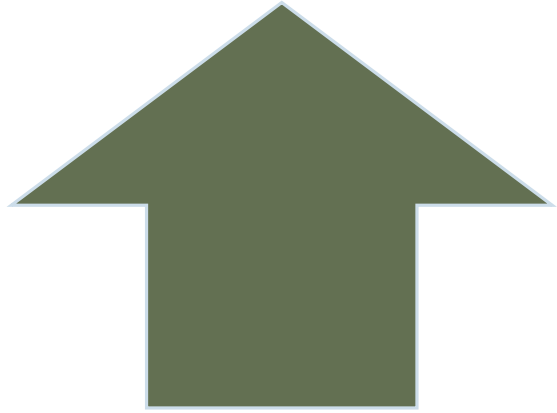
Management
mischief

Lack of personal
interest

Expensive to
establish, manage
and wind up

Profits taxable

Internal management of companies

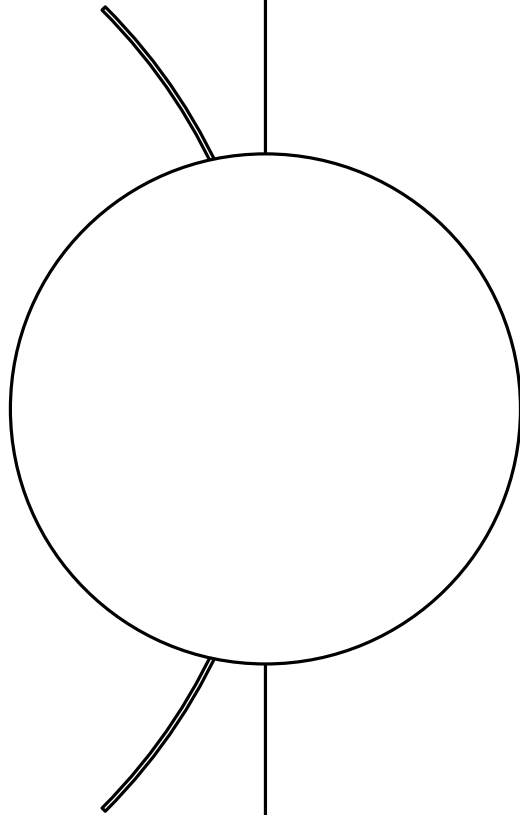


1. Board of directors



2. Meeting of shareholders

Board of directors



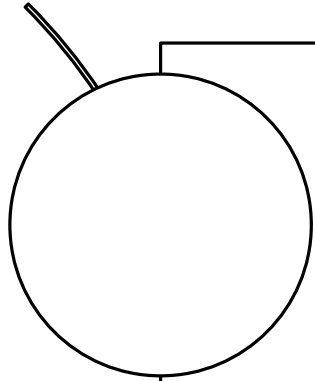
A company is an artificial legal person and runs its affairs through natural legal persons known as directors.

The directors' main responsibility is to manage the company whereas the shareholders' main control lies in the power to appoint directors.

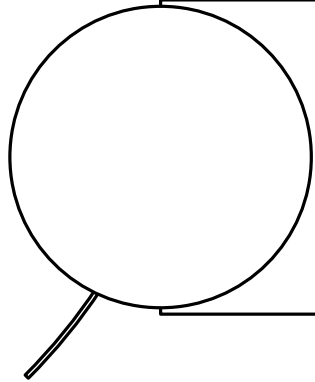
This consists of a relatively small number of persons who have been appointed directors of the company.

Usually they are granted extensive powers under the Articles of Association including the control of day-to-day operations, which they often delegate in turn, to one of them — the managing director/chief executive.

Cont'd



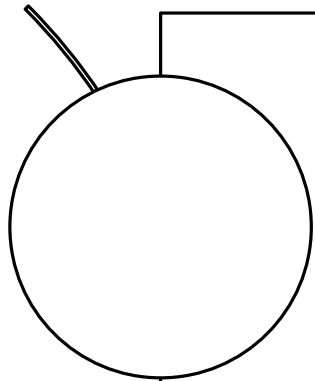
The first directors are usually named in the articles of association but such appointment is not valid until the director named has delivered to the registrar a written consent to act and a written undertaking to take his qualification shares.



Subsequent appointment of directors is done by members of the company in a general meeting by ordinary resolution.

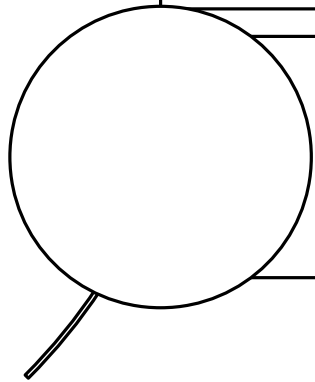
The number, appointment, term and removal from office of the directors will ordinarily be provided for in the Articles.

Duties of directors



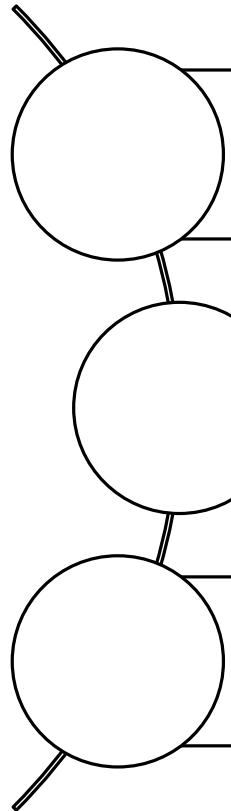
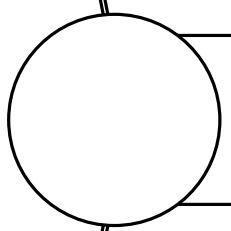
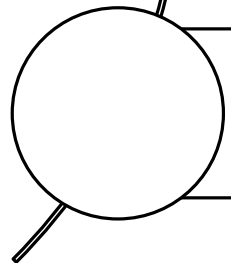
The relationship between a company and its directors is that of a principal and agent.

As agents, directors stand in a fiduciary relationship to their principal.

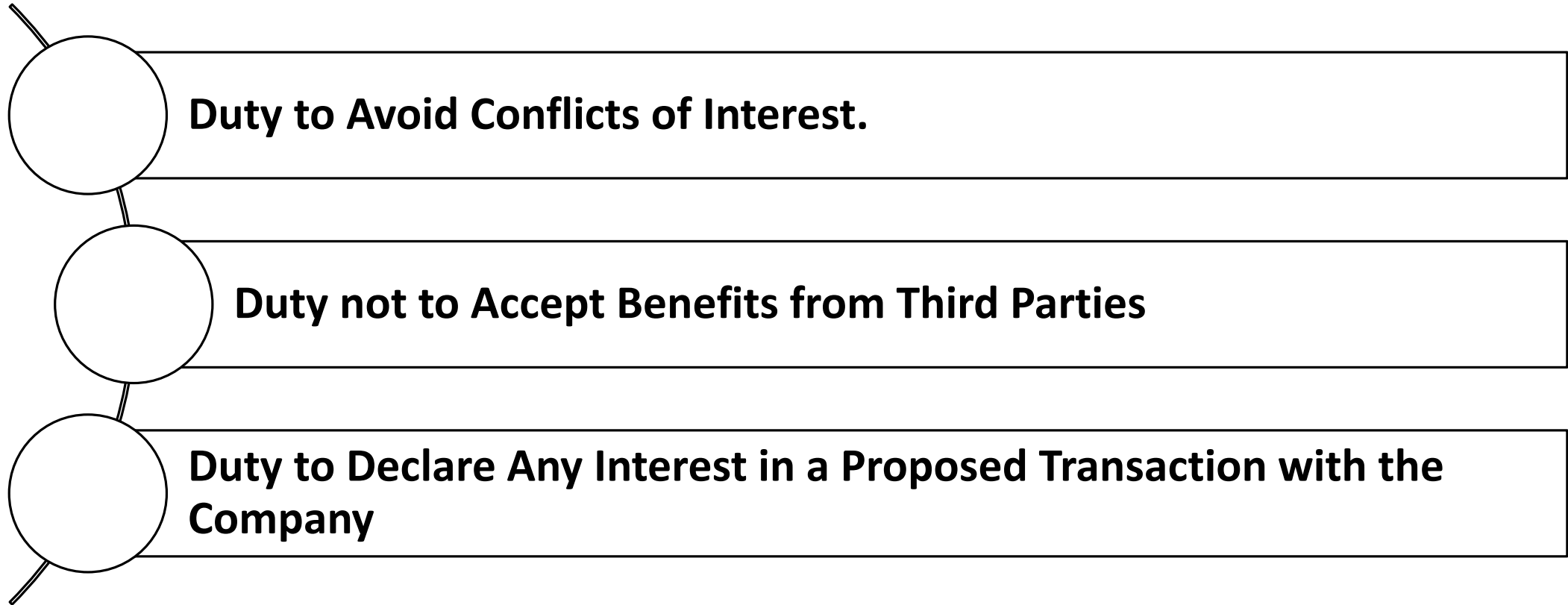


These duties are codified

Cont'd

-  **Act within Their Powers/Intra Vires**
-  **Exercise Independent Judgment**
-  **Exercise reasonable care, skill and diligence**

Cont'd



Duty to promote success of the company by;

- ❖ **Comprehend the long term consequences of decisions;**
- ❖ **Ensure to consider the interests of employees;**
- ❖ **The need to foster the company's business relationships with suppliers, customers and others;**
- ❖ **The impact on the community and the environment;**
- ❖ **The desire to maintain a reputation for high standards of business conduct; and**
- ❖ **The need to act fairly as between members.**

Powers of directors

- ❖ Enter into contracts on behalf of the company;
- ❖ Engage and dismiss employees;
- ❖ Keep a register of members;
- ❖ Call an annual general meeting within the statutory time; and
- ❖ Fill casual vacancies in the board. The number, appointment, term and removal of directors are ordinarily provided for in the articles. Initial directors will normally be subscribers and the articles may provide so.

Remuneration of directors

- ❖ Directors have no right merely by virtue of their office to remuneration.
- ❖ If a director is to receive remuneration, his contract of service or the Articles of Association must expressly provide for it.
- ❖ The Act provides that the remuneration should be determined from time to time by the company through a general meeting.
- ❖ If the directors have a contract of service, the company should keep a copy which is open to inspection by members and the accounts of the company must disclose the emoluments of the directors and the chairperson.

Circumstances of removal of a director from office

Ordinary
resolution in an
AGM

Disqualification

Age

Retirement

Resignation

Disqualification

- ❖ Becoming a person of unsound mind;
- ❖ Being absent for more than six months from the meetings without permission of the other directors;
- ❖ Being declared bankrupt unless with leave of the court to act;
- ❖ By virtue of the age limit; and
- ❖ By sickness.

Liability of Directors and Executive Officers



Third parties

The diagram consists of three rectangular boxes with orange borders. Two boxes are positioned at the top, one on the left and one on the right. The left box contains the text 'Third parties' and the right box contains the text 'Subscribers'. A third box is positioned below these two, centered horizontally, and contains the text 'The company'. A thin horizontal line is located above the top two boxes. From the bottom of the 'Third parties' box, a vertical line extends downwards and then turns right to connect to the top of the 'The company' box. Similarly, from the bottom of the 'Subscribers' box, a vertical line extends downwards and then turns left to connect to the top of the 'The company' box.

Subscribers

The company

Third parties



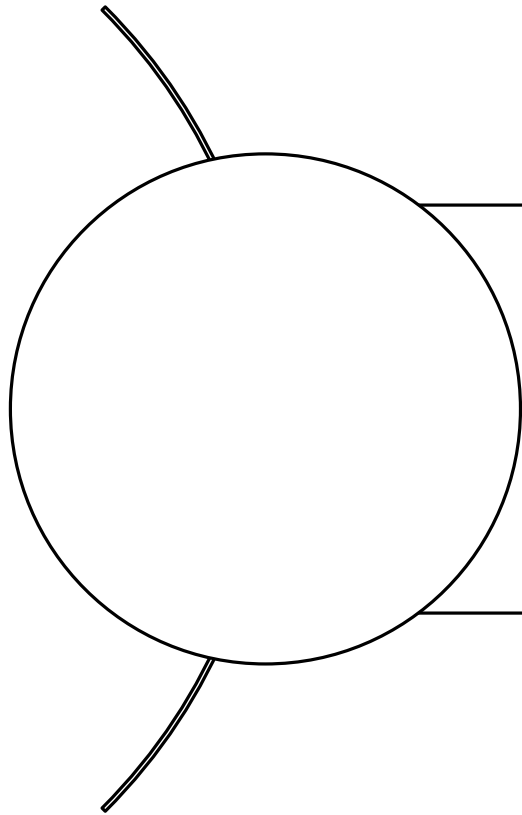
1. Contract

The diagram consists of three rectangular boxes with orange borders. Each box has a solid orange square on its left side. The first box is labeled '1. Contract', the second '2. Tort', and the third '3. Fraudulent trading'. The boxes are arranged with the first two on the top row and the third centered below them. A horizontal line is positioned above the top row of boxes.

2. Tort

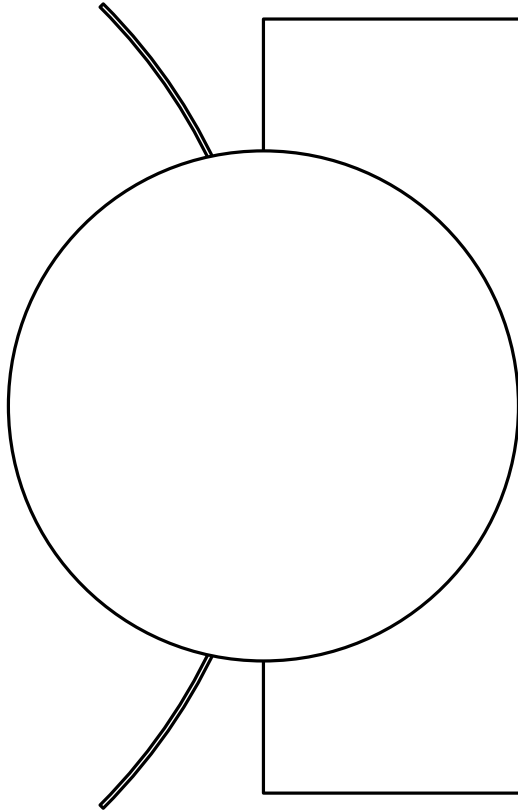
3. Fraudulent
trading

Lifting the veil



Means disregarding the corporate personality of a company in order to apportion liability to a person who carries out any act

Subscribers



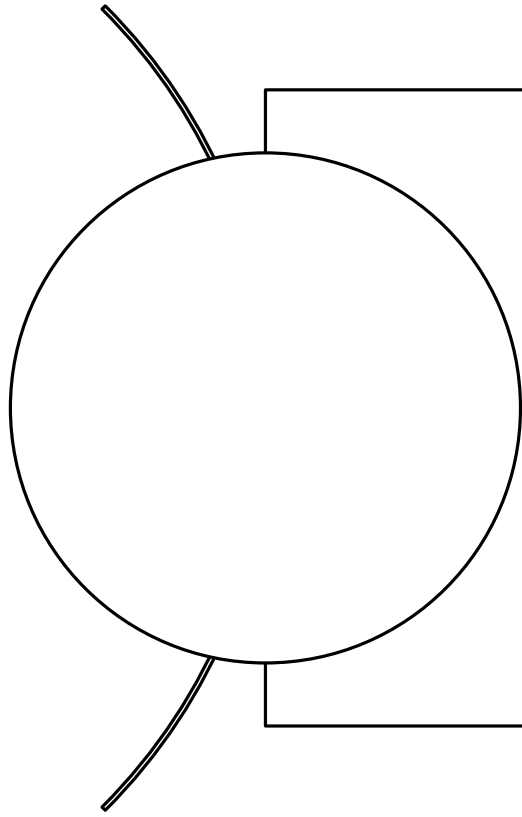
An offer for sale of shares through a prospectus must be signed by two directors of a company.

The intending purchaser is entitled to true disclosure and accurate and fair picture of the company.

Where there are misrepresentations, the subscribers may rescind the contract.

Directors may be held liable for misrepresentations or omissions made in the listing particulars and may be held liable to pay damages.

What is a prospectus

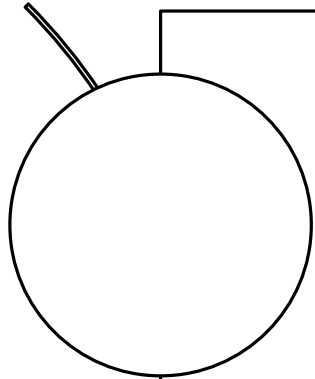


A prospectus is defined as any notice, circular, advertisement or other invitation offering to the public subscription or purchase of shares/debentures of a company.

Contents of the prospectus

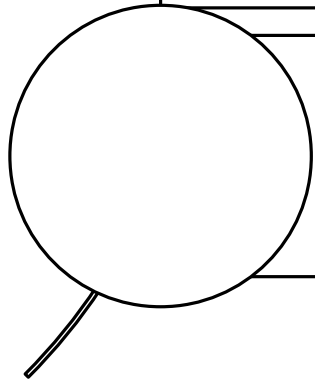
- ❖ The ownership business;
- ❖ The number of shares issued or agreed to be issued;
- ❖ Details of any property acquired by the company and the amount paid or agreed to be paid;
- ❖ Details of the voting rights of each class of shares; and
- ❖ Names, addresses and description of directors.

To the company



Negligence: directors are expected to exercise a reasonable degree of skill and diligence and to act honestly when performing their duties. They can be found liable to the company if in breach of this duty.

The standard of care expected is not one of a specialist. For instance, a director of a life company need not act like an actuary or a doctor.



Breach of trust: this occurs where the director(s) has wrongfully applied the company's funds and includes for instance, paying dividend out of capital or applying funds to *ultra vires* purposes.

Chairman of the board - Duties

- ❖ Declaring the meeting open and welcoming the members.
- ❖ To call the secretary to read the notice of the meeting if necessary.
- ❖ Ensure that they require quorum is present. Ask for apologies and the secretary records.
- ❖ Ensure members have copies of the previous minutes, read through them.
- ❖ Indicate what the items of the agenda are to begin/end (calling the meeting to order).
- ❖ To ensures that each member has an opportunity to speak and encourage the members to speak.

Cont'd

- ❖ Controlling the meeting by ruling the irrelevant remarks disallowing items not in the agenda.
- ❖ Maintaining order (dealing with unruly members and calm down disputes) and any issue to be raised through the chair.
- ❖ Clarify contributions by members so that each is understood by all (can summarize discussion for the benefit of all).
- ❖ The date of the next meeting should be arranged by mutual consent of the chair.
- ❖ The chair is to declare the meeting closed/ended and thank the people for attendance.
- ❖ Ensure impartiality in the meeting

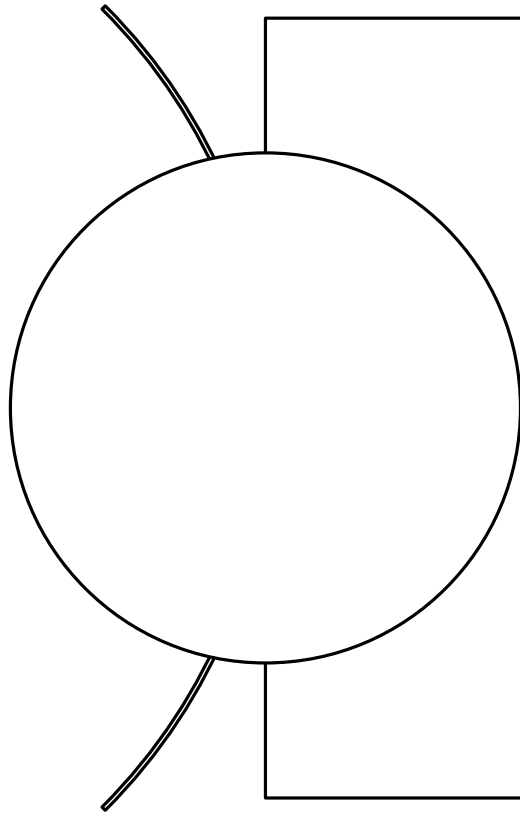
Managing director

- ❖ The board will also usually be authorised to appoint a managing director who reports to the board. The board normally delegates the whole of the management of the day-to-day affairs/operations of the company to the managing director.
- ❖ The MD receives such remuneration as the directors may determine.
- ❖ The board can revoke such appointment. The MD can be removed by a general meeting irrespective of the fact that his duration (term) is not over.
- ❖ Where services have been terminated in breach of the terms of appointment, the directors can claim for damages

Secretary

- ❖ Section 243 of the Company Laws 2015 provides that a private company is required to have a secretary only if it has a paid up capital of five million shillings or more.
- ❖ If a private company does not have a secretary, anything authorised or required to be given or sent to, or served on, the company by being given or sent to, or served on its secretary.
- ❖ Section 244 provides that every public company is required to have at least one secretary.
- ❖ Section 246 of the Act provides that a secretary be a person who appears to have the requisite knowledge and experience to discharge the functions of a secretary of the company; and is the holder of a practicing certificate issued under the Certified Public Secretaries of Kenya.

Cont'd



The appointment of the secretary must be recorded in the register for directors and secretaries.

Termination must also be recorded. The appointment should be notified to the registrar of companies.

The secretary can be removed from office by the directors whether he/she has been appointed in a resolution or under agreement.

Duties of a secretary

- ❖ To send out notice of the meeting in good time to all members.
- ❖ Requests and receives items for discussion at each meeting.
- ❖ He draws up an agenda in conjunction with the chair.
- ❖ Circulate among the members any document which may be necessary to enable to contribute fully to discussion of matters listed on the agenda.
- ❖ Draws up special agenda for the chair include details that will help him/her conduct the meeting satisfactorily.
- ❖ During meetings he sits by the chair to give any assistance required.
- ❖ Records details of what takes place during the meetings.
- ❖ After meeting, writes up the notes into a formal recording and circulates this among members after gaining approval from the chair.

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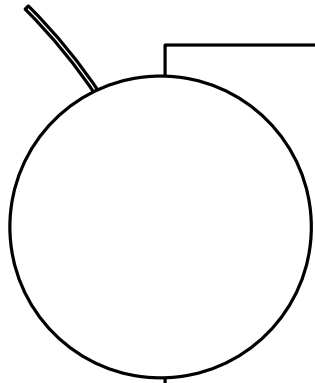
- ❖°advise members of the Board of Directors on their responsibilities and powers;
- ❖°inform members of the Board of Directors about all the necessary regulations or those which may affect the meetings of shareholders and of the Board of Directors, reports thereof and submission of all company documents required by the law to relevant organs as well as consequences due to the failure to comply with such regulations;
- ❖°ensure that minutes of the meetings of shareholders or the Board of Directors are well prepared and that registers provided for by the incorporation documents are accurately kept;
- ❖°ensure that annual balance sheet and other types of required documents are submitted to the Registrar General as provided for by this Law;
- ❖°ensure that copies of annual balance sheet and activity reports are transmitted

Personal liability for a secretary

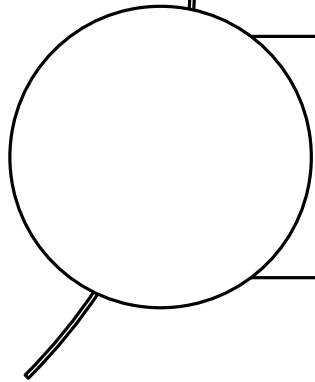
- ❖ He fraudulently issues share certificates where he has forged the signature of directors;
- ❖ Contracts entered into on behalf of the company and sufficient care is not taken that is, failure to disclose that he is an agent of the company.

Management of a company through meetings
of shareholders

A member of a company



**Subscribing their names to the memorandum;
Agreeing to take qualification of shares allotted
and paying for them**



**Having their names entered in the register of
members**

Shareholder vs. member of a company

- ❖ A person who owns shares in a company is a shareholder whereas on whose name is entered in the register of members is a member. Shareholders whose names are entered in the register of members are members
- ❖ One who signs the memorandum of association is a member and only becomes a shareholder when shares are allotted to them
- ❖ Every company must have a minimum number of members
- ❖ The liability of members in a company with a share capital is limited to the extent of their shareholding

Rights of members/shareholders

- ❖ Be sent a proposed written resolution;
- ❖ Require directors to call for a meeting;
- ❖ Receive notices of general meetings;
- ❖ Sell their shares;
- ❖ Get the dividend;
- ❖ Take copies of articles and memorandum of association;
- ❖ Appoint a proxy to act at a meeting; and
- ❖ Be sent a copy of the company's annual financial statements among other rights.

Types of shareholders



Ordinary
(common)
shareholders

The diagram consists of two large, hollow, arrow-shaped boxes pointing towards each other. The left box is a right-pointing arrow, and the right box is a left-pointing arrow. Both boxes have a rectangular body and a triangular point. The text 'Ordinary (common) shareholders' is centered within the left box, and 'Preferred (preference) shareholders' is centered within the right box. A horizontal line is positioned above the boxes, and a solid orange bar is at the bottom of the slide.

Preferred
(preference)
shareholders

Differences

ORDINARY SHAREHOLDERS

- ❖ Own common share
- ❖ Right to vote
- ❖ Right to receive common dividends
- ❖ Right to participate in distribution of assets when the company is being liquidated
- ❖ Right to file a class action against the company in case of any wrongdoing that threatens the company

PREFERRED SHAREHOLDERS

- ❖ Own preferred share
- ❖ No voting rights
- ❖ Have a guaranteed right to be paid a fixed amount of dividends every year before common dividends are paid – fixed amount or attached to a specified interest rate
- ❖ Company pays dividends even when in distress
- ❖ Priority in liquidation

Types of Shares



- ❖ be ordinary; a share entitling its holder to dividends which vary in amount and may even be missed, depending on the fortunes of the company. Shareholders have voting rights
- ❖ redeemable; shares that a company has agreed it will, or may, redeem (in other words buy back) at some future date. The shareholder will still have the right to sell or transfer the shares subject to the articles of association or any shareholders' agreement
- ❖ confer preferential rights to distributions of capital or income; a share which entitles the holder to a fixed dividend, whose payment takes priority over that of ordinary share dividends

Management by members/shareholders

- ❖ Members now have the *locus standi* to go to court and challenge a conduct that they think is oppressive or unfair.
- ❖ The individual members participation is confined to voting in general meetings.
- ❖ By exercising their rights to attend and vote at general meetings, shareholders may exert some control over the running of their company.

What they can do

- ❖ Can alter the articles to reduce the director's powers;
- ❖ May remove a director before his term expires by simple majority at a general meeting; and
- ❖ Can take proceedings against a director in the name of the company for negligence, breach of duty or breach of trust.

Types of meetings

1. Statutory or first general meeting

2. Annual General Meeting

3. Extraordinary General Meeting

Statutory meeting



Every company limited by shares and every company limited by guarantee with a share capital holds a general meeting at least one month but no longer than three months from the date on which it is entitled to commence business.

The object of the meeting is to afford the shareholders an opportunity of obtaining material information as to the circumstances of the company's promotion and its immediate prospects.

A statutory report must be prepared and sent to the members at least fourteen days prior to the meeting. Must signed by at least two directors and sent to the registrar of companies as well

Contents of a statutory report

- ❖ Total number of shares allotted as fully or partly paid;
 - ❖ Total amount of cash received in respect of all shares allotted;
 - ❖ The names, addresses and descriptions of directors, auditors, managers and the company secretary; and
 - ❖ Particulars of any contracts to be modified together with particulars of modification or proposed modification.
- NB.** Only one such meeting is held in the life time of the company

Annual general meeting (AGM)

- ❖ Annual General Meetings (AGMs) for private companies have been abolished although they can elect to provide for them in their articles if they so wish.
- ❖ Private companies can convene meetings at short notice where consent is given by holders of 90% by nominal value of shares carrying the right to vote. This is not so for public companies.
- ❖ A public company is required to hold its AGM within six months of the end of its financial year.
- ❖ The notice of a general meeting for a public company may be given in hard copy or electronic form, or by means of the company website.

Ordinary business of an AGM

- ❖ Declaration of dividends that is, profits of a company distributed among members in proportion to their shares;
- ❖ Consideration of accounts (financial statements);
- ❖ Appointment of directors in place of those retiring; and
- ❖ Appointment and fixing of the remuneration of auditors.

Extraordinary General Meeting (EGM)

- ❖ The Act provides that directors of a company must regardless of anything contained in the Articles to the contrary convene an EGM if one is requested for by members holding not less than one tenth shares of a company.
- ❖ The directors may convene the meeting whenever they deem fit.
- ❖ All business transacted in an EGM shall be deemed special.
- ❖ The directors are required to hold the meeting within 21 days from the time it is requested for otherwise those who requested may convene the meeting as nearly as possible in the manner required under the Articles.
- ❖ The company will reimburse those who requested for the meeting reasonable expenses incurred in convening the meeting.

Requirements for a meeting

- ❖ Notice for a meeting must be sent
- ❖ Quorum
- ❖ Proper chairman
- ❖ Agenda
- ❖ Proper authority
- ❖ Minutes

Quorum

- ❖ This is the number of members of sufficient to transact business at a general meeting.
- ❖ The quorum is fixed by the articles.
- ❖ Those who intend to vote by proxy are not taken into account when determining whether there is quorum or not unless the articles provides for them.
- ❖ If there is no quorum and the meeting proceeds, the business transacted is void.

Voting by proxy

- ❖ A proxy is a document by which one shareholder appoints another to vote in his place and is valid for only one meeting.
- ❖ Section 299 provides for appointment of proxies where a shareholder is unable to attend in person.
- ❖ The proxy may be any person; whether a member of the company or not; whether a natural or corporate person.

Resolutions

- ❖ A company, in a general meeting, conducts the meeting by the passing of resolutions.
- ❖ Due notice of intention to pass the resolutions should be given to the members.
- ❖ The resolutions are written resolutions or meeting of members for private companies.
- ❖ Written resolutions may be **ordinary or special**.

Ordinary Resolution

- ❖ This is a resolution passed by a simple majority of the members present and voting (either in person or by proxy) at a general meeting of the company.
- ❖ It can be by show of hands or by polling.
- ❖ An ordinary resolution is effective on;
 - appointment of auditors and directors
 - authorising issue of shares at a discount
 - declaration of dividends
 - approval of accounts
 - voluntary winding up of a company among others.

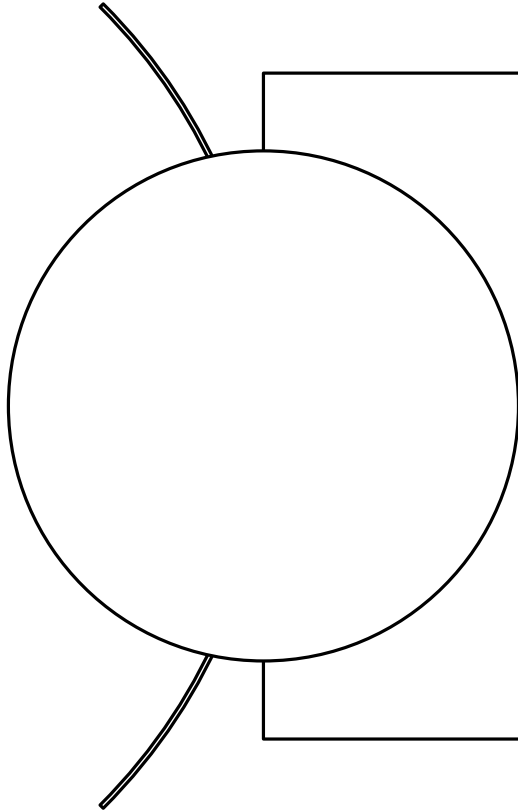
Special resolutions

- ❖ This is defined in section 257(2) of the Act as a resolution passed by majority of not less than seventy five percent and stated as a special resolution at a general meeting of which notice specifying the intention to pass the resolution has been duly given.
- ❖ A special resolution passed relate to the following:
 - Alteration of the objects;
 - Alteration of the articles;
 - Change of status of the company;
 - Appointment of inspectors to investigate the affairs of a company; and
 - To resolve that a company should be wound up.

Powers of shareholders for special Resolution – Rwanda Act

- ❖ adopt, alter or revoke the company's incorporation documents;
- ❖ °authorise a transaction which affects the rights attached to any shares;
- ❖ °adopt a special resolution;
- ❖ °authorise a proposal to change the status of the company to a public or a private company;
- ❖ °authorise an amalgamation;
- ❖ °put the company in liquidation; and
- ❖ °apply for the company, when solvent, to be removed from the register of companies

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Resolutions passed must be registered with the registrar.

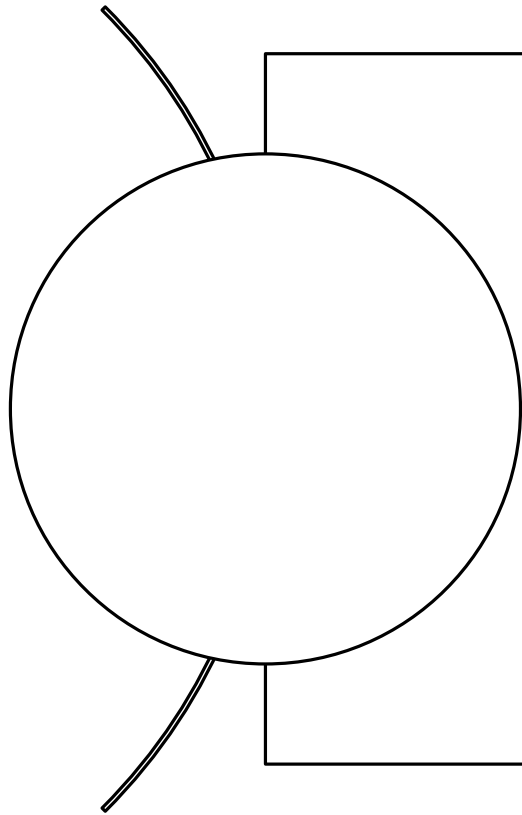
The company is required to keep minutes containing a fair summary of all proceedings of general meetings and any member is free to inspect them without being charged.

Liquidation of Companies

Liquidation of a company

- ❖ A company is regarded as an artificial legal person separate from its members and enjoys perpetual life until it comes to an end through a process known as winding up.
- ❖ Winding up is the process by which a company's legal existence is brought to an end and its property administered for the benefit of its creditors and members. It is carried through by a person known as a *liquidator*.
- ❖ The liquidator is so known because they in effect facilitate the winding up of the company.
- ❖ The company's property does not vest in the liquidator, the liquidator only assumes all the functions of the directors.

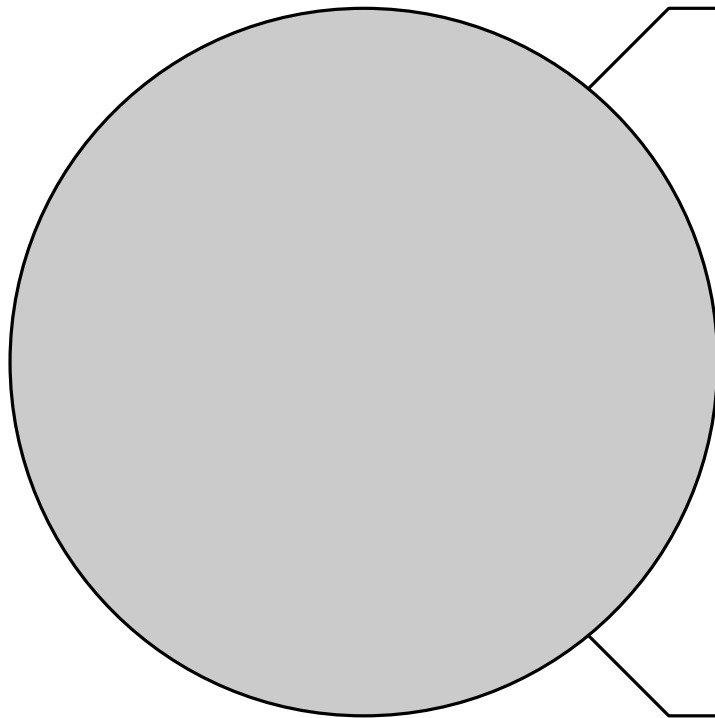
What is insolvency?



Insolvency arises when a business does not have enough assets to cover its debts or is unable to pay its debts when they are supposed to.

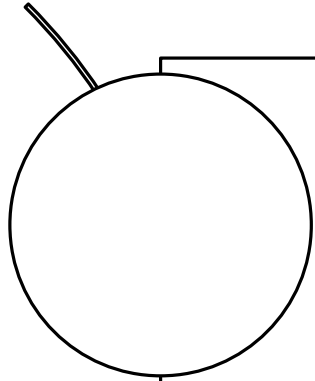
Insolvency can lead to insolvency proceedings, in which legal procedures will commence to ensure that the value of the assets of the business is maximized to pay off the existing debts

Relevant legislation

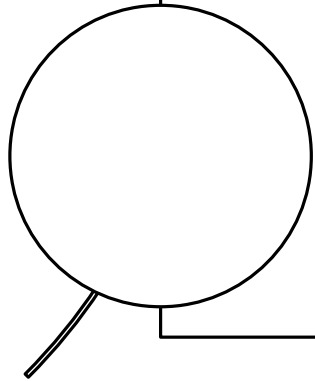


**Winding up
(liquidation) of
companies is now
regulated by the
Insolvency Act No. 18 of
2015.**

Under Company's Act



Under section 894 of the Company's Act, the registrar has power to strike off a company that is not carrying on business.



For this to be effective, the registrar is required to follow the following steps:

Cont'd

- ❖ Send a letter by post to the company where there are reasonable grounds to believe that a company is not in operation;
- ❖ If there is no response from the company, a reminder will be done;
- ❖ When the registrar is satisfied that the company is not carrying on business, they will send a notice to the company of intention to strike it off;
- ❖ The company is then deregistered; and
- ❖ The striking off is published in the Kenya Gazette.

Insolvency Act provides

- ❖ Compulsory winding up by the court;
- ❖ voluntary winding up, which in turn may be;
 - members' voluntary winding up; or
 - Creditors' voluntary winding up.
- ❖ Winding up subject to supervision of the High Court.

Compulsory winding up by the court procedure

1. Presentation of petition to wind up

- ❖ The process is commenced when a petition for a winding up order against the company is presented to the High Court by a petitioner.
- ❖ Section 425 of the Insolvency Act provides that the petitioner may be the Attorney General, director, creditor, contributory, provisional liquidator or a liquidator in case of a company under voluntary liquidation.
- ❖ Section 122 of the Insurance Act provides that where a petition for winding up of an insurer is presented by a person other than the Commissioner of Insurance, a copy of the petition should be served on the Commissioner who should be given an opportunity to be heard.

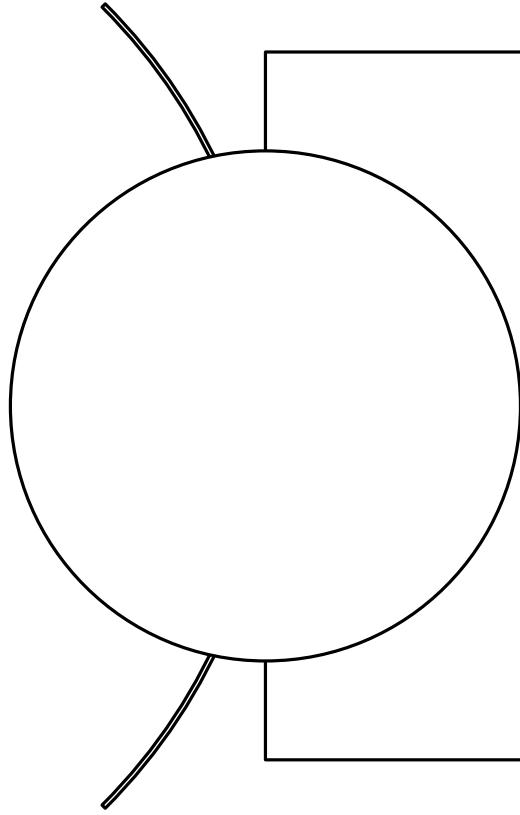
Grounds for petitioning (Section 424 of Insolvency Act)

- ❖ If the company has by special resolution resolved that it should be wound up by the court;
- ❖ The company has not commenced business within a year of its incorporation or has, suspended its business for a year;
- ❖ In case of a public company, it has not been issued with a trading certificate and twelve months have elapsed;
- ❖ The company is unable to pay its debts within the meaning of Section 384 of the Insolvency Act;
- ❖ For private companies, the number of members of the company has reduced to less than two;
- ❖ The court is of the opinion that it is just and equitable to liquidate the company; and
- ❖ When the period of moratorium ends.

Grounds for petitioning under the Insurance Act

- ❖ That the company is unable to pay its debts;
- ❖ A company underwriting long term business and has continued as a closed fund for a period of more than five (5) years;
- ❖ If an insurer has failed to comply with the requirements under the Insurance Act and a notice has been given by the Commissioner but the company continues with the contravention for six months after receiving the notice;
- ❖ Inability by an insurer to fulfil reasonable expectations of the policyholders or potential policyholders;
- ❖ If it is just and equitable in the interests of the policyholders that the insurer be wound up;
- ❖ If the insurer has failed to pay tax that is due and outstanding; and
- ❖ Where a company carries on insurance business and has not been registered as provided for under the insurance Act.

Note

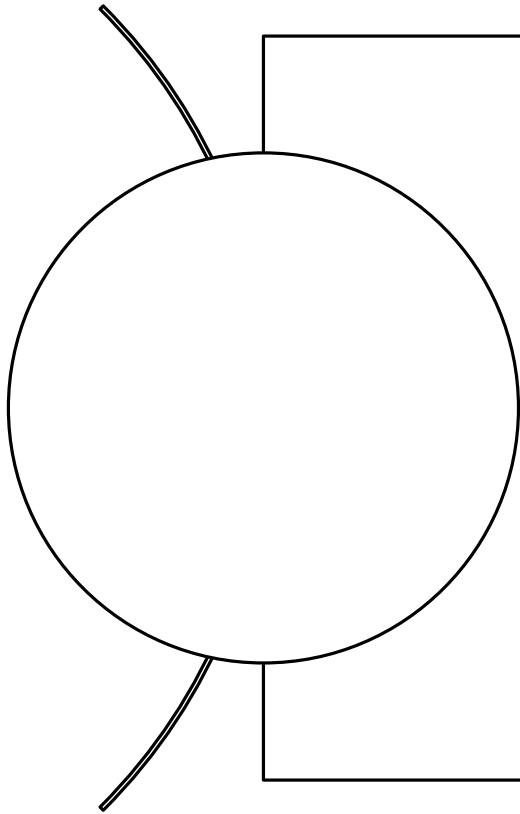


The most common and contentious grounds on which winding up by the court are commenced is inability to pay debts and when it is just and equitable to wind up a company.

Inability to pay debts

- ❖ Creditor(s) or assignees to whom the company owes more than one hundred thousand shillings (KES 100,000) serves on the company at its registered office a written demand for payment and the company fails to pay within three weeks (21 days) to either pay the debt or offer satisfactory security for it. An insurance company is deemed to be unable to pay its debts if it does not comply with the requirements for solvency margin set out in section 41 of the Insurance Act which provides for the extent to which the assets of a company should exceed the liabilities;
- ❖ Execution or other process issued on a judgment decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or
- ❖ It is proved to the satisfaction of the court that taking account of the contingent and prospective liabilities of the company; it is unable to pay its debts.

Winding up if it is just and equitable



Winding up in this case will only be ordered if the court is of the opinion that the company should be so liquidated.

This gives the court a very wide discretion that cannot be challenged.

This ground is often used by a member who is dissatisfied with or is at loggerheads with the directors or controlling shareholders over the management of the company

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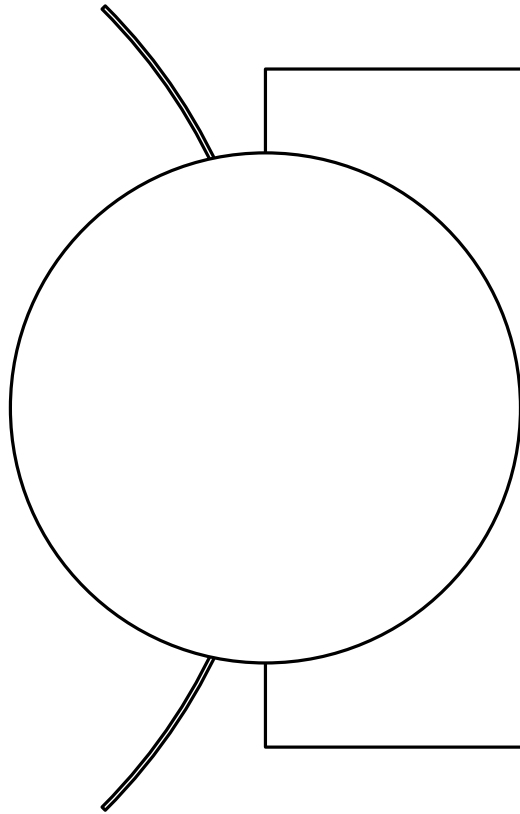
1. Where the substratum (in essence, the reason for its being) of the company has disappeared (or is lost).

2. Where there is a complete deadlock in the management of the affairs of the company. In the case of *Re Yenidje Tobacco Company (1946)*, two sole traders converted their businesses into a company in which they were the only directors and shareholders.

They quarreled bitterly and one sued the other for fraud. In the meantime, they refused to speak to each other and conducted board meetings by passing notes through the hands of the secretary.

The defendant in the fraud action petitioned for the compulsory winding up of the company, which was opposed by the other member. The court held that as the business was in real terms a partnership, it was just and equitable to order liquidation since any prospect of cooperation that sustains a partnership had been destroyed by their animosity towards each other.

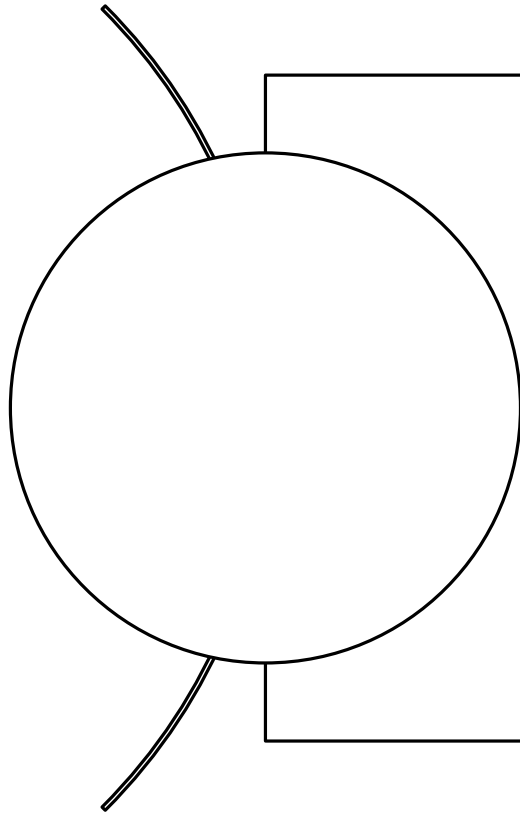
2. Service of the petition on the company;



On filing a case in a court of law against the respondent company, there must be service of the petition to enable the company file a response.

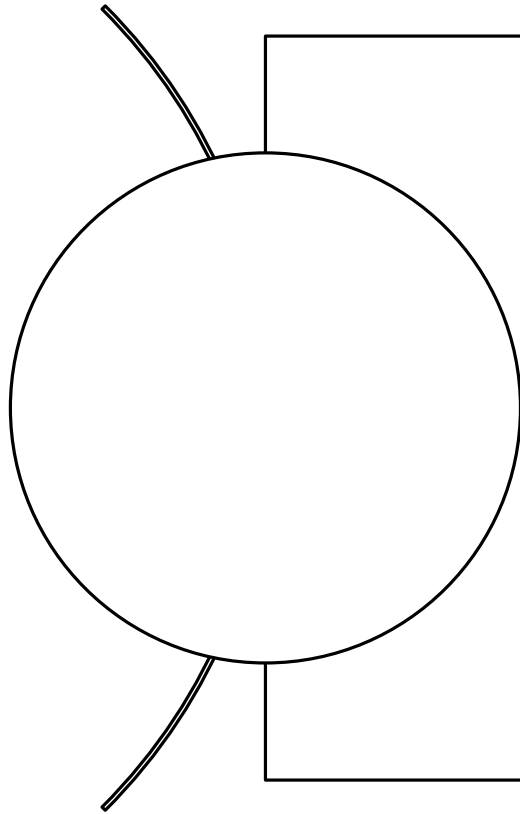
The insurance Act requires that such a petition be also served on the commissioner of insurance

Step 3; Publication



Publishing in the official *gazette* and two daily newspapers to alert the public so that interested parties who may wish to be heard on it may lodge their notices of intention to appear and either oppose or support the petition and hearing in open court once all formalities are complied with;

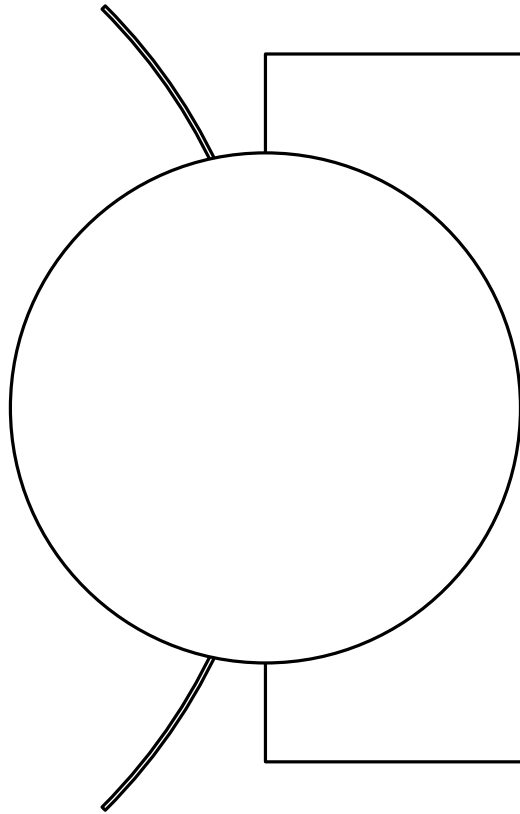
Step 4; Appointment of OR/provisional liquidator



Appointment of the Official Receiver to be the provisional liquidator upon commencement of winding up proceedings but before the winding up order is made.

This is normally done to secure the assets of the company where there is danger of their being wasted. The Official Receiver (OR) is the receiver attached to the High Court for bankruptcy purposes;

Step 5; Hearing the petition by the court

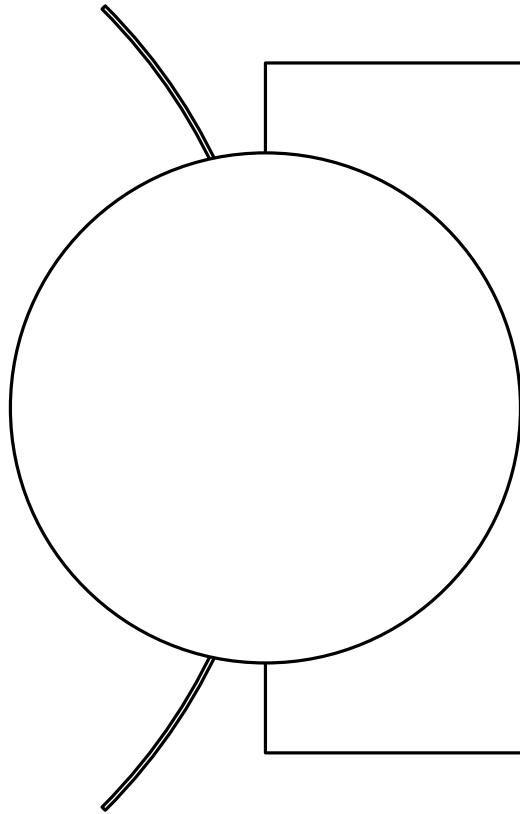


Issue an order to dismiss it with or without costs;
Make an interim liquidation order;
Adjourn the hearing conditionally or unconditionally; and
Make an order it may deem fit including an order for compulsory winding up order or winding up under the court's supervision.

Step 6; Issuing a liquidation order

- ❖ Liquidation is deemed to have started when the petition was presented;
- ❖ All powers of the directors cease;
- ❖ Any disposition of the company's assets is void unless ordered otherwise by the court;
- ❖ Any legal proceedings against the company are halted and can only be proceeded with after leave of the court is obtained;
- ❖ All staff of the company are automatically dismissed;
- ❖ Any attachment of the assets to the company is null and void;
- ❖ The winding up order operates in favour of creditors and contributories; and
- ❖ The date of commencement of the winding up is the date of presentation of the petition.

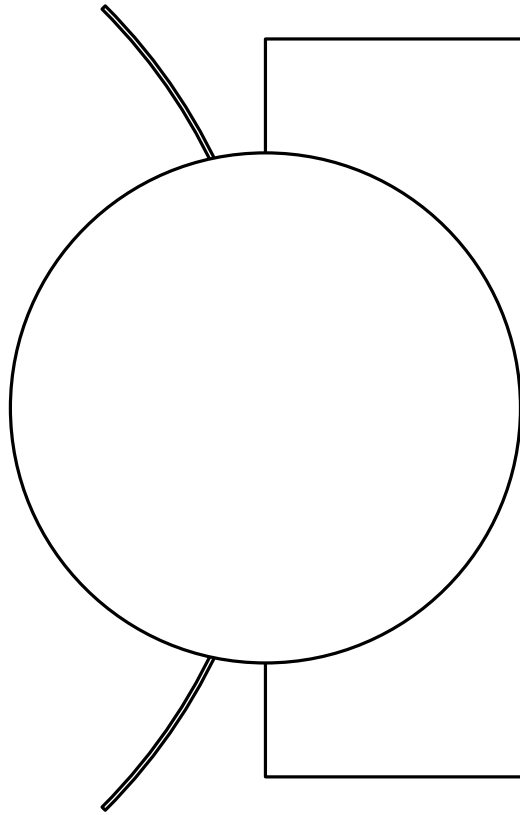
7. Realising the assets and liabilities, paying off and preparing an account



After the official receiver has realised the property of the company and has distributed the final dividends to the creditors and a final return to the contributories, the liquidator can then apply to the court who will arrange on the account to be prepared.

The court will then after considering the report and any objections of the creditors or contributories grant release of the liquidator;

8. Deregistration of the company

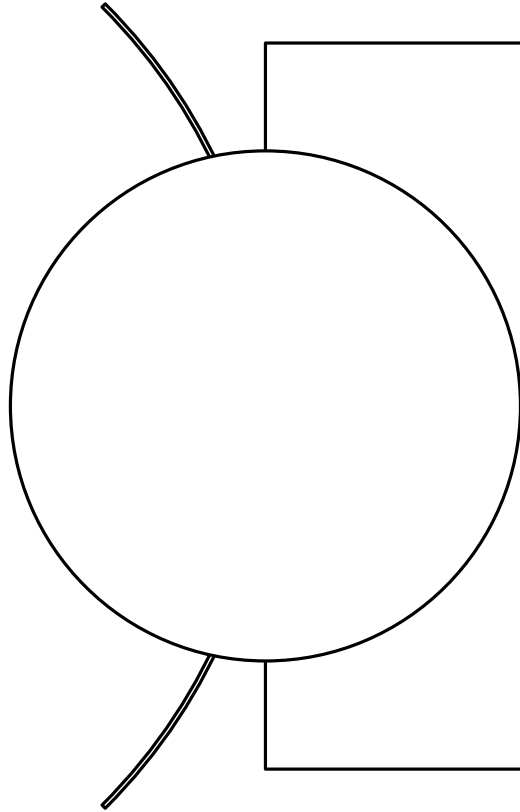


An order of the court releasing the liquidator and deregistering the company from the registrar of companies is issued.

Voluntary winding up - circumstances

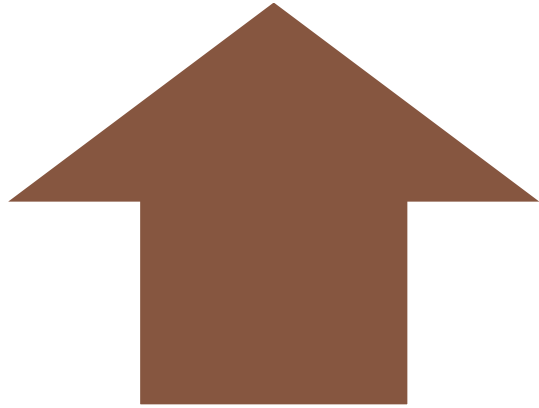
- ❖ If any period set by the articles expires or event occurs as is provided by the articles as being the time when the company shall be wound up and the company has by special resolution resolved that it be wound up; and
- ❖ The company resolves by special resolution that it be wound up voluntarily. The Act requires a notice of such resolution to be published in the Gazette and at least two daily newspapers.

Insurance Act



The winding up commences at the time of the passing of the resolution of winding up. Section 119 of the Insurance Act Cap. 487 provide that notwithstanding anything to the contrary in the Company's Act, no insurer carrying on long term business shall be wound up through voluntary winding up.

Types of voluntary winding up



Members voluntary
winding up



Creditors voluntary
winding up

Procedure for members voluntary winding up - Sec.399

**Holding of meeting
where a special
resolution is passed**

**Notifying the
registrar**

**Appointment of
one or two
liquidators**

**Preparation and
submission to registrar
of declaration of
solvency**

**Publication in Kenya
Gazette and 2 daily
newspapers**

**Liquidator realizing
assets and liabilities
and paying and
preparing report**

**Registrar
removing the
name of the
company**

Creditors voluntary winding up – sect.406

- ❖ A company that is in the course of liquidation to convene a meeting.
- ❖ The creditors' meeting is convened through publishing a notice in the Kenya Gazette and two daily newspapers.
- ❖ The directors are also required to send notices to the creditors individually.
- ❖ For the creditors' meeting to be convened, the meeting of the members must take place first and pass the resolution to liquidate the company.

Cont'd

- ❖ The directors lay down the details of the finances of the company during the meeting and the creditors will appoint their choice of liquidator, which prevails if they are different from the one appointed by the members.
- ❖ The creditors will also nominate a liquidation committee. On appointment of the liquidator, all powers of the directors cease.
- ❖ When the liquidation process is completed, the liquidator will publish the liquidation in the Kenya Gazette and two daily newspapers.
- ❖ The liquidator will then send their final report to the Registrar who dissolves the company by removing its name from the register.

Winding up subject to court's supervision

- ❖ Where a company has passed a resolution for voluntary winding up, the court may order that the same shall proceed but subject to such supervision of the court and with such liberty for creditors and other interested parties to apply to the court and generally on such terms and conditions as the court thinks just.
- ❖ A petition for winding up subject to the court's supervision may be presented by any person or persons entitled to petition under compulsory winding up.
- ❖ The powers of the court in respect of a winding up by the court apply to winding up subject to its supervision.

Cont'd

- ❖ The liquidator winds up the company in the same manner as if liquidation were an ordinary voluntary liquidation.
- ❖ The court is empowered to appoint an additional liquidator when a supervision order is made who has the same powers and duties as the one appointed under voluntary winding up.
- ❖ Winding up commences at the date of the resolution authorising liquidation. When the affairs have been wound up, the court makes an order that the company be dissolved from the date of the order.

LEGAL ASPECTS OF INSURANCE
END OF CHAPTER SEVEN

WELCOME TO CHAPTER NINE

TOPIC: DISPUTE RESOLUTION MECHANISMS

What is a dispute?



A dispute is a disagreement between two or more persons, groups or countries.

A dispute will arise where there are relations between the parties to the dispute which relation can be social, commercial, political etc.

Disputes are inevitable where there are commercial dealings and transactions.

Disputes in insurance may relate to:

Taxation matters with the tax master;

Under the Occupier's Liability Act;

Claims by employees due injury suffered or disease contracted in the course of duty. This may also be as a consequent of breach of employment laws; and

There may also be disputes relating to company law related matter.



Disputes in relation to policies underwritten



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1. Policyholder & insurers

2. Insurer & co-insurer or
reinsurer

3. Third parties & insurer/insured

Case illustration



Pacis Insurance Company Limited vs. Outreach Community Centre & Another (2015)

The plaintiff sought a declaration from the court that they were entitled to avoid liability for injuries to third parties sustained through a road accident on the ground that there was breach of terms and conditions arguing that the vehicle was overloaded.

The court held that the application is without merits and is dismissed with costs.

Case illustration



Kenya Orient Insurance Co. Ltd vs. Kelvin Macharia (2011)

The plaintiff made an application to the High Court seeking a declaration that they be allowed to avoid liability on the ground of non-disclosure of material facts. They alleged that the defendant had sold the insured motor vehicle at the time of the accident and failed to notify the insurer of this fact. It was held that the Plaintiff is entitled to avoid the policy by reason of the non-disclosure of material fact, misrepresentation and want of an insurable interest on the part of the defendant.

Methods of dispute resolution



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Society has therefore over time
come up with ways and
mechanisms of resolving disputes

1. LITIGATION

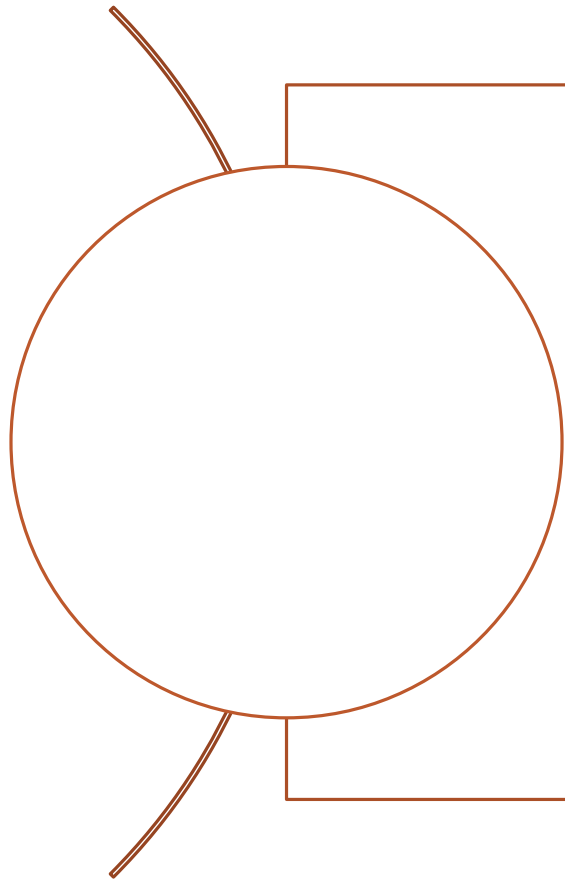


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Litigation is the use of the civil justice system (courts) by parties to a dispute to hear and adjudicate upon their differences of opinion.

The person who commences litigation is known as the claimant/plaintiff and the person who defends litigation is known as the defendant

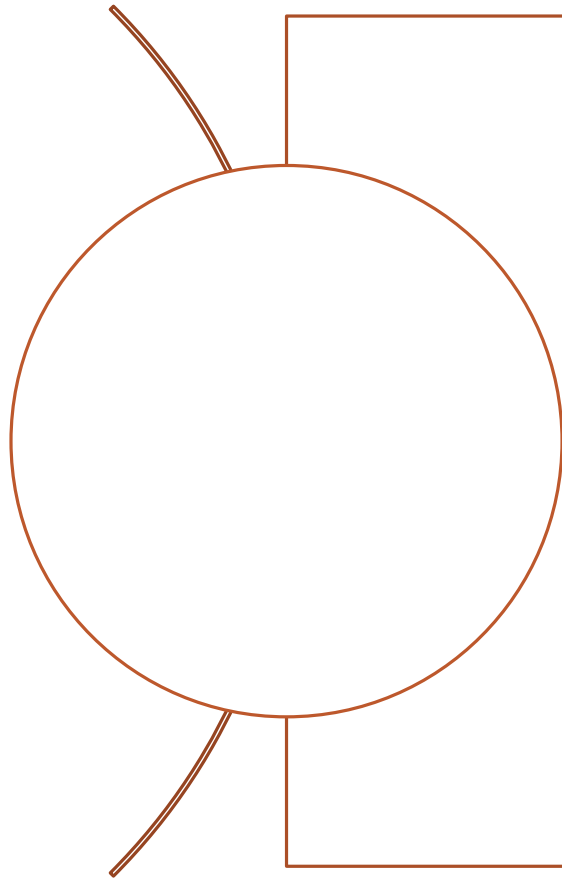
The Litigation Process



Note that majority of disputes that are resolved through the courts involves lawyers who act on behalf of the claimants.

This is mainly attributable to the technical procedures involved and secondly that our civil justice system is a fault system that requires prove of negligence before judgment is given.

1. Choosing the court



There are certain factors considered which will determine the court that will hear the dispute. These include:

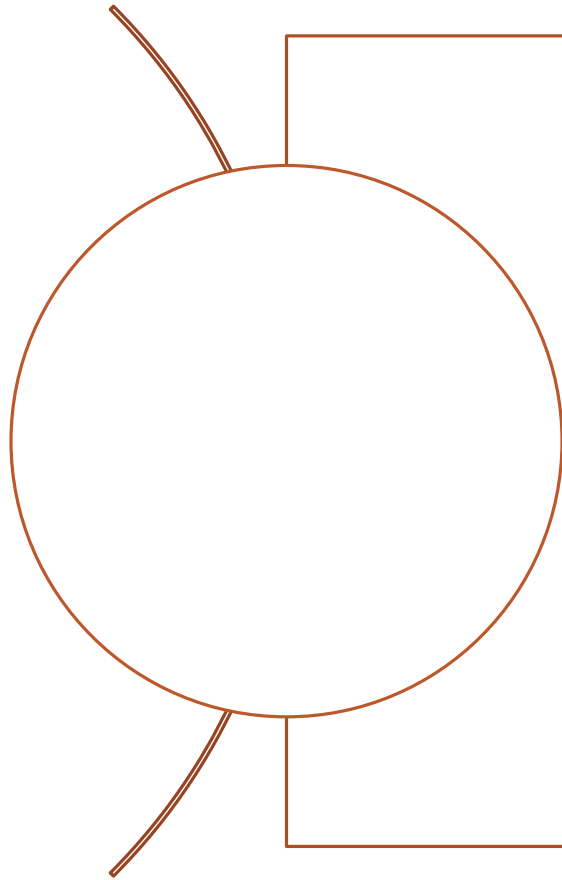
the amount of damages being sought

the nature of the suit and

the geographical location where the cause of action arose.

For example, defamation actions can only be commenced in the High Court where disputes of customary law are commenced in the magistrates' courts. A person injured in a road accident in a given geographical location can file action in the courts within that territory

2. Filing the suit/issuing the claim



There are various ways of instituting a suit in court. It may be by way of a plaint which is the most common for insurance claims, originating summons, notice of motion and by way of petition.

The claimant must begin by drawing up a statement of their case. The rules of court prescribe both the form of the particulars as well as the content. It is only from the particulars that one can see the basis of the action as well as the relief sought.

The particulars of claim, then, sets out the facts that give rise to the claim as well as what the plaintiff wants the court to decide.

Essential elements in a civil suit

A court of competent jurisdiction;

Parties to the suit. It is necessary that the parties to the dispute are clearly identified. Some persons may not have capacity to sue for example minors and mental patients. Such persons can sue or be sued through their next friend or guardian. In case the defendant is the government, a notice of intention to sue must be issued and the suit instituted against the Attorney General who acts on behalf of the government. The case may involve more than one defendant or where the defendant is deceased;

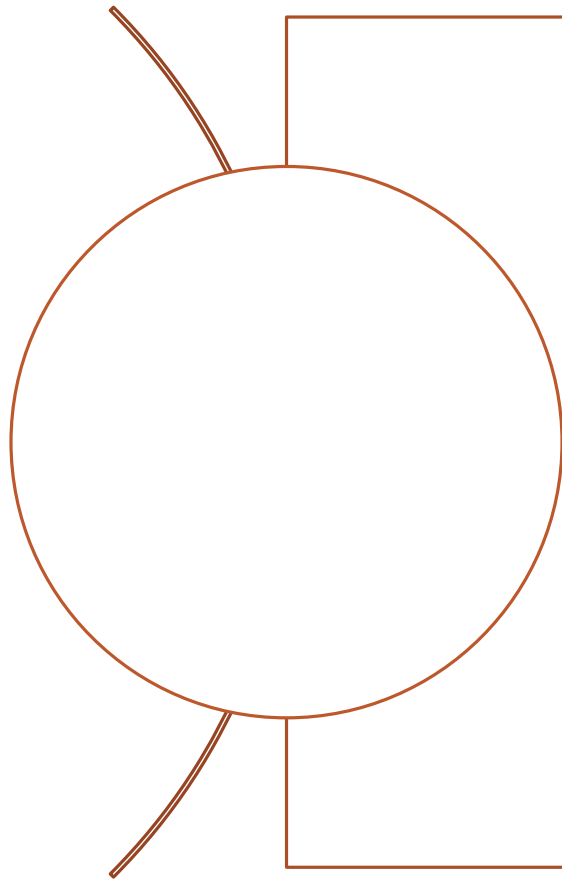
A statement of the facts on which the claim is based;

Jurisdiction that is a statement confirming that the court has jurisdiction;

A cause of action. A legal right must be violated for the defendant to be sued. A demand letter with a notice period will be sent to the defendant to admit liability. When the defendant fails to respond, the plaintiff need to file the suit outlining the cause of action within the statutory period;

A prayer that indicates the relief that the claimant is seeking.

3. Service of summons



The rules of natural justice dictates that a person cannot be condemned unheard.

Article 50 (1) of the constitution provides that every person has the right to have any dispute that can be resolved by the application of law decided in a fair and public hearing before a court or, if appropriate, another independent and impartial tribunal or body.

A person must therefore be made aware of the case against them so that they can prepare as appropriate.

Methods of service

personal Service;

service upon an agent;

On another at the residence or place of business of the defendant;

Substituted service;

Service at the defendant's place of employment; and

Service through registered post.

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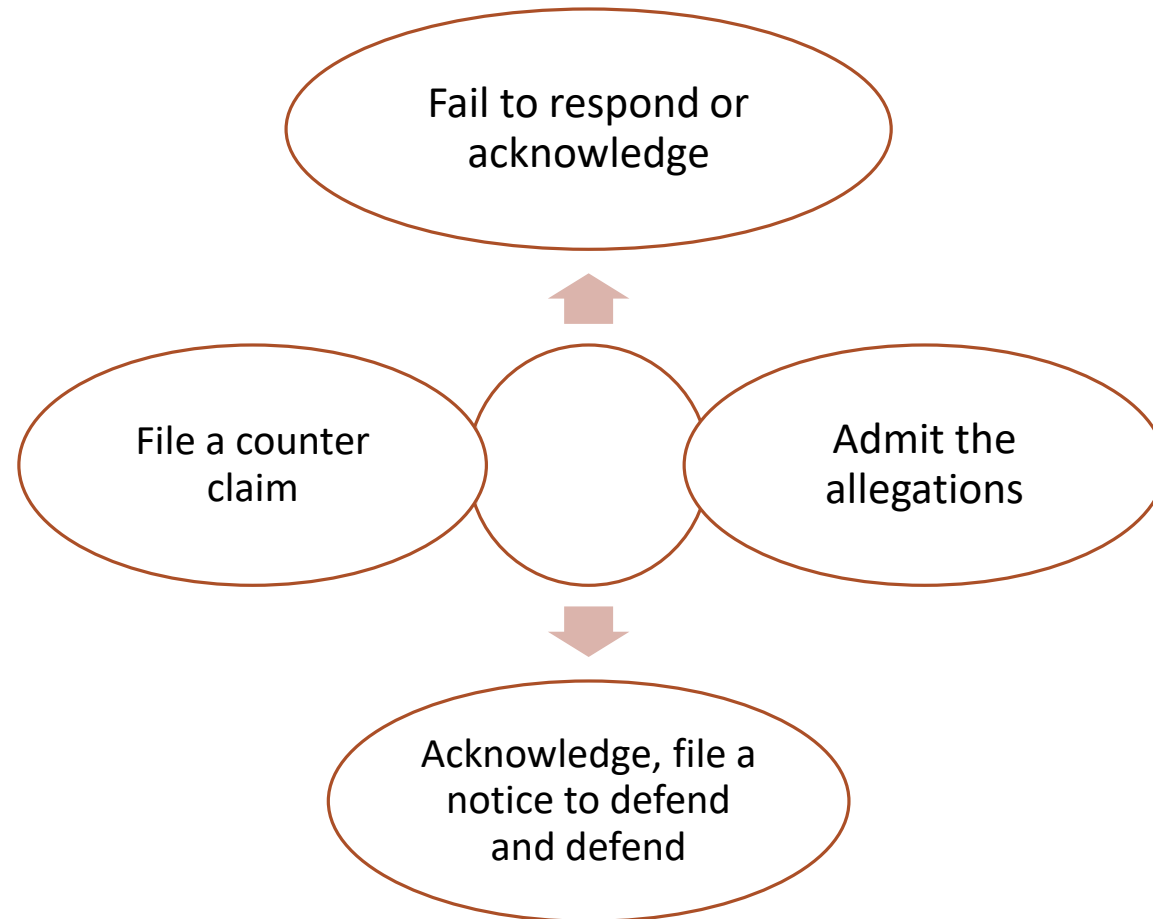
Service of summons on the government is governed by the Government Proceedings Act Cap. 40 of the laws of Kenya.

Service can be effected personally on the Attorney General, through the post office or can be left with the principal officer in the office of the Attorney General.

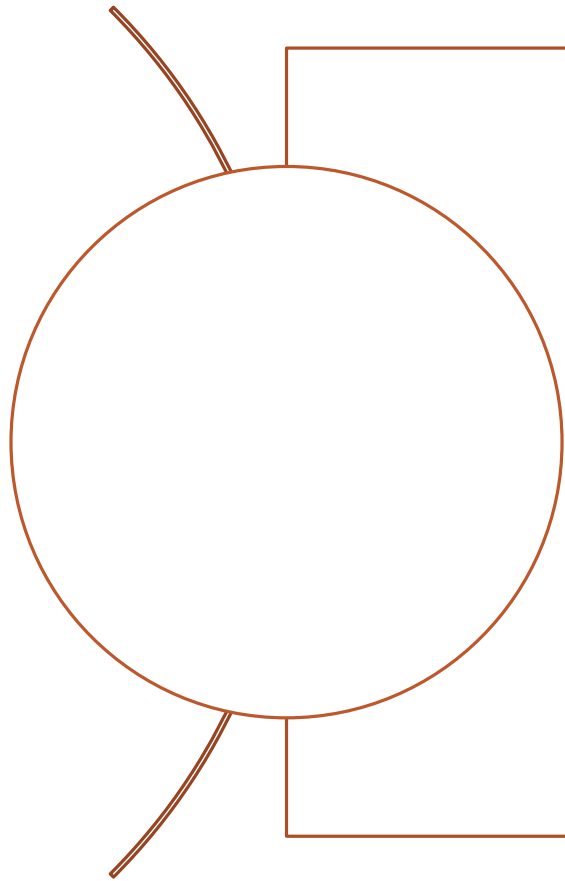
For registered companies, service may be effected on the company secretary or on the chief executive office.

Prisoners can be served through the officer in charge whereas for defendants who cannot be found, it can be by way of substituted service (advertisement in the daily newspapers).

Options available to the defendant

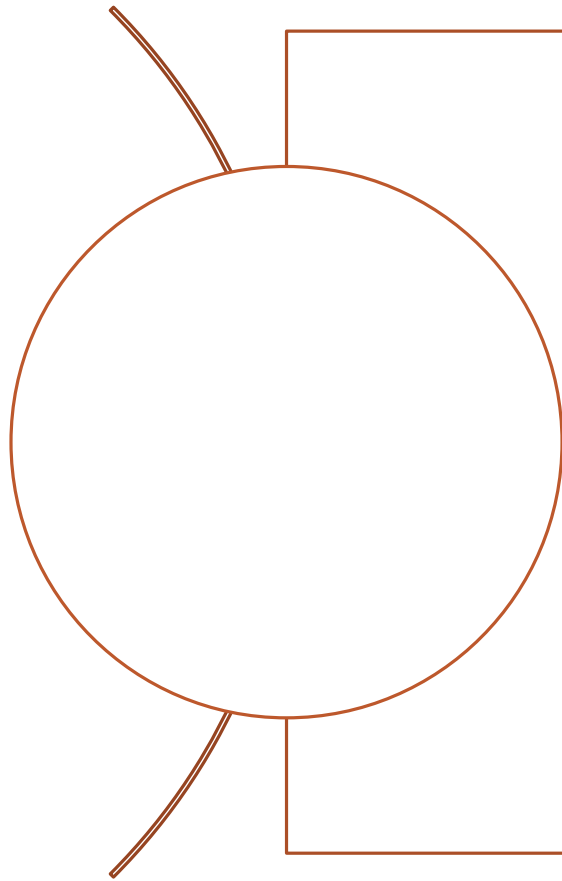


Failing to respond



Once the summons have been served, the defendant is required to acknowledge and file a response within a specified period of fifteen days. If the required time period has lapsed without such a response, a party can apply for judgment. This is judgment on the basis that the defendant is in default. Default judgment under Kenya law is entered or given in the absence of the party against whom it is made.

Admit the allegations

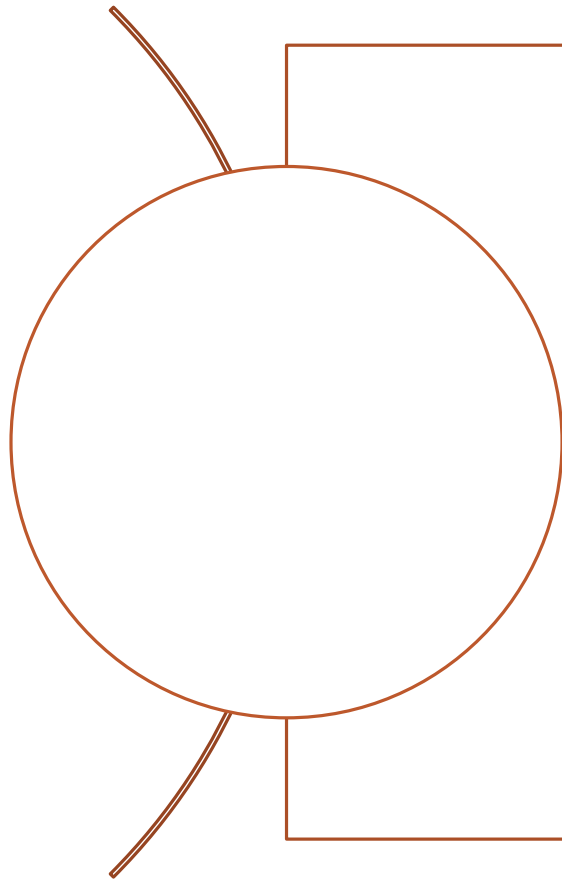


The defendant may admit the allegations as per the pleading either in whole or in part.

Judgment on admission will be entered if the admission is in whole and the defendant will proceed to comply with the judgment of the court and the matter ends.

If the defendant admits in part, judgment on the part admitted will be entered and appropriate defence filed on the allegations denied.

Filing a notice to defend and defending



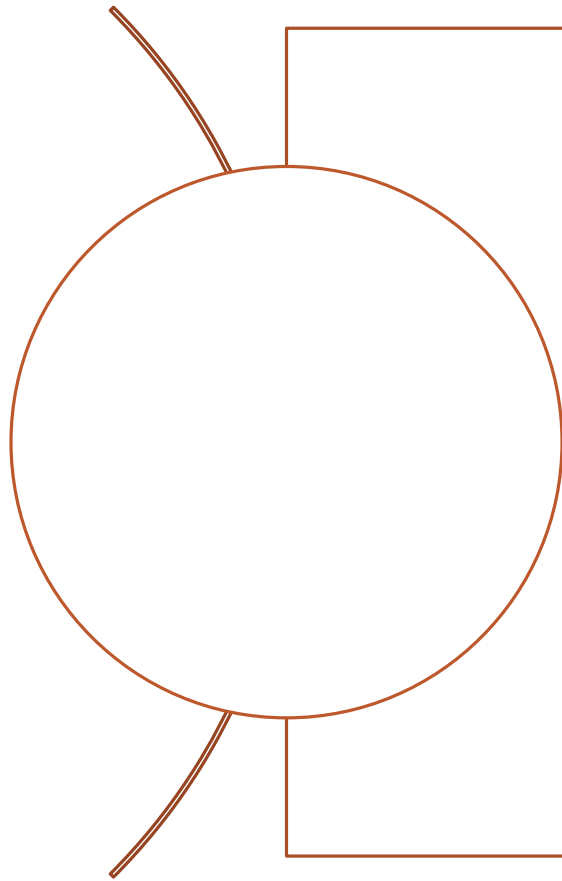
If the defendant decides to oppose the action as set out in the pleadings, he is required to deliver a notice setting out his intention within ten days of receipt of the summons.

The document sets out the defendant's intention to defend the action, as well as the address at which he will receive all further documents in the proceedings.

The document must be signed by the defendant or his legal representative.

A written statement of defence must be filed which specifically denies every allegation of fact made in the plaint. The defendant can also object to the allegations on a point of law.

Filing a counter claim



It is generally known that the plaintiff is the first person to commence litigation by making allegations through the plaint.

However, it is also possible for the defendant to make fresh allegations against the plaintiff.

The rules provide that a party may file a counterclaim against the plaintiff. A counter claim is like a fresh claim but relates to the same parties. It is intended to avoid multiplicity of suits.

The plaintiff in this respect must also be served.

A motorist X may file a claim against another motorist Y claiming for cost of damage allegedly caused by the negligence of Y. Y may file a counter claim against plaintiff alleging that the cause of the accident is X's negligence. A counter claim is also referred to as a set off.

4. Apply to strike out

If the case does not disclose a reasonable cause of action. The cause of action must be one recognized by the courts;

The pleading contains statements that are scandalous, vexatious or irrelevant. For instance where the plaintiff files a case, makes allegations and states that no relief is being sought;

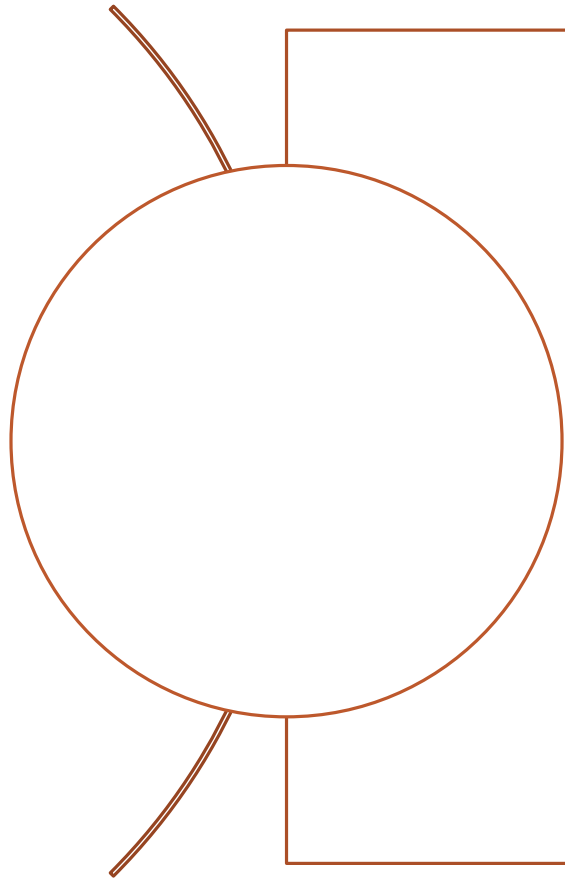
The applicant will be prejudiced in the conduct of his claim or defence if the offending statements are not struck out;

If it is an abuse of the court process;

If the pleadings prejudice, embarrass or delay a fair trial; and

If it does not have a supporting affidavit.

5. Apply to stay proceedings to attempt settlement

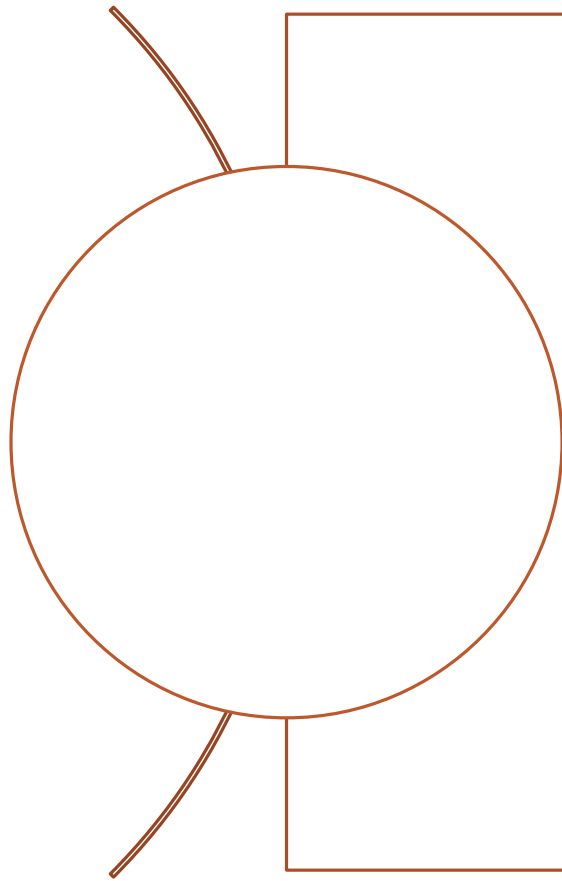


Either party to the case may ask for a stay of proceedings in order to attempt to settle outside court by way of Alternative Dispute Resolution (ADR).

The court will allow the initial stay for a specified period.

If the parties are not able to reach a consensus within the period, it can allow a further specified period.

6. Hearing of the case



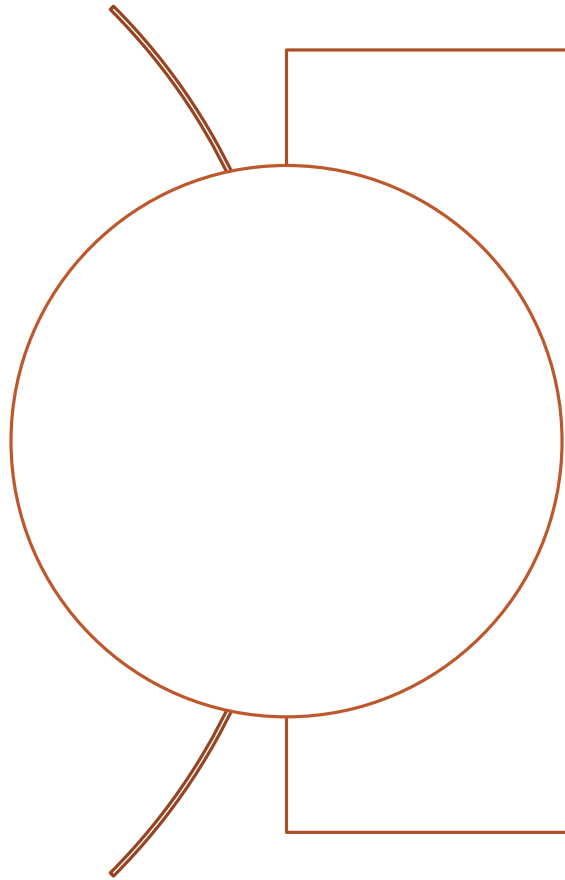
Under the Kenyan legal system, a court case is essentially a contest between two sides. In a civil case, the plaintiff and the defendant while in a criminal case, the prosecution and the defence.

The court itself, consisting of a judge or judges or a magistrate, remains neutral.

The role of the court is not to investigate but simply to listen to the evidence presented by the two sides and then give judgment for one side or the other.

In civil proceedings, the claimant has the burden of proving his case on the balance of probabilities.

7. Judgment

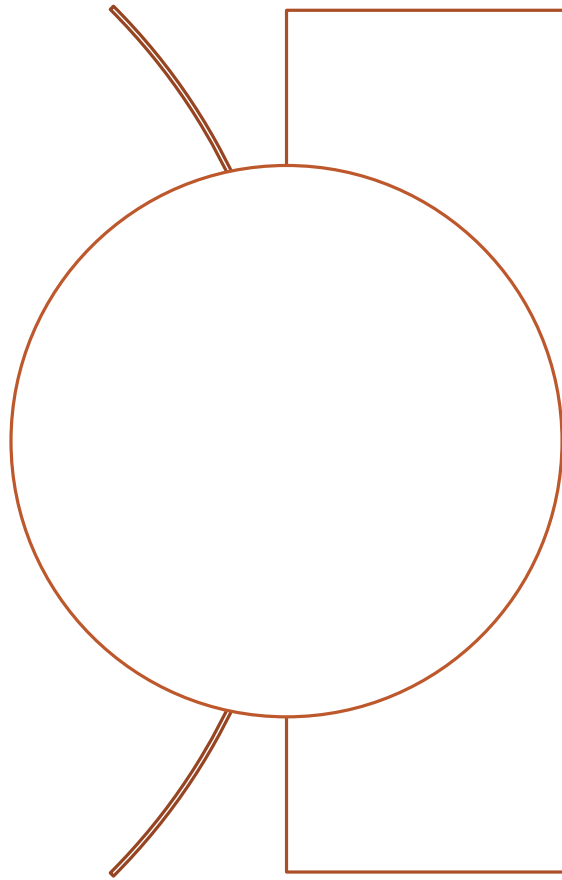


After the parties have argued and supported their case, the court will enter judgment which is mostly an award of damages.

The judgment debtor will be given a grace period within which to make good the judgment.

Failure to honour the decree of the court, this may result into the plaintiff obtaining court orders to attach and subsequently sell property or the judgment debtor been subjected to civil jail.

8. Appeal



A party that is not satisfied with the judgment of the court has a right to file an appeal by way of petition. Such appeal must be done within 14 days from the date of judgment.

The Appeal does not operate as a stay of execution. Even if an appeal has been lodged, and all parties served, the decree holder can proceed and apply for execution.

Advantages of litigation

When one obtains a judgment of the court, the same is enforceable and binding upon the losing party.

Litigation is also involuntary. It is used to force a party who is not willing to settle a matter following demands to do so or who ignores another

Persons whose legal rights have been violated may fail to get justice because of the legal cost involved. However, an advantage of going through the courts is that the winning party is awarded costs which are paid by the losing party

Litigation exposes one to access the knowledge and experience of the courts and the judiciary. Through litigation, just, fair and high quality judgments or decisions are produced. Courts also give detailed reasons for their decisions. These decisions act as future precedents for cases where the facts similar coming before the courts.

Litigation provides a mechanism for curtailing disputes where there is no reasonable defence through a process known as summary judgment. Circumstances where summary judgment may be entered include where the relief sought by the plaintiff is for a debt or a liquidated sum. It can also be allowed where the claim is for recovery of land with or without a claim for rent or profit. It applies in straight forward cases where the only dispute is on quantum. An example is where a person delivers goods on credit and is paid by a cheque that is returned unpaid. Such suits are filed through notice of motion.

Courts also have power to award interest on damages at rates fixed by the statute.

Disadvantages of litigation

Litigation is generally expensive. The potential cost of litigation is likely to be a problem to most people of ordinary means. There are associated costs for technical representation, payment to witnesses, obtaining evidence and high court awards. There is also the additional risk in all civil cases that the loser has to pay the winner's costs

The litigation process is slow and time consuming. This has the effect of discouraging potential litigants from moving to court when their rights are violated. The problem is partly caused by the rigid procedural requirements and also the time taken to finalize a case regardless of the amount involved.

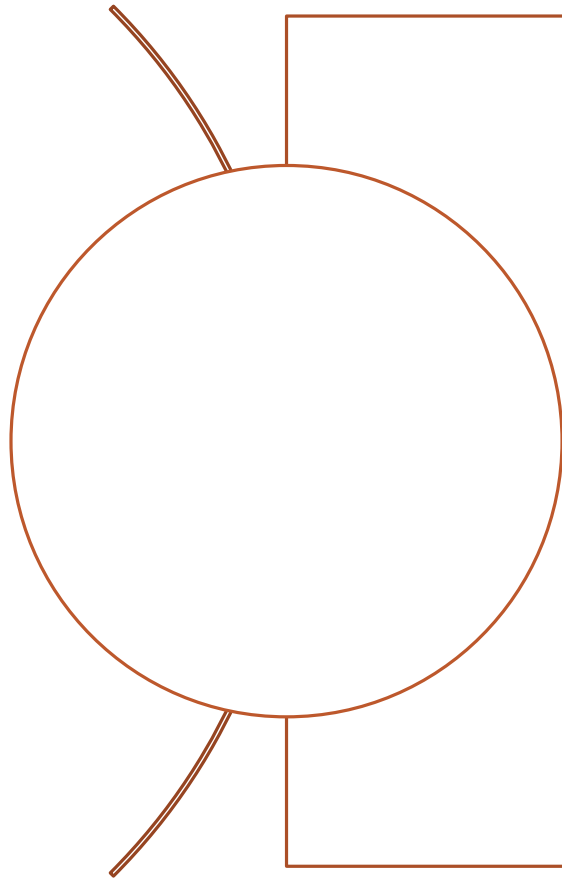
The hearing process is commonly in a public forum. Disputes that are commercially sensitive may cause embarrassment to some of the parties involved for example, insurance companies when in dispute with clients may have a negative reflection on insurance.

Litigation is generally inflexible in terms of the procedure followed. Cases may be thrown out because of the technical grounds for instance, lack of a verifying affidavit or where the advocate does not have a practising licence for the current period.

Technical knowledge of the presiding judge or magistrate may be limited in the area relating to the dispute.

Courts resolve disputes by reference to the law and commercial considerations may not be taken into account when arriving at their decisions. For insurers, customer retention is hampered where a client takes a dispute before a court of law.

ARBITRATION



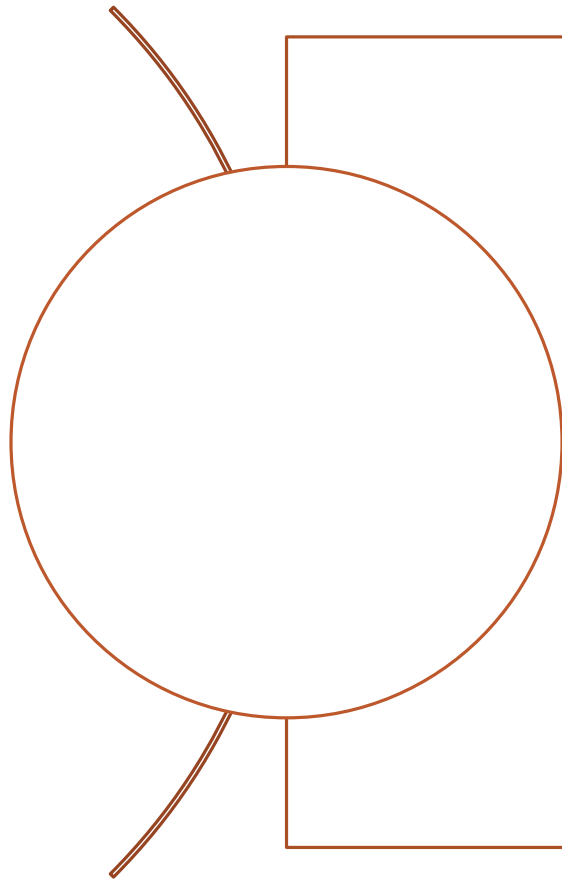
This is the process of settling commercial disputes between two or more parties by one or more persons known as arbitrators. The object is to obtain a fair resolution of the dispute by an impartial tribunal.

The parties should be free to agree on how their disputes are resolved and the courts should not intervene except as provided by the Act. Insurers prefer to refer their disputes to arbitration rather than litigation and many modern insurance contracts contain a clause in the policy requiring disputes arising between the parties on the amount payable to be referred to arbitration.

This enables them to have their disputes resolved in private and avoid a public hearing in an open court by a judge who may not have expertise in insurance.

Arbitration also enables the parties to decide the procedure the arbitrator will follow and what their powers will be because this is primarily governed by the terms of the arbitration agreement.

The arbitration clause in Kenya

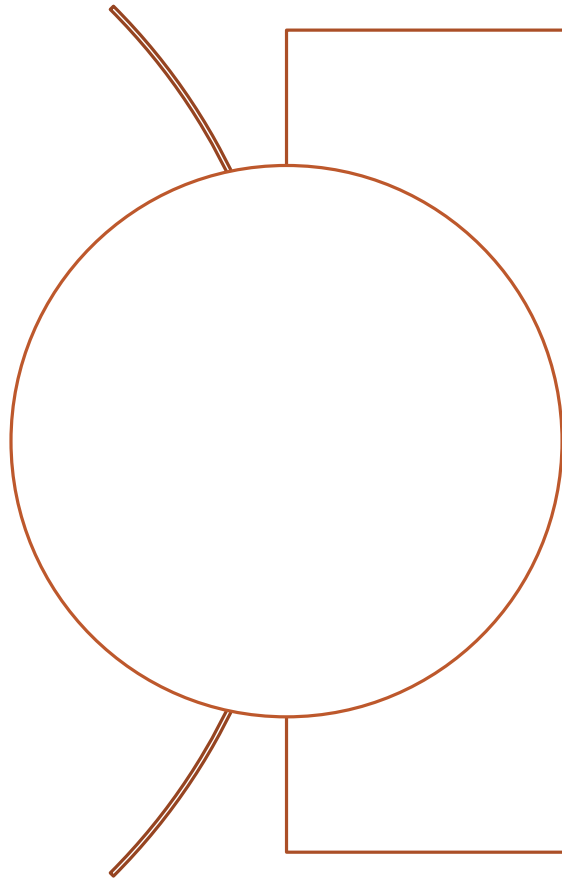


"If any dispute arises between you and us on any matter relating to this policy such dispute will be referred to:

A single mediator to be agreed between you and us within thirty (30) days of the dispute arising and the mediation process to be finalized not later than thirty (30) days thereafter or

A single arbitrator agreed between us, to be appointed within thirty (30) days of the dispute arising. If we cannot agree, either party will refer the dispute to the Chairman of the Chartered Institute of Arbitrators (Kenya Branch) whose decision will be binding on you and us. The arbitral award will be final. If the dispute is not referred to the arbitration process within twelve (12) months we will assume you have abandoned the claim."

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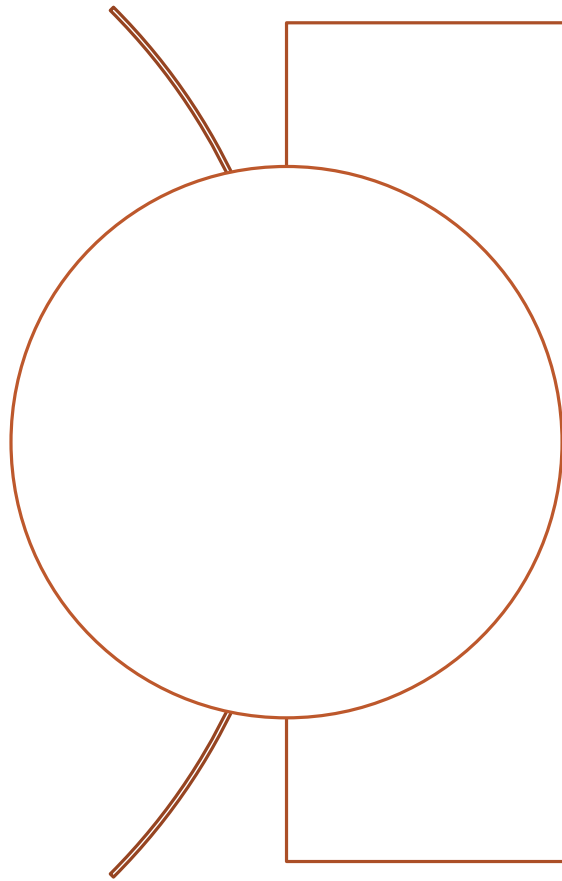
In Kenya, arbitration is governed by the Arbitration Act No. 4 of 1995 of the laws of Kenya.

Section 2 defines an arbitration agreement to mean an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

The Act further provides that an arbitration agreement can be a clause in the contract which is the case for insurance contract or a separate agreement and that such agreement must be in writing and signed by the parties.

Ways of referring a matter to arbitration

1. By court order



A specified or the whole issue where technical or scientific opinion is required may be referred.

Section 6 provides that a matter a party in a matter that is before the court may apply for the matter to be referred to an arbitrator.

The court can allow this unless the agreement is null and void or there is no dispute between the parties with regard to the matters agreed to be referred for arbitration.

Case illustration

Appeal case of UAP Provincial Insurance Co. Ltd vs. Michael John Beckett (2007)

The appellant declined to pay the insured's motor claim on the ground that there was breach of utmost good faith. The insured moved to court to challenge the insurer's decision and have the claim paid. The insurer made an application in the lower court to have the suit by the insured referred to arbitration. The lower court declined to do so and the magistrate held, *"I decline to stay the proceedings herein as there is nothing to be referred to arbitration. There is no dispute between the parties. All there is the Plaintiff's right to be paid as per the agreement, and that has nothing to do with the policy document."*

The insurer appealed and the appeal judge in held that the insured was pursuing his right to payment and that having regard to the settlement agreement there was no dispute between parties capable of being referred to arbitration.

Cont'd

2. Statutes: Certain statutes makes provisions that parties can refer the subject matter of the dispute to arbitration. Tribunals have been discussed in chapter two.

3. Consent of the parties: Where the parties agree in writing, they are under an obligation to do so. The arbitration condition in an insurance policy binds both parties to the insurance contract.

Appointment of an Arbitrator

Appointment of arbitrators is generally the responsibility of the parties. Section 11 of the Act states that the parties are free to agree on the number of arbitrators unless the arbitration agreement provides otherwise.

When a person is approached in connection with his possible appointment as an arbitrator, he needs to disclose any circumstances likely to give rise to justifiable doubts as to his impartiality or independence.

An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his **impartiality and independence**, or if he **does not possess qualifications** agreed to by the parties or if he **is physically or mentally incapable of conducting the proceedings** or there are justifiable doubts as to his capacity to do so.

Other factors that may hinder one from arbitrating

Past or present relationship with either party;

Substantial social relationship with either party;

If the arbitrator has any prior knowledge of the dispute; and

If the arbitrator is unavailable.

Appointment of an arbitrator by the high court

There is a provision in the agreement for arbitration but the parties fail to appoint one;

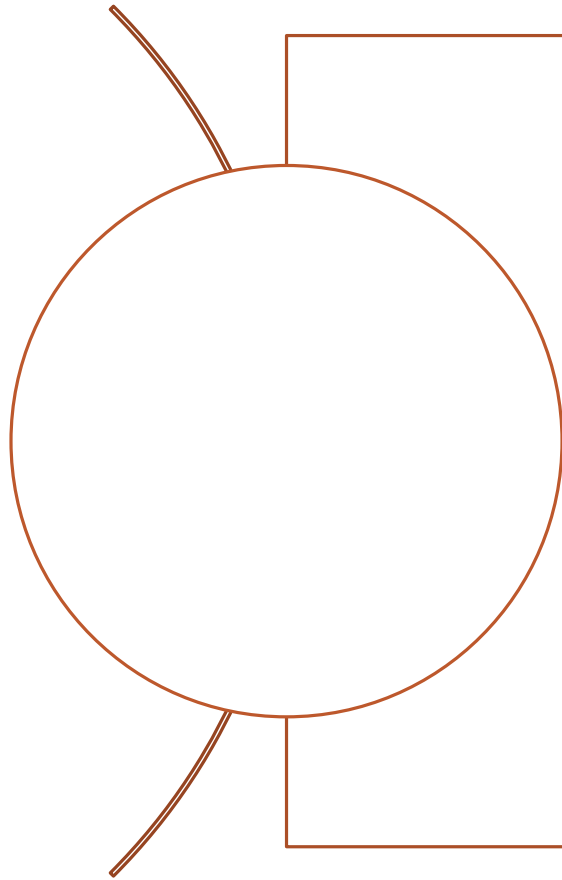
If the one appointed refuses to act, is incapable or dies;

Where reference is made about two arbitrators but one is appointed;

Where an umpire is to be appointed either by the parties or the arbitrators and they fail to do so; and

Where the umpire or the third arbitrator refuses to act, is incapable or dies.

Cont'd



The decision of an arbitrator is known as an award. The award enjoys same respect enjoyed by judgments of the courts of law that is, it is binding and enforceable upon the parties.

Where a person is not satisfied with the decision of an arbitrator, they can file an appeal against the award in the High Court on a mistake of law and not a mistake of fact.

Grounds for appealing/challenging an award

Exceeding the arbitrator's powers;

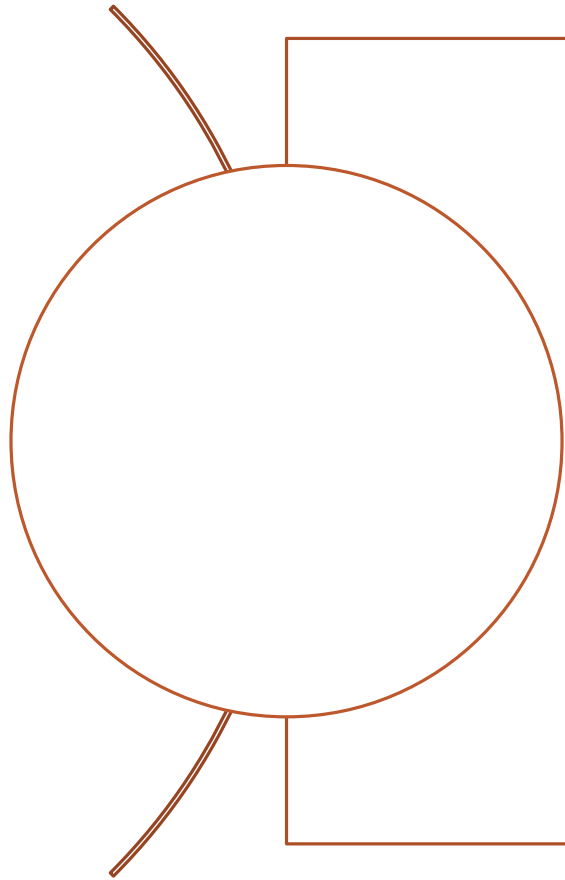
Failure to follow the agreed procedure;

Obtaining an award by fraud;

Failure to deal with all relevant issues; and

Obtaining an award which is contrary to public policy.

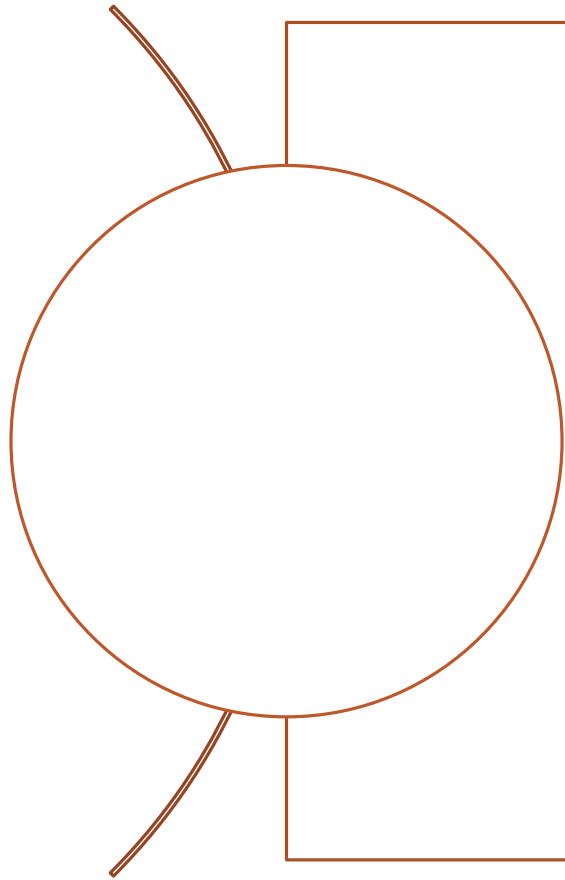
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Where an appeal is filed, the decision of the High Court is final and is not subject to further appeal.

The High Court upon hearing the appeal may remit back the matter for consideration by the arbitrator or umpire if there is defect in the award, a serious omission or where new or material facts are discovered.

Why the High Court may remove an arbitrator



1. Accepting bribes;
2. Being secretly interested in the subject matter of the dispute; and
3. Where he has failed to state a case for the opinion of the court on a material point of law.

Advantages of arbitration

Arbitration takes place in private hence avoiding unnecessary publicity and embarrassment.

There are no rigid procedures followed since they are fixed by the parties. Parties also fix the time and place of conducting the proceedings making arbitration flexible.

Arbitration is faster and cheaper. Due to availability of the arbitrator, the matter is heard and determined speedily and this makes it less expensive in terms of costs and interest.

The award of the arbitrator is binding and enforceable against the losing party unless he finds it unfair and appeals.

The arbitrator may combine his special knowledge and skill with that of the law in arriving at an award. They are normally experts in the field of the dispute.

Arbitration is voluntary and this is at the time of entering the contract.

Disadvantages of arbitration

Arbitration can only be invoked where parties have agreed in writing to resolve any dispute arising through arbitration. It is therefore not always available.

It may be more expensive as opposed to litigation. Courts are partly financed by the public whereas arbitration is financed by the parties.

There is potential for bias especially where one party may be at a more advantaged position than the other i.e. where the parties are not at equal bargaining and one party ends up influencing the appointment of the arbitrator in a way that is hard to detect.

Where arbitration is purely on a question of the law, the arbitrator may be limited in knowledge of the law.

There are no uniform and well settled rules of law that govern arbitration.

Arbitrators also do not have powers to issue such orders as injunctions.

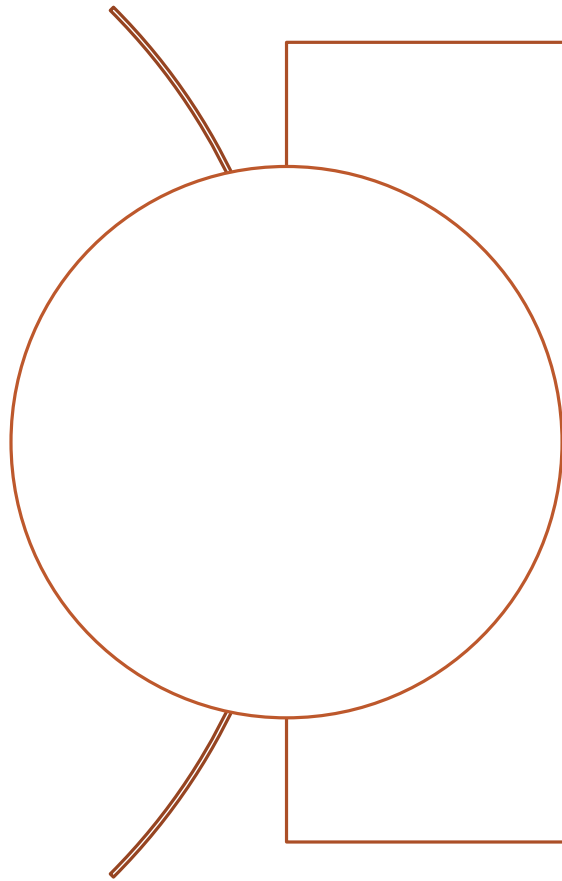
Developments

1. Setting up of Small Claims Court

2. Classifying cases into tracks

3. Introduction of Court Initiated Mediation

ALTERNATIVE DISPUTE RESOLUTION (ADR)



This is any form of dispute resolution that is not litigation.

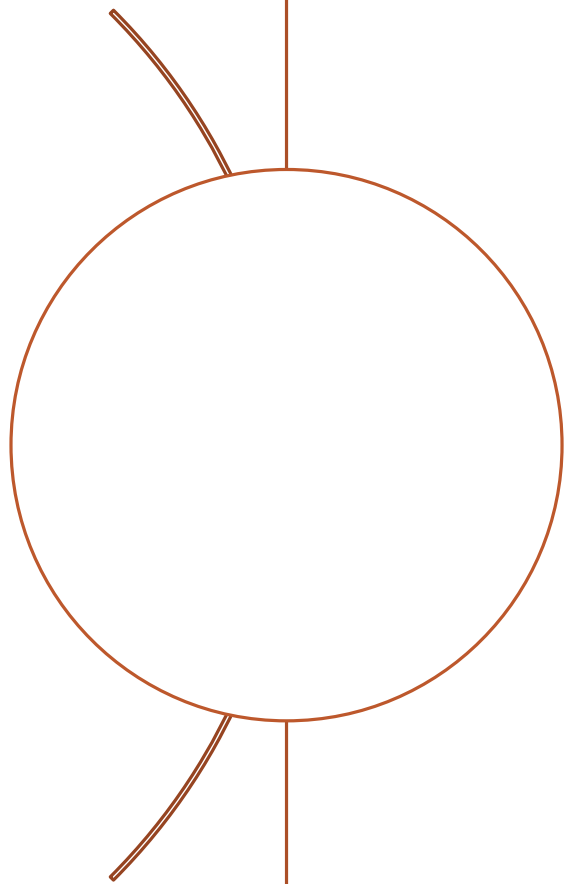
It is based upon non-confrontation and meeting of the minds.

Article 159 (2) of the constitution provides that alternative forms of dispute resolution including reconciliation, mediation, arbitration and traditional dispute resolution mechanisms shall be promoted.

FORMS OF ADR



1. Negotiation



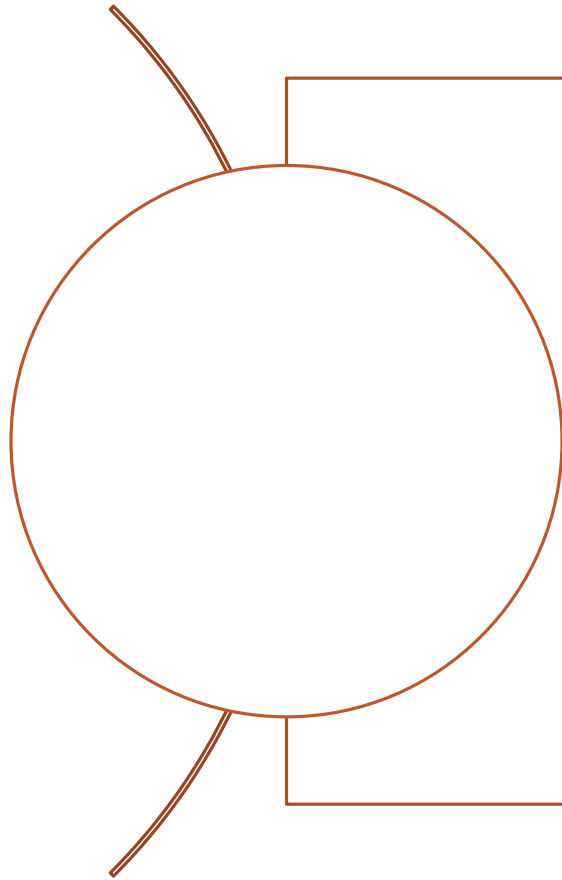
This is dialogue between the parties to the dispute with intent to reach an agreement.

Negotiation involves offers, counter offers and compromises.

What is discussed during negotiation is done on a strictly without prejudice basis.

Negotiation is the most common, and involves the parties themselves attempting to resolve the dispute.

2. Conciliation/mediation



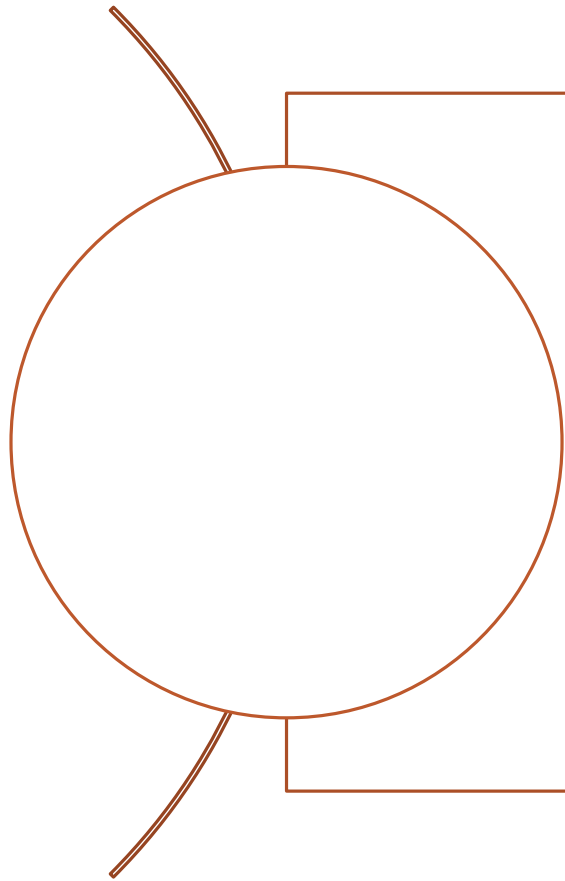
This is where a neutral party is engaged by the parties as a mediator.

His work is to propose or suggest constructive solutions and use persuasive language but he cannot make a determination.

Mediation is a private and structured form of negotiation assisted by a third party that is initially non-binding.

If a settlement is reached, the mediator can draw up an agreement that can then become a legally binding contract.

3. Mini-Trail/Structured Settlement



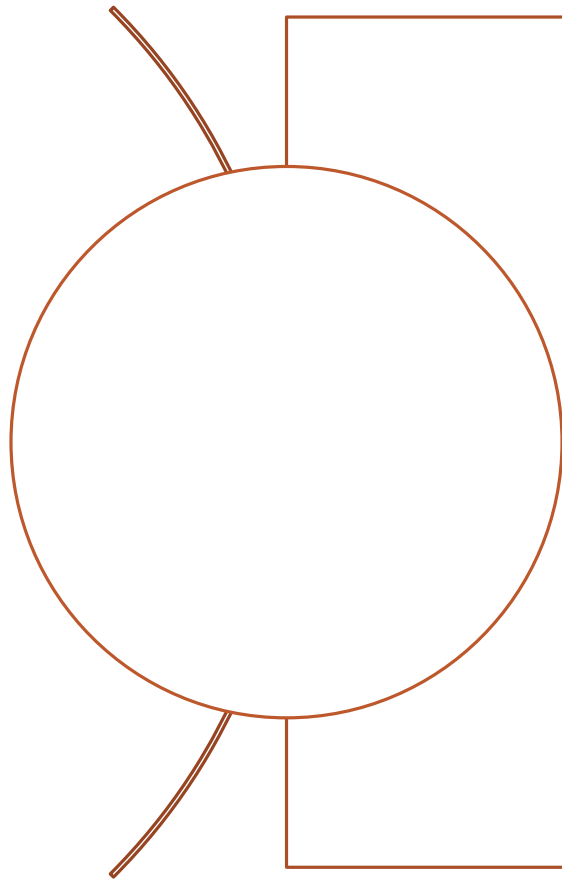
A neutral person sits as a chairman of a tribunal with representatives of each party.

The representatives are people who are not connected with the dispute.

They have authority to reach a compromise.

They negotiate with each other with a view to settlement.

4. Expert appraisal and Neutral evaluation

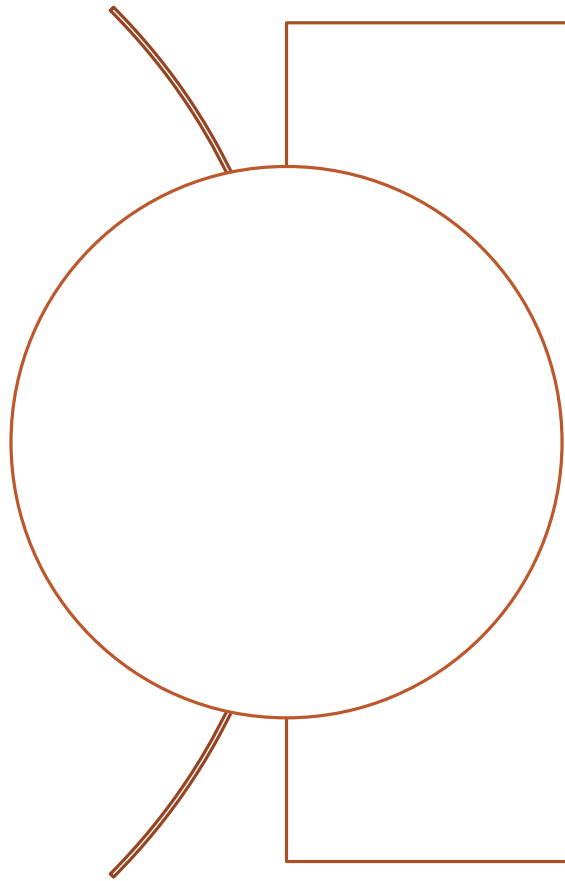


This is a private and non-binding technique whereby a third party, usually a judge or somebody legally qualified, gives an opinion on the likely outcome at trial as a basis for settlement discussions.

Parties refer the dispute to an expert in that field to give an opinion.

The opinion is not binding on the parties but may influence their approach to subsequent negotiations.

5. Adjudication



This involves the use of an expert to rule on a technical issue and is primarily used in construction disputes as set out in Chartered Institute of Arbitrators (Kenya Branch)

At the end of the interim period other processes, like arbitration, can be used by the parties to achieve full and final settlement.

Advantages of ADR

There is privacy since the meetings take place in a private forum.

There are no rigid procedures, no court rules or statutes to comply with and there are no case law precedents to limit their decision.

Alternative Dispute Resolution is voluntary. The Parties use ADR out of their own free will.

There is no time spent by lawyers in preparing and presenting their case the way it happens in litigation. Parties fix the time for hearing the disputes.

The costs involved are lower. This is due to enhanced speed and leads to savings in terms of advocates costs and interest.

More control is retained by the parties over the dispute resolution process.

There is greater degree of trust and openness among the parties to the dispute.

The mediator might be a person with more commercial realities than a judge or a magistrate. He proposes suggestions which parties may not have envisaged.

ADR helps in preserving business relationships and maintenance of the parties' reputation. This is because it is based on non-confrontation and meetings are conducted in private.

ADR makes substantial contribution to the more efficient use of judicial resources.

Disadvantages of ADR

Parties are not bound to resolve a dispute through ADR and the decisions they arrive at are not binding on the parties. Parties can therefore withdraw from the negotiations at any time during the proceedings.

The award of the mediator is not enforceable.

There can be a danger of incomplete disclosure. The parties may not fully disclose all the facts and a wrong decision may therefore be arrived at.

ADR is non-universal in application. It may be problematic to use ADR in cross border disputes where parties are from different territories/jurisdictions.

Some remedies are not available in ADR

ADR does not apply precedents and this may lead to inconsistency in the administration of justice.

ADR cannot be used where there is no real dispute.

The Commissioner of Insurance

The other channel through which disputes can be resolved is through the commissioner of insurance.

Section 112 of the Insurance Act provides that in the event of a dispute relating to the settlement of a claim on a policy of life assurance assuring a sum not exceeding one hundred thousand shillings, arising between a claimant under the policy and the insurer who issued the policy, the dispute may at the option of the claimant be referred to the Commissioner for decision.

The Commissioner may, after giving an opportunity to the parties to be heard and after making further enquiries as he may think fit, will decide the matter. The decision of the Commissioner under this shall be final and shall not be called in question in any court, and may be executed by the court which would have been competent to decide the dispute if the matter had been taken before it.

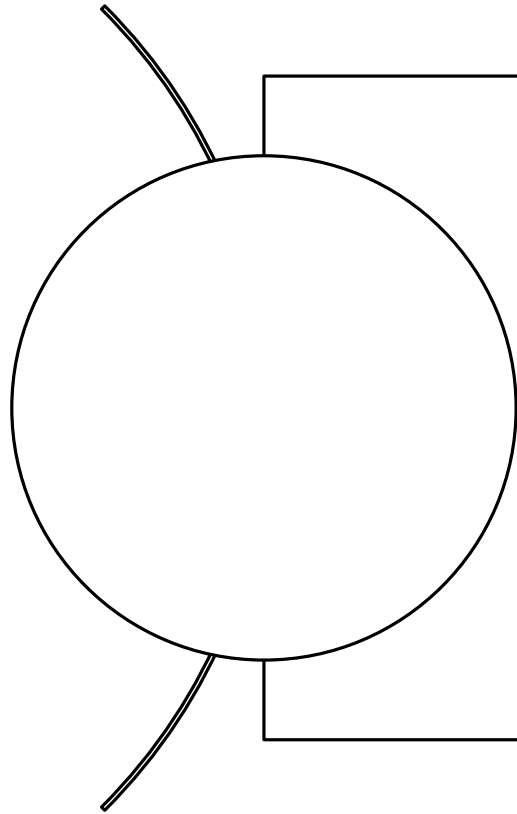
The Insurance Regulatory Authority has also set up a consumer protection section whose mandate is to receive and address complaints from policyholders, insurance beneficiaries and members of the public.

A tribunal has also been created under the Insurance Act to also hear and determine appeals arising under the Act.

CHAPTER TEN

LEGAL CHALLENGES FACING THE INSURANCE INDUSTRY

Introduction



The growth of the insurance industry in Kenya has generally been slow but steady. The insurance penetration is at 3% of the Gross Domestic Product (GDP). A number of factors can be attributed to this state of affairs. The factors may be cultural, social, economic, political and legal.

1. Insurance fraud

- It is any act committed with intent to deceive in order to obtain payment from an insurer.
- It is deceiving, concealing and misrepresenting information with intent to receive benefits from an insurer.
- The exact extent of fraud cannot be determined as the act amounts to a crime and the standard of proof required is beyond reasonable doubt.

What motivates people to commit insurance fraud

- ❖ The primary motivator of fraud is generally financial gain
- ❖ the high standard of proof,
- ❖ the chances of being discovered and
- ❖ lenient penalties.

Forms of insurance fraud

- Purchasing a policy with more than one company on the same subject matter and same interest
- Deliberate damage to insured property. For motor, this can be arranged by the owners, garages and assessors
- Insuring non-existent vehicles i.e. fictitious claims
- Insuring salvage vehicles
- Inflating genuine claims
- Repeat claims
- Filing for injuries not related to the accident Claims by people not involved in the accident

Cont'd

- Over-insurance
- Faking death in life insurance
- Taking out a life policy on the spouse with intent to kill and get the benefits
- Concealing pre-existing conditions
- Ineligible members receiving medical benefits by using the policyholder's name
- Intentional/negligent non-disclosure of material facts by the insured e.g. on claims history
- Backdating of cover

Effects of insurance fraud

- **Increase in premiums**
- **Increase in the cost of operations**
- **Delays in payment of claims**
- **Loss of jobs**
- **Insolvency and winding up of companies**
- **Loss of confidence by the insuring public**

2. High Court Awards

- ❖ Some of the disputes that arise in insurance are resolved through litigation as seen in lecture ten.
- ❖ It was explained in one of the disadvantages of using this mechanism is that it is expensive.
- ❖ A number of costs are associated with litigation like legal fees, witness expenses among others.
- ❖ Award of damages is not standardized.
- ❖ All the costs arising from court cases are normally borne by the insurer.

3. Litigious society

- ❖ The word litigious is defined in the Oxford Dictionary to mean tending or too ready to take legal action to settle disputes.
- ❖ We live in a society that devotes a great focus to the possibility of 'suing' someone and the words 'I'll see you in court', are thrown around more frequently than they should be mainly after [road accident claims](#).
- ❖ This was not the situation in the 1990s. There has been an ongoing suggestion so far that a litigious society is negative and problematic. While that is the case, to an extent, it should be noted that there are also arguable advantages for such practices.
- ❖ An increase in litigation would appear to suggest that there is a consequential increase in access to justice.
- ❖ It supposes that the courts are accessible and that individuals are confident users of the system, able to have any wrong doings addressed by legally qualified individuals.

Reasons for increased litigation

- Increasing awareness by citizens of the rights. This has been possible due to advancement in technology, role of the media and the efforts by government to educate Kenyans of their rights.
- Civil society movement
- Ambulance chasing
- Willingness by lawyers to offer pro bono services as well as conditional fee agreements

Effects of increased litigation

- Increased costs of claims insurance which may impact negatively on the insurers leading to liquidity problems
- Negative perception about insurance by members of the public in instances where the claim is not paid for reason beyond the control of insurers for example where a case is statutory barred because of negligence on the part of the lawyers
- Delays in the judiciary that may be caused by the high no of cases in courts
- Outstretching of the judiciary resources

4. Money laundering

- ❖ The activities involved in concealing the source, identity, and destination of proceeds of crime.
- ❖ It is the process by which the criminals in possession of illegitimate money attempt to conceal the true origins and ownership of their wealth.
- ❖ It relates to the transactions used to transform the proceeds from illicit activities into funds with an apparently legitimate source.
- ❖ It has been defined under the Proceeds of Crime and Anti Money Laundering Act (POCAMLA) No. 9 of 2009 as an offence under any of the provisions of Sec 3, 4 and 7 as; “Any person who knows or who ought to reasonably have known, enters into an agreement, engages in any arrangement or transaction, acquires, uses, transports, transmits or receives property that is part of the proceeds of crime or performs any other acts whose effect is to conceal source, location, disposition or movement commits an offence”

Stages in money laundering

Placement:

Inserting the proceeds into a legitimate financial system i.e. putting dirty money into the washing machine!

Layering:

Separating illicit proceeds from their source by creating complex layers of financial transactions designed to hamper audit trail, disguise origin of funds and provide anonymity to true owner.
Activating the washing machine!

Integration:

Placing laundered proceeds back into financial system in such a way as to appear to be legitimate business funds. Take out washed money and spin dry/hang to dry!

Cont'd

- A customer who usually purchases small policies, suddenly requests a large lump-sum contract.
- A customer who funds its policy using payments from a third party.
- Purchasing one or more single-premium investment-linked policies, then cashing them in as short time later.
- Where the customer is more interested in learning about cancellation terms than about the benefits of the policy.
- Purchasing products that are inconsistent with the buyer's age, income, employment or history.

Cont'd

- A customer who wants to pay a large premium with foreign currency or by way of wire transfer.
- Paying a large top-up into an existing life insurance policy.
- Purchasing a general insurance policy, then making a claim soon after.
- Purchasing an annuity with a lump sum rather than paying regular premiums over a period of time, particularly if the beneficiary is of an age which entitles him to receive the funds as soon after.
- Any want of information or delay in the provision of information to enable verification to be completed.

Cont'd

- The client accepts very unfavourable conditions unrelated to his or her health or age.
- Large funds flows through non-resident accounts with brokerage firms
-
- The clients request an insurance product that has no obvious purpose and is reluctant to divulge the reason for the Investment.
- Insurance policies with values that appear to be inconsistent with the client's needs.
- Any transaction involving an undisclosed party.
- A transfer of the benefit of a product to an apparently an un-related third party.
- The applicant for a policy appears to have policies with several institutions.

5. Regulatory changes

- Popular distrust by the insuring public and potential policyholders has been a historical challenge for the insurance sector in Kenya.
- The insurance regulator has been prioritising building confidence and cleaning up after several insurers closed in recent years, due to poor governance and insufficient oversight
- . A number of regulatory changes to the sector, including a move towards risk-based capital, increased capital requirements, new guidelines for short-term business and takaful rules have been introduced.
- Since then, the emphasis has been on tightening legislation and regulations to root out abuses.
- The new wave of regulatory changes is the greatest risk currently facing the insurance industry.
- The new rules relating to issues such as increased capital could swamp the industry with costs and compliance problems.

Industry response to the challenges

Establishment of the Insurance Fraud Investigation Unit

The mandate of this unit is to investigate and prosecute persons who engage in insurance fraud.

Regulatory requirements for insurers

The Insurance Regulations 2015 provides that every licensee (insurer) shall have in place a sound strategy approved by its board to manage fraud risks and financial crime arising out of its operations and which strategy shall be compatible with its risk profile and shall include:

Cont'd

- a) a clear mission statement to indicate the insurer's level of tolerance to financial crime and insurance fraud;
- b) the development of quantitative risk tolerance limits on financial crime and insurance fraud; and
- c) provide direction to the overall financial crime and insurance fraud management plan.

Use of Alternative Dispute Resolutions

Insurers are willing to negotiate claims through out of court negotiations which is cheaper compared to litigation.

Cont'd

Investigation of claims

A high proportion of fraudulent cases are in liability claims. Insurers investigate cases using both internal and external investigators. Cases that also raise doubts or arose suspicion are also investigated.

Mergers and Acquisitions

M&A essentially involves an equity transaction between companies; mergers involve the combination of two or more companies to form a single entity, while acquisitions involve the purchase of an equity stake in a company, be it minority or majority, by another. In this context, the cardinal equation follows that one plus one is greater than two, the rationale being the advantages of pulling together will lead to value creation for all stakeholders.

END

THANK YOU

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