LEGAL CONSIDERATIONS FOR DOING BUSINESS IN KENYA

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INTRODUCTION

Commercial legal practice is concerned primarily with ensuring that business transactions are not only legally sound but are unlikely to lead to unnecessary disputes. Granted, human beings being who they are, there will always be individuals who will enter into contractually binding obligations without the slightest intention of honouring any of the agreed commitments, not to mention, of course, the odd category which has been described by courts as "*vexatious litigants*" who will never miss an opportunity to be in court regardless of the hopelessness of their case.

The role of a commercial lawyer is to ensure that should the rights of the parties ever come to be determined by the court, the innocent party will be vindicated while the party on the wrong will be forced to carry the can.

While this paper highlights in broad terms the relevant considerations which a prudent entrepreneur ought to take into account while starting, conducting or terminating a business venture, the ideas expressed herein do not constitute a dose of gratuitous legal advice. Specific legal advice must be sought before implementing any of the suggestions made below.

1. LEGAL FORMS OF SETTING UP BUSINESS

Once a decision to go into business has been made, the primary legal consideration that immediately arises and very frequently resolves itself without much thought is the kind of legal structure to adopt. Various options exist under Kenyan law and the choice of each should be informed by sound considerations depending on the objectives of the budding entrepreneur.

a) Sole Proprietorship

A sole proprietorship is a business owned and conducted by one person either in his own name or under a business name which he has chosen and registered with the Registrar of Business Names.

The process of registering a business name is relatively simple, straight-forward and much less expensive than for any other form of business. Upon application, the Registrar will reserve the proposed business name if it is available (i.e. not already registered). The applicant will then complete a statutory form known as a "Statement of Particulars" giving his full names, address, occupation, nature of business, location of the business, etc. This form is lodged with the Registrar and upon payment of the prescribed fee, a Certificate of Registration is issued soon thereafter.

The registration of a business name only confers on the proprietor the right to trade under that name but does not confer any corporate status either on him or the business.

The proprietor remains personally liable for the debts and liabilities of the business.

Registration of a business name gives the proprietor the exclusive right to trade under that name and ensures that no identical or deceptively similar business name can be registered. However, it does not constitute a trade mark registration for the brand constituting the name. The brand should be protected by means of trade/service mark registration (see below).

b) **Partnership**

When business is conducted in or through a partnership, it is normally owned by 2-20 persons. The partnership would usually trade under a business name registered in the same manner as a sole proprietorship, the only difference being that the name is owned by all the partners jointly.

It is advisable for partners to regulate and record their relationship by means of a Partnership Agreement (also known as a Partnership Deed). If the terms of the Partnership Agreement are clear and inclusive, the likelihood of disputes between the partners is substantially minimized.

The most notable characteristic of a partnership is that it ceases to exist upon the death or retirement of one of the partners. The remaining partners must therefore constitute a new partnership. To avoid disruption of business, the Partnership Agreement normally contains transitional provisions in the event of the death or retirement of a partner.

Partnerships are best suited for professional practices which are regulated by laws that do not permit operation of limited liability companies in the provision of professional services. For other businesses which are not so regulated it is difficult to find a reasonable justification for operating in partnership rather than via a limited liability company.

The most basic form of partnership is the general partnership in which partners manage the business and are personally liable for its debts.

In most countries (including Kenya), however, limited partnerships exist, in which certain limited partners relinquish their ability to manage the business in exchange for limited liability for the partnerships debts.

In a partnership, the principal activities of the business are carried out by the partners.

Every partner or person held out to be a partner of the firm is both an agent and principal of the firm and may bind the firm and the partners.

Partners are jointly and severally liable for the debts of the business. This means that while all the partners are personally liable for each and every transaction done in the name of the business, a judgement holder can recover the entire debt from any or some of the partners who have the wherewithal to satisfy the claim. There is no limitation of liability whatsoever.

The general rule therefore is that each partner is his brother's proverbial keeper and will be responsible both legally and financially for the actions of the other partners in the general course of business.

However, liability will not be joint and several as between the parties where the partners have stipulated among themselves that:

- one or some of them only shall enter into particular contracts, or into any contract; and
- as to certain of the contracts entered into by the firm, only those partners who are actually involved in the making of the same shall be liable.

It should be noted that even when the partners have made the above private arrangements, if third parties dealing with them have no notice of such arrangements, then all of them will nonetheless be liable. The principle behind this position is that the public has a right to assume that every partner (or person described as such) has authority from his co-partners to bind the whole firm in contracts made according to the ordinary usages of trade.

Therefore:-

- every partner is liable for his or her own actions;
- every partner is liable for the actions of the other partners; and
- every partner is liable for the actions of the employees in the business.

There is also the concept of a "*sleeping partner*". This is a partner who plays no part in the business of the partnership but is nevertheless a partner, usually having provided business capital as an investment. Even though he plays no role in the business, if an active partner does something within the actual agreed authority, the sleeping partner is bound under normal agency principles.

Depending on the nature of activity from which liability arises, the partners as the principals of the firm have unlimited liability so long as the activity in question was carried out in their capacity as agents of the firm and within the authority vested on them in the natural course of business.

c) **Limited Liability Company**

A limited liability company is a form of business entity created by registration under the Companies Act (Cap 486) and having a certificate of incorporation as the evidence of its existence. It may either be private or public. A private company is usually created by persons having a common bond, e.g. family, friendship, investment objective, etc. In a sense, it is a "members' club" open only to members within that bond and closed to strangers and outsiders. For that reason, the key feature of a private company is that shares in it are not freely transferable outside the membership.

The Articles of Association (read "Constitution" of a private company) not only prohibit the free transfer of shares but impose an obligation on the members wishing to transfer their shareholding to first seek the consent of the other members and give them the first option of buying the shares before they are offered to a third party. Even where such consent has been given, the Articles usually provide that the shares may not be transferred to a person whom the directors do not approve of, meaning that the directors can reject a transfer if they do not like the colour of the proposed transferee's hair.

In contrast, a public company is one in which there is no restriction on the transfer of shares, either within or outside the existing membership. The minimum number of people required to form a public company is 7 and there is no statutory maximum.

A distinction must be drawn between public and listed companies. Contrary to popular belief, a company does not have to be listed on the Stock Exchange to be "public" but to be listed on the Stock Exchange, the company must be public.

Shares of companies that are listed on the Stock Exchange can only be transferred via trading on the Stock Exchange and never by private treaty. On the other hand, shares in public companies which are not listed can be privately transferred.

Since the abolition of exchange controls in the mid 1990s, Kenyan law no longer requires directors of companies to be Kenyan. Similarly, save for companies operating in certain specific sectors such as telecommunications, broadcasting, insurance, banking, etc, there is no longer any requirement for all the shareholders in a company to be Kenyans. The law does, however, require that if a director is not a Kenyan, his nationality must be indicated in all official documents of the company e.g. letterheads, catalogues, annual reports, invoices, etc alongside the names of all other directors. Looking at the letterheads of most companies in Kenya it is quite evident that this particular law is honoured more in breach than in observance. It is difficult to tell whether the contempt fro this law arises from ignorance or the fact that the fine is only Kshs. 100/=.

The law requires each company to have a Company Secretary who must be a qualified and registered Certified Public Secretary (CPS).

The constitutive documents of a company are the Memorandum and Articles of Association. Contrary to common belief that this is in fact one document, the bound document, in fact, consists of two separate but interdependent documents, namely, the "*Memorandum*" and "*Articles*".

The Memorandum of Association principally sets out the main objects (activities) that the company may lawfully engage in. The objects clause, as it is known, is normally very broad and reading through it can be both tedious and hilarious depending on the mood of the reader and the time at his disposal. The basis of this "wide net approach" is found in the *ultra vires* doctrine which provides that a company, being a creature of the law, has no power to do anything except that which is set out in its Memorandum of Association. If the company purported to carry out any activity or business which is not provided for in the objects clause, the liability flowing from such activity or business can be easily avoided by the company on grounds that it did not have the power to incur such liability in the first place.

It should be noted, however, that although there has been substantial development of the law regarding the *ultra vires* doctrine in the developed economies, in the Kenyan context the essence of the doctrine remains largely undiluted.

Although the Memorandum appears like a standard document (and to some extent it is), it is essential to ensure that the document is tailor-made for the specific needs and objectives of each company. It is a big mistake to reproduce the Memorandum of another company as quacks do and imagine that the cost saving is worthwhile. It is not uncommon to find Memoranda lacking in essential provisions e.g. power to borrow or even carry out the main business of the company. The first few paragraphs of Clause 3 in the Memorandum should at a glance give a clear indication of the main objectives for which the company is incorporated.

On the other hand, the Articles of Association are the constitution of the company. They contain rules and procedures to govern the affairs of the company which the directors and shareholders must observe in operating or dealing with the company or with each other.

Limited liability companies are, of course, also regulated and governed by the provisions of the Companies Act. The Kenyan Companies Act contains the substance of English company law of 1948! English law has since undergone tremendous developments to cope with the challenges of modern business but despite the various task forces that have been set up in Kenya over the last 10 years to review and recommend a model law based on the requirements of modern business, we are still using the law that was in force in England almost 60 years ago and which has since been discarded in most of the commonwealth.

Unlike sole proprietorships and partnerships, limited liability companies are subject to stringent statutory compliance requirements under the Companies Act, e.g. the filing of annual returns, holding of statutory meetings, appointment and removal of directors, winding up, etc.

So, why would one choose to do business via a limited liability company when it is so much cheaper and hustle-free to register and operate a sole proprietorship or partnership?

There are many advantages but the principal one is called the '*corporate veil*'. This is a doctrine enunciated by the House of Lords in the famous case of ***Salomon v. Salomon*** in which it was held that a registered company is in law a legal person distinct and separate from its shareholders and/or directors. In this regard, the company's debts and liabilities cannot normally be borne by or enforced against its shareholders or directors. In other words, the incorporation of a company shields the owners against liability incurred by the company.

The only risk which a shareholder assumes in connection with the activities and liabilities of the company is the amount of share capital which he has contributed or is liable to contribute which, in most cases, is not substantial. Any liability exceeding that threshold is borne by the company itself, whether it has assets or not, without regard to the sometimes evident lavish lifestyles of the shareholders while the company is in financial distress.

It should be noted, however, that there are circumstances under which the 'corporate veil' can be lifted by the court, thereby exposing the shareholders to personal liability but the courts are normally extremely reluctant to 'lift the veil' except in cases of manifest fraud on the part of the shareholders/directors.

The courts have consistently held that the "corporate veil" is an essential feature of registered companies and this character should not be easily diluted by wanton lifting of the "corporate veil" except in very clear and demanding circumstances where it is established that the corporate entity is being used as a "mask" for some improper purpose. As a general rule, the corporate veil cannot be lifted merely on grounds that the company has no assets or is unable to pay its debts or is insolvent.

The undisputed ground for the lifting of the "corporate veil" is fraud on the part of the shareholders/directors. In ***Re William Letch Bros Ltd*** case, the court gave the word "fraud" a very liberal definition and noted that *"where a company continues to carry on business and incur debts at a time when there is to the knowledge of the directors no reasonable prospects of the creditors ever receiving payment of these debts, it is, in general a proper inference that the company is carrying on business with the intent to defraud and in that case the 'corporate veil' can be lifted."*

The Kenyan Companies Act does recognize under Section 323 that shareholders and directors can be held liable for the debts and liabilities of the company if it is proved that they were fraudulent in their dealings. However, the practical challenge that arises in attempting to lift the 'corporate veil' is the difficulty of proving fraud. The degree of proof required is higher than in ordinary civil cases and oftentimes there is never enough evidence to prove it.

2. SHAREHOLDERS' AGREEMENTS

As the old time-tested albeit hackneyed wisdom goes, prevention is better than cure. Evidence shows that many disputes between shareholders arise from misunderstandings that can be substantially reduced or avoided altogether by agreeing and recording beforehand all the principal terms relating to their relationship *inter se* and their relationship to the company. The document that achieves this purpose is called a *Shareholders' Agreement*.

A Shareholders' Agreement is the company law equivalent of a pre-nuptial agreement except that unlike a pre-nuptial agreement which is entered into prior to the marriage, a Shareholders' Agreement may be entered into after the incorporation of the company or indeed at any time after the company has become operational.

Unlike the Articles of Association which are largely standard and are contained in a public document available to any member of the public at the Companies Registry, the Shareholders' Agreement is a private and invariably confidential document whose contents are known only to the parties concerned. It is not required to be filed in any public registry.

The key advantage of a Shareholders' Agreement is that the shareholders can practically make provision for any conceivable eventuality in their relationship and thereby address in advance most of the issues which lead to disputes, litigation and even the winding up of a company. Examples of such matters include but are not limited to:-

a) *shareholding ratios*: the parties agree and record the proportional shareholding which each of them will have in the company depending on the respective contributions of each member to the share or working capital of the company either in cash or in kind e.g. provision of technical, marketing or managerial skills;

b) *appointment of directors*: each shareholder is normally entitled to nominate directors according to his proportionate shareholding strength in the company i.e. ordinarily the shareholder with a higher stake in the company would be entitled to appoint more directors.

c) *Chairman and Managing Director:* The parties agree and record in advance who between them will nominate the chairman and managing director of the company and the terms applicable to each of these appointments;

d) *formulation of Business Plan*: any company aiming at profitability must have a business plan for each financial year or agreed specific period. The shareholders therefore would agree when the business plan would be prepared and by whom, how and when it is to be approved by the Board of Directors as well as who is charged with the responsibility of implementing it;

e) *working capital*: the shareholders must agree and record how the present and future working capital requirements of the company will be met. This may either be by way of loans from banks or financial institutions or by a direct contribution by the shareholders. If the working capital is to be raised by the shareholders, it must be agreed whether such contributions will be treated as loans or equity. If they are treated as loans, it is advisable to set out the terms of repayment and the interest applicable. The usual provision is that no dividend shall be declared or paid by the company until the shareholders' loans have been repaid. On the other hand, if the contributions are treated as equity, the contributing shareholder is entitled to allocation of more shares in the company as compensation for the funds advanced to the company, thereby diluting the equity of the other shareholders correspondingly;

f) *oppression of minority shareholders*: according to the Articles of Association of most companies, decisions of the company are made on the basis of the shareholding which logically means that the majority shareholders can bulldoze their wishes on the minority to the extent that the minority shareholders have no voice on the affairs of the company, leading to disillusionment, frustration, disputes and, in some cases, petitions for winding up of the company. To avoid this, the Shareholders' Agreement would normally contain certain safeguards to ensure that all major decisions affecting the affairs of the company can only be made by a unanimous vote irrespective of the shareholding ratios between the shareholders. This in effect confers a veto power on the minority shareholders in respect of certain key decisions affecting the company. The matters that are usually reserved for unanimous approval include (without limitation):-

- concluding contracts exceeding an agreed amount in value;
- employment and dismissal of senior employees;
- investment of surplus funds;
- alteration of the company's Memorandum and Articles of Association;
- approval of the balance sheet, profit & loss account and other accounting documents;
- lending of moneys in excess of agreed limits;
- fixing of directors' remuneration;
- disposal of a substantial portion of the company's assets;
- repayment of shareholders' loans;
- finalization of budgets, cash flow statements and business plans;
- opening of bank accounts or changing banking arrangements;
- reduction of the capital of the company;
- declaration of dividends;
- allotment of un-issued shares;
- replacement of auditors;
- winding up or dissolution of the company;
- merger, de-merger or similar arrangements;
- appointment and dismissal of directors;
- issue of debentures and other securities convertible into shares;
- creation of encumbrances over the assets, rights, revenues, undertaking or goodwill of the company;
- formation of subsidiary companies;
- effecting a material change in the business of the company;
- commencement of any litigation, arbitration or the settlement of any disputes other than routine debt collection; and
- borrowing money in excess of an agreed limit;

g) *deadlock provisions*: these provisions provide a mechanism for dispute resolution among the shareholders by providing an avenue for ventilating and resolving disputes before they unnecessarily escalate;

h) *transfer of shares*: although the Articles of Association of private companies would ordinarily contain pre-emption rights, the Shareholders' Agreement goes a few steps further to impose more stringent restrictions on how shares in the company may be transferred to a third party. For instance, the document would have "*tag along*" provisions which provide that if one shareholder was to sell his shares to a third party at a price agreeable to the other shareholders, he must get the intending buyer to also purchase the shares of the other shareholders at the same price. This provision ensures that a shareholder is not left saddled with a new business partner whom he would never have chosen to do business with. It also ensures that such a shareholder gets good value for his shareholding in the company without having to struggle looking for a buyer of his shares following the departure of the previous shareholder;

i) *dividend policy*: the shareholders agree in advance on the percentage of the company's annual profit after tax which will be distributed as dividend or ploughed back into the business. This is a useful provision because not only does it ensure that a dividend will be paid as agreed if the company makes a profit, but also that the wishes of the majority shareholders will not prevail in that regard at the expense of the minority shareholders;

j) *supremacy over Articles of Association*: this is a very useful provision which ensures that the provisions of the Shareholders' Agreement take precedence over those of the Articles of Association in the event of a conflict between the terms of the two documents; and

k) *arbitration*: this provision ensures that disputes between the shareholders or a shareholder and the company are settled by means of arbitration rather than litigation in the courts. Arbitration has various advantages over litigation in terms of cost, time and preservation of relationships.

Considering that none of the above matters will be provided for in the ordinary Articles of Association, the reader should begin to see the amount of darkness in which shareholders operate in the absence of a Shareholders' Agreement. No wonder most disputes revolve around one or more of the above issues.

It should be noted that it is not mandatory for shareholders to enter into a Shareholders' Agreement but it is an indispensable tool to the modern entrepreneur who gets into a shareholding relationship with other persons mainly on considerations of business (as opposed to personal/family) relationships.

Shareholders' Agreements are particularly useful in joint ventures i.e. where two companies/individuals identify a business opportunity and contribute various resources to exploit the objective jointly through a new company which they incorporate for the purpose.

3. <u>BUSINESS PREMISES</u>

Having complied with the relevant statutory requirements for setting up the preferred form of business and obtained the certificate of registration from the relevant Registrar, the next consideration is to identify the physical location of the business.

The following legal considerations are relevant in that regard:-

a) **Lease**

Unbeknown to most business people, leases (tenancies) are creatures of the law and must therefore comply with certain legal requirements to be effective e.g. depending on the statute under which the title of the property is issued, if the interest of the tenant in the property is to be recognized by law, any lease for a period of more than a year must be registered by the Registrar of Lands. Since leases convey certain rights to the landlord and tenant, it is prudent for the tenant to ensure that the validity of the lease is not compromised by want of the necessary legal formalities.

Before signing the lease, however, it is important for the tenant to seek legal advice on the various terms contained in the proposed lease and to negotiate for amendments if the terms are oppressive. In this regard, relevant issues for consideration include the amount of rent payable, security deposit required, service charge, term of the lease, legal fees, etc.

One of the most controversial terms in any lease for business premises in Kenya is the term (duration). Virtually all commercial leases provide for a minimum tenancy of six (6) years and have no termination clause, meaning that if the tenant wished to vacate the premises prior to the expiry of the specified term, he could only do so upon paying the full rent for the remainder of the term or get a replacement tenant wiling to pay the same rent! This is a critical issue especially for new businesses which for any number of reasons may not wish to remain in the same premises for six years due to certain variables such as unexpected expansion, reduction, security, neighbourhood, change of main business, etc.

The source of the problem is traceable to *The Landlord and Tenant, (Shops, Hotels and Catering Establishments) Act* (Cap 301) which was passed soon after independence to make it easier for Kenyans of African origin (the majority of whom did not own business premises then) to conduct their businesses without harassment from the landlords (most of whom happened to be of non-Kenyan origin).

The principal provision of this Act is that any lease for a term not exceeding five years or which contains a provision for termination is a "controlled tenancy" and therefore regulated by the Business Premises Rent Tribunal, also set up under the Act.

In a controlled tenancy, the landlord cannot, *inter alia,* increase rent or terminate the lease before first referring the matter to the Tribunal which may or may not approve the proposed action. The Act therefore deprives the landlord of certain rights over his property in order to protect the tenant.

It is therefore not surprising that owners of commercial properties invariably seek to avoid the application of the Act by eliminating all provisions in the lease which would give it the character of a controlled tenancy. The landlords (no doubt on the advice of their smart lawyers) have discovered that the easiest route to achieve this objective is to provide for a lease term of more than five years and omit any reference to termination. By so doing the application of the above Act is swiftly displaced, thanks to the ingenious exploitation of just one of the many marvelous loopholes that exist in the majority of our laws!

Before condemning the landlords for their ingenuity, however, we should perhaps ask whether Kenya indeed needs such a law in the first place in the year of our Lord 2007 when the historical basis upon which it was initially enacted no longer exists. It is arguable (with justification in our view) that in a liberalized economy such as Kenya's there is no room whatsoever for controlled tenancies.

Turning to the tenant, *is it then the case that a tenancy which has no termination clause cannot be terminated under any circumstances?*

The good news is that notwithstanding the absence of a termination clause in commercial leases, the courts have held that such tenancies can indeed be terminated by giving a reasonable notice. In at least one case it was held that three (3) months would be deemed to be reasonable notice for this purpose.

The above exit mechanism is, however, subject to certain conditions, namely, if the landlord proves that despite his reasonable endeavours to get a replacement tenant he has completely failed to secure one then the exiting tenant would be compelled to pay the rent for the remainder of the term. If, on the other hand, the landlord proves that he has found a new tenant who is only willing to pay less rent than what the terminating tenant was paying, then the terminating tenant will be compelled to pay the difference between the rent he used to pay and the rent payable by the new tenant up to the end of the remaining term.

The upshot of the above convoluted jargon is that the safest method of terminating a commercial lease is by finding a replacement tenant willing to pay the same amount of rent unless, of course, the landlord agrees to an unconditional surrender of the lease.

Pending the possible (one would say inevitable) repeal of the statute to eliminate the concept of "controlled tenancies" from the Kenyan legal menu, lawyers have devised other ingenious methods of circumventing the law to ensure that a lease which has no termination clause can still be terminated on a need basis without outstanding liability in respect of the remainder of the term of creating a controlled tenancy. Specific legal advice in this regard should be sought if required.

b) **Signage**

Depending on the size and proposed positioning of signage on the business premises, the permission of the landlord and the local authority (city, municipal or town council) may be required. It is therefore essential for the entrepreneur to find out what consents, if any, are required and make the necessary payment for them before erecting the signs.

4. SPECIFIC LEGISLATION

Depending on the nature of the business, there are specific laws which govern various sectors of the economy e.g. manufacturing, agriculture, mining, tourism, etc. It is prudent for the entrepreneur to identify the relevant legislation that regulates his industry and seek full compliance with such laws. If in doubt, legal advice should be sought.

5. LICENCES

The next legal consideration after putting up the brass plate is obtaining the necessary licences applicable to the business. The appropriate licences will depend on the type of business concerned and specific legal advice should be sought. Licences are required from both the central Government as well as local authority within which the business premises are situated.

The Government announced in 2006 Budget its intention to abolish most trading licences by repealing the Trade Licensing Act (Cap 497) but there are no indications yet that the local authorities will follow suit any time soon.

6. COMMERCIAL CONTRACTS

Once trading commences, the business will inevitably from time to time enter into contractual relationships with other trading partners, suppliers, customers, etc. As contracts are a record of legally binding commitments, it is advisable to seek specific legal advice before signing or terminating any contract to avoid unnecessary liabilities and fruitless litigation.

7. EMPLOYMENT ISSUES

Regardless of the size or nature of the business, it is unlikely that it can operate without human resource. The employment relationship is of a legal nature and must therefore comply with the applicable legal requirements. Kenyan law requires that employment contracts for any period exceeding six months must be reduced in writing. It is therefore a sound business practice to ensure that each employee signs an employment contract based on a template prepared or approved by a lawyer. Only then can the entrepreneur be confident that all the relevant legal requirements are covered in the contract e.g. salary, housing, duration, designation, job description, annual leave, sick leave, termination, etc.

In the absence of a well drafted employment contract, the court will, in the event of a dispute, rely on the oral evidence of both the employer and employee and may end up reaching an unjust finding due to the absence of a clear record of the agreed terms of employment.

Employers in Kenya frequently complain that Kenyan courts tend to favour employees when determining employment disputes. While this may be so, one of the reasons for it is that the disputed terms of employment are in most cases not clearly defined or recorded, yet the court must do substantial justice on the basis of the available oral evidence which may not always be accurate or truthful.

We highlight below some of the most controversial and misunderstood issues in Kenyan employment law. There are, of course, many others that are not mentioned here.

a) *Casual Employees:* One misconception that rules the minds of most Kenyan workers is that after working as a casual employee for a given period, (usually three months), the employee is entitled to confirmation (into permanent and pensionable terms). The bad news is that nothing could be farther than the truth! The legal position is that save for certain sectors which are clearly specified in the various Orders set out in *The Regulation of Wages and Conditions of Employment Act* (Cap 229) or in cases where the employer has signed a collective bargaining agreement with the relevant trade union which provides otherwise, there is no legal obligation on the employer to confirm a casual employee after any period.

b) *Payment for "Service":* Another common misconception on Kenyan employment law is that after termination, an employee is entitled to payment or "benefits" for the years worked. This misconception arises from two sources, namely, (a) confusion between ordinary termination and redundancy and (b) failure to distinguish between the rights accruing to unionisable and non-unionisable staff. Unionisable staff generally enjoy certain benefits outside their employment contracts which are negotiated by their trade unions and many of which include provision for payment of a gratuity following termination even in the absence of a redundancy. In the absence of a specific provision to that effect in the contract there are no “benefits” payable in respect of years of service except in the case of a redundancy (see below).

c) *Redundancy:* Redundancy arises where the services of the employee exceed the requirements of the employer. This may be due to reduction of business, abolition of office, lack of funding, closure of factory, staff rationalization, etc. In that case termination occurs automatically because there is no more work for the employee to do. The law provides that upon the occurrence of a redundancy, in addition to fulfilling the other requirements set out in various Orders in *The Regulation of Wages and Conditions of Employment Act*, the employee is entitled to compensation for loss of employment at the rate of a minimum of fifteen (15) days pay for each completed year of service. This payment is intended to assist the employee to adjust to his changed circumstances and the law only prescribes a minimum, leaving it to the parties to agree on a reasonable package. Failure to agree results in an automatic trade dispute.

d) *Work Permits:* Where the person to be employed is not a Kenyan, he can only start working after obtaining a valid work permit issued by the Immigration Department. Both the employer and employee commit an offence by engaging in an employment relationship when the employee has no valid work permit.

e) *Statutory Benefits and Deductions:* In addition to complying with the provisions of the Employment Act (Cap 226) and a host of other statutes which govern labour issues in Kenya, the employer must also comply with the relevant statutory requirements relating to employment such as provision of water, housing, annual leave, sick leave, maternity leave, medical care, etc. The employer must also observe provisions relating to the deduction and remittance to the relevant authorities of payments relating to NSSF, PAYE and NHIF.

f) *Certificate of Service:* Kenyan law provides that upon the termination of employment by whatever means and for any reason, the employee is entitled to a *Certificate of Service*. This is not a letter of recommendation but merely confirmation of the fact that the employee worked for the particular employer during the period shown on the certificate.

8. WORKMEN’S COMPENSATION

It is a wise discretion to procure adequate cover for workmen’s compensation under the Workmen’s Compensation Act (Cap 236). At the practical level, it is advisable to have clear guidelines within the organisation to avoid processing and paying fictitious claims from fraudulent employees and ex-employees. With regard to the former category, there should be a clear procedure on what to do after an injury, setting specific periods within which an incident must be reported, etc. With regard to ex-employees, the employer should ensure that all terminated employees execute a discharge confirming full settlement of their dues including workmen’s compensation if indeed they have been paid.

9. INTELLECTUAL PROPERTY

This is a most misunderstood, nay, unknown concept, never mind that the most valuable business asset in the world today is the *Coca-Cola* trade mark. Creating and popularizing a brand to the point where the mere sight of it automatically triggers in the mind of a consumer the origin and quality of the product (or service) takes time, effort, money and intensive market research.

It is therefore only a very ignorant entrepreneur who will not seek protection for his brand, invention, industrial design or copyright. There are specific laws dealing with the registration and protection of various forms of intellectual property and specific legal advice must be sought in that regard.

10. ACQUISITION OF BUSINESS

The two obvious ways of acquiring a home (apart from inheriting it) is to build or buy one. The same is true of business. If the choice is to acquire an existing business, the following legal considerations will be relevant:-

a) *Due Diligence:* This is a detailed investigation into the business which is targeted for acquisition. The investigation is conducted by the legal and financial consultants of the potential purchaser. While the financial due diligence will seek to provide a financial justification for the acquisition, the legal due diligence will establish, *inter alia*, the corporate and shareholding structure of the target, identity of the directors, assets and liabilities, pending litigation, contractual arrangements, employment issues and potential liabilities arising therefrom following the acquisition, validity and coverage of insurance policies, licences, intellectual property, tax compliance, etc. The due diligence is normally carried out under the aegis of a *Memorandum of Understanding* also known as a *Letter of Intent* prior to entering into a binding Sale Agreement. It is also usual to execute a *Non-Disclosure Agreement* at this stage to safeguard the unauthorized disclosure or misuse of each party's confidential information obtained in the course of the due diligence process.

b) *Warranties and Indemnities*: The purchaser may require certain warranties from the vendor e.g. to the effect that the business has no potential tax liability or pending litigation which may have an adverse effect on the net value of the business as disclosed by the vendor. Depending on the outcome of the due diligence, the warranties and indemnities can be as few or as many as the circumstances require. The objective is to enable the buyer to either retain a portion of the purchase price on account of the possible breach of the warranties or sustain a claim against the vendor in the event that the warranties turn out to be false or misleading. The indemnities are intended to cushion the purchaser against liabilities arising after the acquisition but which ought to be borne by the vendor notwithstanding the effective date of the transfer of the business.

c) *Disclosure Letter:* This is the antithesis of the Warranties and Indemnities. The disclosure letter is normally attached to the Sale Agreement as the Vendor's considered qualifications to the warranties and indemnities given. The vendor is never held liable for a warranty or indemnity against which he has made a disclosure. The disclosures are meant to whittle down the effect of the warranties and indemnities and a prudent vendor will disclose as much as possible against each warranty or indemnity to lessen the potential liability arising therefrom.

d) *Monopolies Law:* Legal advice should be sought on whether the consent of the Minister for Finance will be required under the *Trade Restrictive Trade Practices, Monopolies & Price Control* Act (Cap 504) for the proposed acquisition. The principal objective of this statute is to promote competition in the economy and avoid the creation of monopolies and unfair trade practices. The Act therefore gives the Minister power, through the Commissioner of Monopolies, to grant or refuse consent for the consummation of certain acquisitions which might result in the creation of monopolies in the economy or result in unwarranted concentrations of economic power. This Act is not one of the most well drafted statutes in Kenya. It is therefore strongly advisable to seek legal advice on whether it applies to an intended transaction or not. Any transaction that disregards the provisions of this Act is null and void.

e) *Restrictive Provisions:* These are also called non-compete provisions. In most cases it would make no sense to buy a business and start competing with the vendor the following day if he sets up a competing business next door. The Sale Agreement normally imposes certain restrictive conditions on the vendor restraining him from engaging in the same or similar business in the same locality or within a certain radius of the purchaser's business either indefinitely or for a certain agreed period. Other restrictive provisions restrain the vendor from poaching employees, clients/customers or making disparaging remarks about the business.

f) *Change of Name:* If the acquisition includes the goodwill of the business (which is usually the case), consideration should be given to whether the old name will be retained or it will be changed.

g) *Notice Under Cap 500: The Transfer of Businesses* Act (Cap 500) essentially provides that in the absence of a notice issued under the Act, the purchaser of a business is deemed to have also acquired the liabilities of the business. Therefore, to avoid the creditors of the former owner knocking at your door, it is advisable to issue the transfer notice under the Act in the prescribed manner. This process requires specific legal advice.

11. <u>LITIGATION</u>

Commercial lawyers regularly advise their clients that *"a bad settlement is better than a good judgement"* which loosely translates in layman's terms to *"a bird in the hand is worth two in the bush."* This advice stems from the experience which teaches that litigation should be resorted to only after all avenues for negotiation and attempts at reaching an amicable settlement have completely failed.

Granted that even after taking all the necessary precautions some matters will end up in court, the following considerations are relevant when that Rubicon is crossed:-

- seeking proper legal counsel on the actual and relative strength of your case. It is no use engaging in expensive and time-consuming litigation if loss is almost certain to follow as surely as day follows night;

- making available to your lawyer all the relevant documents and information to support your case;

- availing all the relevant witnesses whenever required and accommodating the cost of doing so;

- likely time-frame for the conclusion of the case;

- proven ability of the other party to settle the judgement of the court (a judgement against a pauper is not worth the paper on which it is written); and

- the cost of the intended litigation, bearing in mind that unless the court decides otherwise, the losing party pays the costs of the winning party as assessed by the court.

12. ARBITRATION

As an alternative to litigation, one should seriously consider alternative dispute resolution (e.g. arbitration) bearing in mind, however, that while this process may resolve the dispute faster, it is in most cases more expensive than litigation. In addition, it should be noted that in the absence of a provision in the underlying contract providing that all disputes arising from the contract shall be referred to arbitration, this option may not be available unless both parties consent to it. This provides one more justification for ensuring that the underlying contract contains an arbitration clause.

Whether or not the decision of the arbitrator is final and binding on the parties depends on the wording of the relevant arbitration clause pursuant to which the arbitration is conducted. It is usual for the clause to provide that the arbitrator's award shall be final and binding on the parties but it is not uncommon to find a clause stating that a party who is dissatisfied with the award given by the arbitrator may appeal to court. In such cases most parties choose to go to court straight instead of commencing a meaningless arbitration. Arbitrations are governed by the Arbitration Act, 1995.

13. TAX

Prudence requires every entrepreneur to be conversant with the relevant tax laws applicable to his business, to pay taxes on time to avoid penalties and interest and to always keep abreast of the changes introduced into the tax laws annually in the national budget.

14. INSURANCE

The business should have adequate insurance cover depending on the risks normally experienced in the specific sector.

CONCLUSION

This paper is not and should not be misconstrued as legal advice on any of the topics covered above. Its contents are purely informatory and cautionary to assist entrepreneurs to take into account the relevant legal considerations of doing business in Kenya today. Law is a dynamic subject and does change from time to time. It would therefore be the height of absurdity for any entrepreneur to assume that the law as stated in this paper will be the same at any future date or worse, that the information given above is sufficient without the necessity of seeking specific legal advice.

The general legal principles and concepts enunciated above are as of the date of writing and may change from time to time. The reader should therefore be wary of the inherent danger in the blind reliance on the contents of this paper for purposes of making important business decisions. The writer, however, hopes that the guidelines provided in this paper can, at best, serve as a checklist or reference point for the reader and enable him to seek specific legal advice from a lawyer of his own choice in good time.

This paper was first presented by the author at ***The Competitive Enhancement Programme Conference*** *in Nairobi organized by* ***Centre for Development of Enterprise (CDE)*** *on 2nd February, 2007.*

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