

## **COMPANY LAW**

### **FORMATION OF COMPANIES - 2**

- The person who forms a company is called a promoter.
- The process of forming a company is called promotion.

#### **➤ The process of forming a company**

1. Reservation of companies name
2. Assembly of resources
3. Preparation of constitutive document-**Memorandum and articles of association**
4. Presentation of constitutive document
5. Payment of stamp duty
6. Registration and issuance of certificate of incorporation.

- One or more person who wish to form a company may:

- i) Subscribe their names to the memorandum of associations.
- ii) Comply with the requirements of the company's act with respect to registration.

*A company formed for unlawful purposes may not be registered.*

- The following is the process of registering a company
- ✓ **Check: November 2016 QN Six B** Requirement that an application must meet before the registrar can approve it.

**1. Reservation of company's name**

- The promoter after identifying name of the proposed company must search at the company's registry to check if the name is desirable for registration. The company's act states, "No name shall be reserved and no name shall be registered if its considered undesirable in the opinion of the registrar."

**Quiz: What is a desirable name in the opinion of a registrar?**

- The following names are considered undesirable in the opinion of the registrar
  - a) Names similar with names of existing companies or other legal entities.
  - b) Names which are misleading as to the nature of the company area of business or geographical area of operation.
  - c) Names that connote immoral activities.
  - d) Names associated with the head of state or royal family
  - e) Names similar to government department or county government.
  - f) Names associated with our independence i.e. Madaraka day
  - g) Names similar to international organisation to which Kenya is a member i.e. UN
  - h) Names similar to churches or a holy place of worship i.e. All Saints Cathedral
  - i) Names of individual who are not directors to the company e.g. Kamau Ltd yet Kamau is not a director of the company.
  - j) Names promoting violence
  - k) Initials are not accepted unless their full meaning are written out e.g. NBK Ltd National Bank of Kenya

## ***2. Assembly of resources***

- The promoters have a duty to assemble various resources which may include capital, human resources, to enable the company to be operational after registration.

## ***3. Preparation of constitutive documents***

- These documents include:
  - i) Memorandum of Association
  - ii) Articles of Association
  - iii) Statement of capital and initial shareholding for companies with share capital
  - iv) Statement of the company's proposed officers for companies limited by guarantee.
  - v) Written undertaking of the directors of the company including the consent in writing.

## **4. Presentation of the above documents to registrar for verification.**

## **5. Payment of stamp duty**

## **6. Registration and issuance of company's certificate of incorporation and allocation of a unique identifying number.**

## **Certificate of incorporation**

- This is a document issued by a registrar on the date of incorporation.
- It's the company's birth certificate.
- It establishes a body corporate.

➤ Contents of a certificate of incorporation include:

- a) The name of the company and its unique identifying number.
- b) The date of the company incorporation.
- c) Whether the company has limited or unlimited liability i.e. by shares or guarantee
- d) Whether the company is a private or a public company.
- e) Signature and seal of the registrar

*N/B: The certificate is a conclusive evidence that the requirement of a company's act relating to the registration have been complied with.*

➤ Circumstances when certificate of incorporation can be withdrawn

✓ *Check; May 2016 QN Six A Check; December 2012 QN 2b*

- a) Where the company to which the certificate has been issued turns out to be an enemy of the state.
- b) In cases where it's discovered later that the objectives of the company are immoral the certificate can be withdrawn.
- c) Where the entity that was registered as a company is not a company in nature. e.g used to evade taxes

### **Certificate of trading**

- A private company is entitled to commence business at any time after incorporation i.e. after issuance of certificate of incorporation
- Public company requires certificate of trading to commence business'
- A certificate of trading issued by the registrar is a conclusive evidence that the public company is duly authorised to **commence business and exercise borrowing powers.**

*N/B: Any contract entered to by a company before it is entitled to commence business are provisional*

- It is a criminal offence for a company to commence business before it is entitled to do so.
- Every person in default is liable to a default fine.
- A company is liable to the court if it fails to commence business within a year of incorporation.

**A PROMOTER** - *Check; November 2019 QN 2A*

- This is a person who undertakes to form a company with reference on certain project and who takes the necessary steps to accomplish that purpose.
- A person who plan for business nature and who takes the necessary steps for the formation of the company.
- **Legal position of a promoter**
  - Legal relations such as agency and trusteeship only exists between legal entities. I.e. persons capable of establishing a contractual relationship amongst themselves.
  - **There is no legal relationship that can exist between the company and the promoters.**
  - Promoters are therefore neither agents nor trustees for the company they promote.
  - This is because the company does not exist as a legal entity before it is incorporated..

- The true position of the promoter was concluded in the case *Erangier and others vs new somb phosphate co. ltd (1518)*
- It was held that the promoters stand in a fiduciary position i.e. the promoters are regarded to act in good faith.

➤ **Duties of promoter**

- ✓ Check; *December 2011 QN Five B, May 2016 QN 3B, September 2015 QN one, November 2019 QN 2A (ii)*
- ✓ *Fiduciary duties- duty to act in utmost good faith*
- ✓ *Common law duties*

**I. FIDUCIARY DUTIES**

**1. To act bonafide (in utmost good faith)**

Promoters are allowed to act in good faith for the benefit of the company under formation.

**2. Proper accounting**

Promoters are required to explain the application of money or assets they apply during formation of the company.

**3. Disclosure**

They should disclose any personal interest they may have on the contracts entered by the company.

4. They should not make secret profits.
5. They should exercise care and skill when carrying out their duties.
6. They must not act fraudulently or negligently in their performance of duties.
7. They should ensure the prospectus is not misleading.

**Common Law Duties/ General duties.**

1. Duty to determine and settle the company's name.
2. Duty to prepare the constitutive and other documents necessary for incorporation.
3. Duty to register the company.
4. Duty to secure the services of the directors.
5. Duty to meet the preliminary expenses.
6. Duty to ensure that the company under formation has an independent body.
7. Duty to prepare a prospectus.
8. Duty to acquire assets for use by the company.
9. Duty to enter into business transactions or contracts on behalf of the company.

**➤ Remuneration of promoter**

- Payments in form of salaries are known as remuneration.
- The general rule is that promoters are not entitled to any remuneration from the company.
- This is because:
  1. At the time they rendered their services, the company is not a legal entity and therefore does not have the capacity to contract.
  2. The company did not ask them to promote it.
  3. The company doesn't have the capacity to contract.

**Notwithstanding the above legal position, a company may remunerate promoters in appreciation for their efforts/services under the following ways:**

✓ *Quiz: Ways in which promoters are remunerated*

1. They can be given founders shares/management shares/deferred shares.
2. They may be paid a lump sum amount upon retirement.
3. They may be afforded the option to earn a commission when they facilitate transactions between the company and 3<sup>rd</sup> parties upon disclosure.
4. They may be appointed as first directors of the company.
5. By giving them an option to purchase a number of shares below market price.
6. By allowing them to sell their personal properties at a profit provided they disclose such profits.
7. Upon disclosure, promoters may be allowed to sell their personal properties to the company in return for fully paid shares.
8. They can take fully or partly paid up shares or debentures at a lower price as member or as creditor to be.

✓ *Quiz: can the promoter make profit in the process of promotion? YES*

- A promoter is not prohibited by law to make profits in the course of promotion provided he makes a full disclosure of such profits to an independent body/board through the prospectus.
- A promoter may also sell their own property to the company at a profit, provided they disclose.
- Disclosure is necessary because such secret profits is one way of remunerating them.



### **Liabilities of a promoter**

- Incase promoters make secret profits and they fail to disclose to the company, the company has the following legal remedies: (*November 2019 QN 2A(ii)*)
  - i) Can be sued for damages for breach of fiduciary duty either the company or 3<sup>rd</sup> party.
  - ii) They can be sued for damages for the fort of deceit if they acted in a fraudulent manner.
  - iii) They can be made criminally liable for including misleading statements in the prospectus.
  - iv) The company may rescind contract entered into by the promoter.
  - v) Accounting back the secret profit.

### **➤ Pre-incorporation contracts**

- This is a contract entered into by the company before incorporation.
- These are contracts entered into by the promoters with 3<sup>rd</sup> parties on behalf of the company which is to be registered.
- ***Check: Explain the general effect of pre- incorporation contracts. November 2016 QN Two A:Dec 2010 QN One B)***
  1. A company cannot ratify a pre-incorporation contract since the company was not in existence at the time the contract was being made. It cannot approve such a contract or ratify such contract. **(Ref Kelner vs Baxter).**
  2. The company cannot sue 3<sup>rd</sup> parties in pre-incorporation contract. Under the doctrine of privity of contract, no person can sue or be sued unless he/she is a party to a contract.  
Pre-incorporation contracts are made at a time when companies are not in existence and the company cannot be a party to such contracts.  
**Ref case Newbone vs Sensolid (Britain 1953).**
  3. Third parties cannot sue the company on pre-incorporation contracts, even if the company had taken the benefits of the contract. **Ref case, English and colonial produce co. ltd**

4. The company may after incorporation enter into a new contract to carry on the pre-incorporation contract. This principle is known as **Novation**.( *Entry into the contract afresh*)
5. Company has a right to retain any benefits acquired through a pre-incorporation contract i.e. property acquired. (***Ref case 11 and 12***)
6. Promoters are personally liable on all pre-incorporation contracts. They are held liable since they are the ones who entered into the contract.

✓ *Quiz: how can a promoter escape liability of pre-incorporation*

✓ *Check: **November 2016 QN Two B** – Discuss how a promoter might overcome the liability of pre-incorporation of contracts.*

- a) By preparing the contract to remain in **draft form** only to be executed by the company after incorporation.
- b) By preparing the contract and including the clause stating that the promoter shall be bound only by the contracts **up to the date of incorporation of the company, thereafter the company shall assume liability.**
- c) By ensuring that the company enters into contracts under novation soon after incorporation.
- d) By preparing the contract containing **repudiation clause** stating that if the contract is not adopted by the company after incorporation. It shall stand repudiated (avoided).
- e) By preparing a contract in such a manner, that if the party is in **breach of a contract**, promoters are discharged from the contract.

➤ **Provisional contracts (for public companies)**

- These are contracts entered into after incorporation before the trading certificate is issued for a public company.
- These contracts are not void, they are merely provisional but do not bind the company until after the certificate is issued.

- If the directors fail to get the trading certificate within 21 days of being called upon to do so by 3<sup>rd</sup> parties, the company becomes jointly liable to indemnify the 3<sup>rd</sup> party, when loss resulting due to failure to perform the contract.
- Constitutive documents (company's constitution)
  - The constitution of a registered company consists of:
    1. Memorandum of association
    2. Articles of association
    3. Shareholders agreement
  - The company secretary must ensure that the constitutive documents are in order.

### **Memorandum of Association**

- MOA was judiciary defined in the case *Ashbury Railway carriage company limited vs Richie as the companies charter*.
- It defines the limitation of the powers of a company to be established under the act.
- **It is the company's external constitution.**
- It enables the members of the company, its creditors and public to know the powers of the company.
- It regulates relationships between the company and its outsiders.
- ✓ Statutory Format of MOA Check; May 2014 QN A
  1. It must be in the English language.
  2. It must be printed.
  3. Must be divided into paragraphs, number consecutively.
  4. Must be dated.
  5. Must be signed to the subscribers to memorandum in the presence of at least one witness.

### **Purpose of MOA**

1. It informs the investors about the various activities their money shall be involved in
2. It defines the boundary with the creditors.
3. It is the foundation upon which the structure of the company exists.
4. The provisions of the company's existing memorandum shall become a part of its articles of association under company's act 2015.

### **Contents of MOA**

1. Name clause
2. Registered office
3. Limitation of liability clause
4. Capital clause.
5. Association clause

#### **A. The name clause**

- Once the companies name is approved by the registrar, it will be reserved for 30days, this period may be extended for a further 30days.
- Thus maximum of 60days.

#### ***Public Limited companies***

- They is required to include the words public ltd co. (PLC) at the end of its name.

#### ***Private Limited companies***

- They must include the word limited at the end of its name. Private company may apply to private cabinet secretary to obtain a license to dispense with the word ltd under the following ways/circumstances.

### **How to dispense with the word ltd**

1. If the company is formed for **promoting commerce of science, religion, charity or any other useful object** i.e. NGOs
2. Its intended **that its profits if any or other income would be used in promoting its objects** i.e. profits are ploughed back
3. **Payment of any dividend to the association members is prohibited.**

*N/B: Any existing company may apply to obtain a license in order to omit the word ltd if it's a private company and it meets the above conditions.*

✓ Check: **May 2014 QN B**

### **PUBLICATION OF COMPANIES NAME**

1. Every company is required to paint or affix its name in a conspicuous position on the outside of every office or place it carries its business.
2. To mention its name on all letters, notices, cheques, invoices, bills of exchange and all other official publications.
3. Should engrave its name on its companies seal.

*N/B: Penalty*

- Failure to publish the companies name or any mis-descriptions the companies name shall render the company liable and every other officer of the company in a default fine, of sh. 500,000 or conviction of 3 years.

### Change of name

✓ *Check; June 2012 QN Five B*

- A company can change its name either voluntarily or compulsory.

### **Voluntary change of name**

- A company may change its name in the following circumstances:
  - i) Special resolution
    - A company may pass a special resolution to change its name and must obtain a written approval from the registrar.
    - In such cases i.e. registrar is notified within 14 days
    - A special resolution requires 75% membership support
  - ii) Too similar/alike
    - In case a company was by mistake registered by a name which in the opinion of the registrar is too alike to an existing company the registrar may order the company to change its name.
  - iii) License
    - A private company can obtain a license from cabinet secretary to dispense with the use of the word ltd. In such a case it must pass an ordinary resolution supported by single majority (50 + 1 person)

### **Compulsory change**

- A company may be compelled to change its name by the registrar of companies or by court of law.
  - a) ***Registrar of company may order the company to change its name:***
    - If its registered by mistake
    - In opinion of registrar, it is too alike to an existing name
    - The registrar may within 6 month of registration direct the company to change its name, failure to which every officer of the company is liable to a default fine.
  - b) *Court of law may compel the company to change name on the following grounds:*

1. When confirming the reduction of capital by a company. It may order it to add the word-**and reduced**-to its name.
2. when the court issues a liquidation/ receivership order to the company, it compels it to add to its name-**under receivership**-to its name.

***N/B: After the company changes its name, it shall give to the registrar a notice within 14days. Upon receipt of the notice, the registrar shall:***

- Enter the new name on the register in place of the former name.
- Issue to the company a certificate of change of name
- Publish the change of name in the Kenya gazette.

#### **Effects of change of name of a company Dec 2010 Q4**

1. It has no effect on the rights and liabilities of the company.
2. It does not render defective any legal proceeding by or against the company.
3. Any legal proceeding that might have commenced against the company under the old name may be continued under the new name.
4. Have no effect in the rights and duties of a member.

#### **B. Registered office clause**

- Company Act states that the registered office of the company to be situated in Kenya.
- Company is required to give notice to the registrar of its registered office within 14days from the date of its incorporation.

### **Purpose/function of the registered office**

1. Nationality – helps determine the company's nationality.
2. Domicile of the company for tax purpose.
3. It is at this office where important documents of the company are kept i.e. MOA & AOA
4. It is the official correspondence or communication centre of the company where it can be served with notice.

### **Important documents kept on the company registered office**

1. Register of directors and secretaries.
2. Register of members
3. Register of charges if the company is a limited company
4. Register of director's interest in shares/debentures of the company or associated companies.
5. Minutes books of general meeting.
6. A copy of any instrument creating any charge requiring registration.
7. Register of debenture holders.

### **Rights of inspection**

The above documents are subject to the following rights of inspection.

- i) The company's members are entitled to inspect them free of charge during business hours, at least 2hrs each day.
- ii) Debenture holders of the company are entitled free of charge during the period beginning 14day before the companies AGM and ending 5 days after the date of conclusion.
- iii) Any member of public is entitled to inspect the register of directors and secretaries and the register of debenture holders upon payment of prescribed fee.



### **C. Limited liability clause**

The clause states whether the company is unlimited or limited and if limited, whether limited by shares or guarantee.

### **D. Capital clause**

- The act provides that in case of a company having a share capital, the MOA shall also (unless the company is unlimited) state the amount of share capital with which the company proposes to be registered and a division thereof.
- Reason for stating share capital – it acts as a security to creditors for any money they lend to the company.

### **E. Association clause**

- Deals with relations of the promoters and the company.

### **F. Object clause**

- The memo must state the main objects, incidental and ancillary to the main object.

#### ➤ *Categories of object*

- i) Main object
- ii) Subordinate objects
- iii) Incidental objects/implied objects

#### Main object

- This is the 1<sup>st</sup> business mentioned in the object clause. It is assumed that from the company point of view, it is the most important of all and that is why it is mentioned. (*It is the substratum of the company*)

### Subordinate object

- Any other business mentioned in the memorandum after the main object shall be subordinate object of the company. (*They are important in attaining the main object*)

### Incidental object/implied objects

- The incidental objects are not written anywhere in the memorandum. They are implied from the nature of the business. **Courts have implied powers to companies on the following:**
  1. To acquire similar business.
  2. To sell the company assets but not the entire undertaking.
  3. To issue bills of exchange and cheques.
  4. To engage and dismiss employees.
  5. To sell the undertaking of the company for shares in another company or for other consideration.
  6. To pay gratuity and pension to officers and employees of the company and their dependant.
  7. To institute and defend legal proceedings.

### **The doctrine of ultra vires**

- The term ultra means 'beyond'.
- The term vires means 'powers' hence ultra vires means beyond powers.
- A company is not expected to engage in any activity which is beyond its powers as authorised in AOA.  
(*Case Ashbury Railway company ltd vs Ritchie 1875*)
- **The defendant company was incorporated to manufacture and sell railway carriage and accessories. It was awarded a contract to construct railway line in Belgium. The issue before court for determination was whether or not construction of the railway line in Belgium was within the scope of the companies object. The court ruled that the contract was ultra-vires.**

**Effects of ultra vires act Check: November 2015 QN Four C**

1. Null and void.
2. Totally unenforceable against the company or even third parties.
3. Not capable of ratification by the shareholders in a company meeting.

**Exception of the ultra vires/ when can Act that are ultra- vires be ratified**

1. If an act is ultra vires in regard to the directors only e.g. their borrowing powers, the shareholder can ratify it in the AGM making it intra vires.
2. If an act is ultra vires in regard to the articles, the company can alter its articles in the proper way by passing a special resolution.
3. Where a company obtains property from a 3<sup>rd</sup> party under ultra vires contract, the 3<sup>rd</sup> party has no claim against the company on the basis of the transaction but has a right to follow his property if it exists in original form.
4. Where the company has power to borrow money, a lender is not bound to inquire into the purpose for which the loan is to be used.
5. An act which is intra vires to the company but irregularly done may be ratified by the consent of the shareholder.
6. Certain acts are deemed implied within company authority and are not deemed ultra vires.

### **Remedies for ultra vires transaction**

- i) **Injunction** – This is a court order restraining the company parting with the possession of the property.
- ii) **Tracing and identification** – since the company does not acquire any title on a property from ultra vires, the property remains the property of the owner and if he can take it and identify he has a right to take it back.
- iii) **Subrogation**- The party whose rights are taken away, takes over the right
- iv) **Personal suit against directors**
- v) **Quantum meruit**- This is part payment. If the party has completed part of the work of the contract, he is entitled to payment in relation to the part of work completed.

### **Alteration of the MOA/procedure of altering MOA**

1. A board meeting to pass a resolution to convene a general meeting.
2. Convening of the general meeting to pass a **special resolution** to permit the alteration of the MOA.
3. Holders of 15% of the issued share capital have 30 days to apply to the court to challenge the alteration.
4. The altered MOA must be filed with the registrar within 14 days

### ***Articles of Association Check, May 2015 QN Two A, December 2010 QN Two***

- It is the primary constitutive document.  
AOA sets out the internal regulations for management of a company.
- It regulates the relations between companies and its members under the company act 2015.
- Company is able to carry out any activity so long as it is not restricted by its articles.

### **Doctrine of constructive notice**

- An outsider contracting with the company should familiarize himself with the public documents.
- These documents are:
  - MOA
  - Articles of association
  - Shareholders agreement
  - Special resolution
  - Annual returns
- These documents are available for public inspection in the registrar of companies office upon repayment of prescribed fees.

### **Doctrine of indoor management/rule of Turquand case**

- It is an exception to the rule of constructive notice.
- It states that an outsider dealing with a company is entitled to assume that everything has regularly been done so far as its internal procedures are concerned.
- It was the rule in the case of **royal British bank vs. Turquand**.

### **Exception to rule of Turquand case**

1. **Knowledge of the irregularity:** A person dealing with a company and is aware of its internal procedures and happens to note an irregularity cannot plead the rule of Turquand.
2. **If the person is an insider** i.e. a director
3. **Negligence:** a person cannot benefit from the rule of Turquand in circumstances under which he would have discovered an irregularity and he made proper enquiries.
4. The company's articles prescribes a special resolution in approving a certain transaction but the resolution had not been passed.

5. The transaction relates to an issue of a forged document i.e. forged share certificate

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