

COMPANY LAW

MEMBERSHIP OF COMPANY – 3

- A member is any person whose name appears in the register of members.
- A shareholder is any person who has or claims some proprietorship or ownership rights in the company share.
- It is therefore possible for a person to be a member without being a shareholder or a shareholder without being a member.

➤ **Membership without shareholding**

Check; December 2009 QN 3D

- *A person shall be a member yet not a shareholder in the following cases.*

i) **In case, a company is limited by guarantee or unlimited companies.**

They have members and not shareholders because they do not have share capital.

ii) **In case of a deceased member**

A deceased member whose name is in the register of member continues to be a member yet he is not a shareholder because death deprives the capacity to own property.

iii) **Bankrupt member**

A bankrupt member is a member as long as his name is in the register of members yet he is not a shareholder.

iv) **Transfer of all shares**

Remains a member as long as his name is in the register yet he is not a shareholder, because the shares belongs to transferee who is yet to be registered.

v) **Subscriber to the MOA**

A subscriber to the MOA is a member because the moment the company is registered his name shall be entered in the register of members.

vi) **In case the company goes into liquidation**

He shall be a contributing (he will contribute to the debt of the company)

Shareholding without membership

1. **A transferee of shares**

- A person to whom shares are transferred but before his transfer is registered and his name entered in the register of members is not a member but a shareholder.

2. The bearer of share warrant

- A public company limited by shares may if authorized by its AOA issue share warrants in respect of fully paid shares.
- Upon the issue of share warrant, the company removes the name of the member from the register of members and indicates the fact that the share warrant has been issued.
- The bearer of a share warrant is a shareholder yet not a member.
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WAYS OF BECOMING A MEMBER OF A COMPANY

a) Subscribing to the memorandum

- Subscriber to the companies MOA shall be deemed to have agreed to become members of the company and registration of the MOA shall have their names entered in the register of members.
- Failure to enter the name in the register by mistake does not affect pre-existing membership.
- A subscriber to MOA cannot rescind (withdraw) the contract to take shares on the ground of misrepresentation made by the promoter because:
 - i) By his own act, he brought the company into existence.
 - ii) The company could not appoint an agent before it came into existence and it is therefore not liable from the promoter's acts (pre-incorporation contracts).
 - iii) By signing the MOA, he became bound on registration of the company.
- A person whose subscribes to MOA for a certain number of shares is bound to take that number of shares and pay for them.

b) By agreement and registration

i) Application and allotment

- An application for shares is an offer to take shares.
- Allotment is acceptance of that offer by the company, which creates binding contracts between the applicant and its company.
- A person who is allotted shares becomes a member.
- Membership commences from the moment the name is entered in the register.

ii) Transfer

- Transfer is a purchase of shares from company's shareholder and not from the company itself.

- A transfer of share is effected by lodging with the company an instrument of transfer signed by both transferor (seller) and transferee (buyer) along with the share certificate.
- A transferee agrees to become a member from the moment his name is entered in the register of members.

iii) Transmission on death of a member

- Transmission is a legal process by which ownership of shares in the company automatically changes on death of a member to his personal representative.
- The personal representative may decide to be registered as a member, thereby agreeing to become a member.
- His name is entered in the register of members.

iv) Transmission on bankruptcy of a member

- A bankrupt member shares in a company will be transmitted to his trustee in bankruptcy. The company articles may give trustee an option of being personally registered as a member.

v) Estoppel

- A person who without having agreed to be a company member is aware that his name is wrongly entered in the register of member but takes no steps to have the name removed there or who allows his name to remain in the register of members will be stopped from denying that he is a member to someone who relied on it and extended credit to the company.

Cessation of membership

Check; September 2015 QN 3A, May 2017 1 A

Ways in which a person membership might cease to be a member of a company

- A member ceases to be a member of a company if his name is struck off the register of members for any sufficient reason/cause.
- A person whose name is removed without any law justification from the register of members retains of the rights and liabilities in respect of the shares and remains a member; such a person may apply to the court for rectification of register through sec 118 of companies act.

A person may cease to be a member of a company by:

- Operation of law
- An act of the parties

1. Operation of law

a) Death

- When a person dies his membership of a company will come to an automatic end under law of succession. The shares will be transmitted to his personal representative.

b) Bankruptcy

- When a person becomes bankrupt, his membership of a company will end, his membership will be transmitted to his trustee in bankruptcy.
- A bankrupt shareholder will remain a member of the company until the name of trustee is entered in the register.

c) Liquidation/winding up

- A company liquidation or winding up terminates all former members from the moment it becomes effective.

2. An act of the parties

a) Forfeiture of all shares

- Shares are forfeited or cancelled for non-repayment of the calls.
- Where the company's articles authorise directors to forfeit a members shares, and the shares are cancelled, a member will cease to be a member.

b) Transfer of all shares

- The transferor of all shares cease to be a member of the company when the transferees name is entered in the register of members.

c) Valid surrender of all shares

- When shareholder validly surrenders (gives up) his shares to company and its accepted by BOD. The person cease to be a member.

d) Sale by company in exercise of lien

- Lien is a right of a company to retain shares of a member as a security. The company may sell such shares thereby the member ceases to be a member.

e) Rescission of a contract

- If a shareholder rescinds (withdraws) a contract of purchases, transfer or allotment of shares because of misrepresentation within reasonable time, the person ceases to be a member of a company.

f) Redemption of redeemable preference shares

- A shareholder whose redeemable shares bought back by a company ceases to be a member.

g) Repudiation by infant

- If an infant avoids the contract of membership during infancy or within reasonable time after attaining the age of majority, he ceases to be a member of the company.

➤ **Disclaimer by trustee in bankruptcy**

- If the trustee in bankruptcy disclaims the shares of a bankrupt shareholder, he ceases to be a member of the company.

THE FOLLOWING CATEGORIES OF PERSONS MAY BECOME MEMBERS OF A COMPANY/CAPACITY TO BECOME A MEMBER

1. A corporation

Check; December 2011 QN 7 C

- A corporation can become a member of another company if it is authorised by articles.
- A company cannot be a member of itself i.e. a company cannot purchase its own shares because it involves a reduction of capital.
- A subsidiary company cannot hold shares in its holding company except where the subsidiary is acting as a trustee or personal representative.

2. Personal representative

- On death of a member, his personal representative is entitled to be registered as a member unless the articles provides otherwise.

3. Trustees in bankruptcy

- When a person is declared bankrupt, his membership passes to his trustee who may be registered as a member.

Bankrupt

A bankrupt may become a member either as a subscriber to MOA, allottee or transferee until his name is removed from the register of members.

Foreigner

- A foreigner friend can be a member of a company, however foreigner enemy of the state cannot be a member

4. Minor

- Is a person who has not attained the age of 18 years
- A minor has common law right to enter into a contract to buy shares in a company and thereby becoming a member of the company.
- The contract is voidable i.e. it is optional and the minor may avoid the contract during his infancy or within reasonable time after attaining the age of 18 years.

- A minor who may repudiate the contract is entitled to get back the money

RIGHTS OF MEMBERS

Check; May 2014 QN 3C

Membership rights may be classified as follows:

1. Corporate membership rights
2. Corporate rights
3. Individual membership right
4. Derivative action

Corporate membership right

- These are rights conferred by law on members as a group
- If these rights are violated, no single member has a personal action, however a representative action is available as a remedy
- These rights are covered by majority rule which is the case in the rule of Foss vs Harbottle.
- **These rights include:**
 1. Right to object to proposed alteration of the companies object.
 2. Right to apply to the court for cancelation of a proposed variation of the right attached to a particular class of shares
 3. Right to apply for a court order in case of oppression of the minority.
 4. Right to apply to court for winding up of the company.
 5. Right to inspect without fee the register of debentures holders of the company.
 6. Right to inspect without fee copies of the instrument creating charges and the company register of charges.
 7. Right to require the directors to convene an extra ordinary general meeting of the company.
 8. Right to convene an extra ordinary general meeting if the director fails to do so.

Individual Membership Rights

These are rights centred on MOA and AOA which are:

- Right to receive dividend.
- Right to attend the company meeting and vote.
- Capital rights – Right to receive a return of capital on winding up of the company.

Corporate rights

- Rights centred upon the company by law and exercisable by the company as a legal person.
- If violated, the company is prima facie the proper plaintiff for seeking redress i.e. it is the company to sue and not shareholders.

LIABILITY OF MEMBERS

Check; June 2011 QN 5 A, May 2016 QN 4 A

- It is defined in articles: for ltd company, liability is either ltd by shares or guarantee.
- For unlimited companies their personal properties can be sold to pay for the debts of the company (similar to partnership)

THE REGISTER OF MEMBERS

- Sec 93(I) requires every company to keep a register of its members and prescribe the contents of the register.

Contents of the register of members Check; (June 2011 Q 4b)

1. Name and address of members.
2. A statement of shares held by each member, distinguished by its numbers if it has one.
3. The amount paid or agreed to be paid as stated on the shares of each member.
4. The date at which each person was entered in the register as a member.
5. Date of cessation if the member has ceased to be a member.

N/B: Failure to keep a register of members, renders the company and every officer of the company who is in default to a default fine of sh50, 000.

Location of the register of members

1. The law requires the register of members to be kept at the registered office of the company. It may be kept in another place provided:
 - a) It is made up at another office of the company or at some other office of lawyers.
 - b) If the company arranges with some other person for making up the register.
 - c) That other office provided the office is not a place outside Kenya.
 - d) The registrar must be informed where the register is kept other than the registered office.
- Any other change, the registrar must be informed within 14 days.

- Failure to comply with the following provision, the company and every officer of the company in default is liable to a default fine not exceeding sh500, 000.

Index of members *Check; June 2013 QN 3A*

- In respect of public company, which have more than 50 members, the company, must maintain an index of the register of **members, which must contain similar details to those contained in the register of members.**
- The index must be altered within 14days if there is any transaction in respect of the shares.
- It must contain sufficient indication to enable the account of each member to be easily found.
- The index should be kept where the register is kept.

Inspection of register

- Company's register of members and debenture holders are public documents and open to public inspection
- The law provides that the register and index of members shall during business hours be open to inspection of any member, without charge any other person on payment of fees prescribed by a regulation.
- Any person may require a copy of the register or any part thereof on payment of a prescribed fee.
- In case a member requires a copy, it must be supplied within 14days of receipt of such demand.
- If a company officer refuses an inspection or fails to provide a copy, the company and every officer of the company in default shall be liable to a fine not exceeding sh 75,000.

In such case, the court may:

- Compel an immediate inspection of register and index.
- Direct that the copies required shall be sent to the person requiring them.

Rectification of the register

- The law empowers the high court to rectify the register of members in two cases namely:
 1. Where the name of any person is without sufficient cause or reason entered in or omitted from the company's register of members.

2. Where default is made or unnecessary delay takes place in entering on the register.

The application to the court to rectify the register may be made by:

- The aggrieved person
- Any member
- The company

Where the application is made, the court may:

- Refuse the application
- Order rectification of the register and payment by the company at any damage sustained by any aggrieved person.

No notice of trusts on register

- Section 119 states that no notice of any trust expresses or implied or constructive shall be entered on the register.
- Thus the company is entitled to treat anyone in the register of members as beneficial owner of the shares and is not liable for any sale of shares in breach of contract

Example

X, a shareholder dies appointing K as the executor shares to G a minor 'K' will hold the shares for G until he attains maturity. K is a trustee and G is the beneficiary. K's name is entered in the register and the dividend is paid by the company, he votes and attends in meeting. K is under an obligation to hold the dividend payable to him in trust for G but the company is not obliged to take notice of the relationship between K and G. K will be liable for all calls but G the beneficiary will be entitled to indemnify K for any expenses.

The majority rule (Rule of Foss vs Harbottle)

- The rule states that the **proper plaintiff is the company itself**.
- The principle of the majority rule is the **rule of Foss vs Harbottle** also known as **majority rule** or **proper plaintiff principle**.
- Companies are democratic organisations whose affairs are managed by the directors.
- According to the provisions of the company act, the MOA and AOA of the company grant members voting rights which they exercise in a general meeting.

- The supremacy of the majority is the fundamental principle of the company law.
- The enjoyment of corporate membership rights is covered by the majority rule under which the will of the majority prevails.
- The rationale of the principle of majority rule is that a company is separate legal entity from the members who compose it.
- If any right of a company is violated, it is the company which can bring action.

Principles of Foss vs Harbottle

Check; May 2014 QN six, December 2009 QN 2

1. Proper plaintiff principle

- This principle is to the effect that when a wrong is done to a company, the company is prima facie the proper plaintiff to seek redress

2. Internal management principle

- Court of law will not generally interfere with the internal management of the company.

3. Irregularity principle

- A member of company cannot generally sue to rectify an irregularity or informality, which the company can by its member internally correct.

Doctrine of derivative action *Check; September 2015 QN 3 D(i)*

- Derivative action refers to action instituted by a shareholder in his name on behalf of a company to remedy a wrong done to the company. It is available under the **exception to the rule of Foss vs Harbottle**.

Characteristics/conditions of derivative action

Check; September 2015 QN 3D(ii)

1. **Fraud on minority:** conduct complained of must be some fraud on minority i.e. expropriation of corporate asset as was held in *Cook vs Deeks*.
2. **Control:** must be evident that the wrong doer are in legal or factual control of the company i.e. the majority are in control of the company.
3. **Representative:** A liable action is representative in character in that the plaintiff sues on behalf of the company.
4. **Nominal dependant:** The Company must be named as a nominal dependant in the case to benefit from a court order.

Exception to the rule of Foss vs Harbottle

Check; Nov 2015

Exceptions to the rule of Foss Vs. Harbottle are the same as reasons for derivative action.

- These are circumstances in which the majority rule does not apply.
- A person may bring a representative action on behalf of a company.
- *These exceptions **to the rule of Foss vs Harbottle/reasons for derivative action** are:*
 1. **Ultra vires or illegal acts**
 - Where the company is acting or threatening to work in ultra vires or illegal manner, the majority rule will not apply for this reason, a member may bring a representative action on behalf of a company to prevent or restrain the company from engaging or continuing with the transactions.
 2. **Special or qualified majorities**
 - Majority rule will not apply where the articles of association require a special majority to pass a procedure, in case of inadequate majority, passing a decision, a member may bring a representative action to compel the company to obey its regulations.
 3. **Infringement of violation of membership rights**
 - If a members personal rights are violated, members may sue in a representative capacity i.e. on behalf of all members whose rights have been violated
 4. **Fraud or minority**
 - The majority rule will not apply if the conduct complained of amount to fraud or minority i.e. breach of duty by directors or expropriation of assets
 5. **Oppression of the minority**
 - Any member of a company who complains that its affairs have been conducted in a manner oppressive to some parts of the member including himself may petition the court for winding up.

➤ ***Minority protection rule***

1. *Minority protection at common law/court of law*
2. *Minority protection by statute/company's act*

1. Minority protection at common law/court of law

- Court of law protect minority interest against majority in certain circumstances:
- a) Majority decisions made in back faith maybe challenged before a court of law.
- b) Majority decision made in contravention of the articles or regulations of the company may be challenged before a court of law.
- c) Although court of law cannot prevent the majority from voting selfishly, they must always do so in the best interest of the company.

A majority decision may be set aside if its purpose is:

- Facilitate expropriation of corporate asset, as was the case of *Cook vs Deeks*.
- To benefit the majority at the expense of minority as was the case of *Menier vs Hooper*.

2. Minority protection by the statute

a) Variation of class right

- A company whose capital is divided into different classes of shares may vary the rights attached to any class by a special resolution or written consent of not less than 75% of the holder of the shares.
- However, variation may be disallowed by court upon application within 30 days of the consent of the resolution by the holders of not less than 15% of shares who did not vote in favour.

b) Convention of the AGM in case of default

- If a company fails to hold an AGM in accordance with the act, any member of the company may petition the registrar to convene or direct the convention of an AGM.
- Such an AGM is duly constituted by one member present in person or by proxy.

c) Convention of a general meeting pursuant to a court order

- In case of default in holding general meeting in accordance to articles and law, court may order its convention upon the application by the director or a member entitled to attend and vote.
- One member present in person or proxy duly constitutes such a meeting.

d) Requisitioning of an extra ordinary general meeting

- It may be convened at the option of the minority members.
- If the director do not convene the meeting within 21 days of requisition, the requisitionists may convene the meeting.

e) Investigation of the company's affairs by the inspector

- The high court may appoint one or more competent inspector to investigate the affairs of a company upon application by members.

The application may be made by:

1. Not less than 200 members.
2. Holders not less than 1/10 of issued shares
3. Not less than 1/5 of number of members in the register.

f) Take-over bid

- If a scheme involving the transfer of shares in a company is proposed and - within 4 months of the offer, holders of not less than 90% of the share have accepted the offer, the offeror is required within two months to notify the dissenting shareholders of its intention to acquire their shares compulsorily.
- However, the dissenting shareholders may petition the court within one month for cancellation of the offer. The court may appropriately cancel the offer in protecting the minority.

g) Winding up under just and equitable ground

- A company may be wound up by court if it is of the opinion that it is just and equitable that the company should be wound up.
- In such a case, minority may petition the court to wind up the company on the ground of oppression or in case, they have lost confidence in management.

h) Alternative remedy

- This is the remedy entitled to minority on winding up.
- This remedy is available to minority in case of oppression.
- The alternative remedy may take any of the following:
 - A court order to regulate the conduct of the company affairs in the future.
 - An order to compel the oppressor to purchase the shares of the oppressed.