PERSONAL LIABILITY OF DIRECTORS AND THE COLLAPSE OF PRIVATE COMPANIES IN KENYA

SUBMITTED BY: OLIVE NJOKI MUASYA

ADMISSION NO: G62/7095/2017

A Thesis Submitted to the University of Nairobi in Partial Fulfilment of the Requirements for the Award of the Degree of Masters in Laws (LLM)
DECLARATION

I declare that this thesis is my original work and has not been presented before for a degree in this or any other university.

Olive Njoki Muasya

Date:

This thesis has been submitted for examination with my approval as university supervisor.

Constance Gikonyo
Lecturer, University of Nairobi, School of Law
DEDICATION

This thesis is dedicated to my mother and Sister Dr. Juliet Njeri Muasya and Mrs. Caroline Muasya-Mutinda respectively.

You are a source of great inspiration and greatest support system anyone would ask for and I thank the Almighty each day for the support and inspiration that you have accorded me.
ACKNOWLEDGEMENT

I wish to acknowledge the assistance and contribution of those without whom, this thesis would not have materialized. First, I thank the Lord Almighty for blessing me with good health and ability to be able to undertake this study. Secondly, I thank my family for their support and encouragement during the study. Thirdly I acknowledge the contribution of my supervisor, Ms. Constance Gikonyo who always challenged and pushed me to attain higher levels of clarity of thought and presentation. Any shortcomings in this thesis are mine entirely.

Thank you all.
ABSTRACT

The general legal rule is that a corporate or company is considered a “legal person” distinct from its members and this has led directors of companies to act arbitrarily knowing that they have this legal shield. For the purpose of advancing justice, it is only prudent for specific directors who have made decisions that serve their own interests be held culpable for their actions. The research is mainly qualitative with analysis of cases from four specific jurisdictions i.e. United States, United Kingdom, South Africa and Kenya.

Ultimately, the aim of the research is to get answers to three pertinent questions: What reasons are given by the courts in holding directors personally liable for misconduct? What reasons are given by courts in reaching the decision not to hold directors personally liable for misconduct? What best practices can Kenya borrow from the United Kingdom and South Africa? The answers to these questions form part of chapter five.

CA 2006 provides various remedies to an aggrieved stakeholder which are: recovery of company’s property misappropriated by a director, reconciliation of the company’s books to enable the director to give a satisfactory explanation of the company’s profits and application for an injunction to prohibit a director from furthering actions that aggrieve the stakeholder. CA 2008 contains clear provisions on the liability of directors, which helps seal the gap in the legal issue of personal liability.

Another major finding of the research is that the main shortcoming in Kenya is that having borrowed heavily from CA 2006, failed to make improvements while developing CA 2015. Kenya would have benefitted from borrowing or referencing CA 2008 when CA 2015 was
being drafted concerning the personal liability of directors due to the fact CA 2008 has express provisions on this.

In conclusion, the research found that there is a need to have express provisions of holding directors personally liable in the companies act. This way directors are aware of their responsibilities and consequences in case of breach of any of their duties.
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<tr>
<td>AGM</td>
<td>Annual General Meeting</td>
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CHAPTER ONE

BACKGROUND TO THE STUDY

1.1. Introduction

To advance the interests of a company, directors must promote the success of a company ensuring that the company’s best interest takes precedent rather than their own. CA 2015 has defined a director to include *inter alia* an individual taking up the role of a director and one who gives directions or instructions which directions or instructions are not being given in a professional capacity. CA 2015 introduced one man companies in that a company should have at least one director2 “one natural person as a director”3 and the minimum age for the director has been prescribed as eighteen years. Initial directors are appointed by members and subsequent directors are appointment via a notification of appointment as prescribed in CA 2015.

The following are the duties of directors as provided in CA 2015: “act within powers”5, “promote the success of the company”6, “exercise independent judgment”7, “exercise reasonable care, skill and diligence”8, “avoid conflict of interest”9 and “not accept benefits from third parties”.10

In an effort to enhance corporate governance levels in companies, the Companies (Amendment) Act of 2017 came into effect on 16th August 2017. The amendment act made

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1 Section 3.
2 Section 128.
3 Section 129.
4 Section 131.
5 Section 142.
6 Section 143.
7 Section 144.
8 Section 145.
9 Section 146.
10 Section 147.
some changes to CA 2015 by enhancing the directors’ duties, liabilities and protecting shareholders. Some notable changes are: definition of a member of a director’s family for purposes of declaring conflicts of interest.\textsuperscript{11} The definition of family was broadened to encompass: a director’s sibling, siblings of the spouse of the director and a director’s grandchild. The effect is that directors are required to disclose the above mentioned persons’ interests in any dealings with the company. Further, the amendment act changed section 135\textsuperscript{12} of the companies act to include disclosure of information on directorships held by a director in another company if any. This is to ensure that companies are fully aware of any potential conflict of interest that may arise out of such directorships.

Despite the above legal provisions, the research using case law will bring forth scenarios in which directors act arbitrarily and advance their own agenda at the expense of the company and its stakeholders. This research will look into the duties of directors as prescribed by law and the situations where courts have found directors guilty of misconduct emanating from decisions made that have led to the collapse or near collapse of private companies.

It is not in doubt that the failure of directors to act diligently has led to the demise of the world’s biggest companies. One of the earliest cases is the case of the South Sea Company. This company was incorporated with the main aim of consolidating and reducing the cost of the country’s debt. The company experienced tremendous success which led to price of its

\textsuperscript{11} The Companies Act at section 123 listed family members of a director as the director's spouse, a child or step-child of the director, a child or step-child of the director's spouse who lives with the director and has not reached eighteen years of age or a parent of the director.

\textsuperscript{12} Particulars of directors to be registered: natural persons.
shares up over 30%. In 1720, the bubble burst and investor confidence began to wane due to deceit, corruption and bribery and eventually the collapse of the company.\textsuperscript{13}

The demise of Enron in the United States shed a light of the impact that directors have on a company and the consequences of non-adherence with regulatory requirements and bad decision-making. Enron was a Houston based energy company founded in 1985. The causes of Enron’s bankruptcy are attributed to various factors which can be summarized as lack of truthfulness by management, conflict of interest, lack of independent oversight of management by the board and accounting misjudgments.\textsuperscript{14}

1.2. Relevance of the research in the Kenyan context

Kenya has not been spared from corporate demises, in the 1980’s Kenya’s economic sector faced some challenges where some financial institutions and government agencies collapsed.\textsuperscript{15} Following the collapse of big corporations, corporate governance became a major policy priority.\textsuperscript{16} In addition to government agencies, private companies that were once thriving have been shut down leading to thousands of Kenyans losing their jobs and employees, suppliers, shareholders and other stakeholders of these companies are left to their own devices. The following reasons could have contributed to this dire situation; liquidity problems, inadequate financing and failure to anticipate or react to competition, technology or market place changes.\textsuperscript{17} For example, the directors of Chase Bank Limited (in receivership) irregularly advanced KShs.16.6Bn to entities many of them associated with

\textsuperscript{16} Ibid n.17.
\textsuperscript{17} Nakumatt Holdings Limited, Chase Bank Limited, Imperial Bank Limited and Dubai Bank.
insiders, without proper security putting its depositors at risk. This research will show that the main reason for the collapse of most companies can be attributed to the role-played by directors in their decision-making. These directors have always found a shield in the legal doctrine of separateness of the company. Hence, this research will show that despite the old legal adage of doctrine of separateness, it is possible for a director to be found culpable of wrong doing in their own individual capacity meaning that they do not have the shield of separateness.

1.3. Statement of the problem

As stated in the abstract section of this research, a company in law is considered a “legal person”. This legal concept was cemented in *Salomon-vs-Salomon Co. Ltd*\(^\text{18}\) where the court held *inter alia* that in law a company is a different person distinct and separate from its shareholders. This decision forms the foundation upon which law on a company being a legal person is based. As stated in the abstract, it is only judicious for the specific directors who have made decisions that serve their own interests be held personally liable. The crux of this research is to look into circumstances where the courts have held directors personally liable for their misconduct and the reasons given for reaching such decisions. Courts have been known to decide on cases of misconduct of directors by taking a fact based approach hence there is no universal formula. The research analyses case law to find out the specific actions which the courts have considered as misconduct that qualify as personal liability.

1.4. Justification of the study

Directors take shield in the corporate veil as it is not always easy to establish if a director acted in a personal capacity which has led to the murky legal problem the research will

\(^{18}\) [1897] AC 22.
explore. Liabilities for breach of director duties are well prescribed in law at section 148\textsuperscript{19} of the CA 2015 and section 282\textsuperscript{20} of the Penal Code\textsuperscript{21} however aggrieved stakeholders are not able to get justice due to the complex nature of bringing claims that are meant to hold directors personally liable for misconduct.

This research illuminates the legal and regulatory expectations of an individual once they are appointed a director. Being a director was once associated with plum payments and other benefits, however, with CA 2015 and the 2017 amendment act, there is a lot of scrutiny into the role played by directors in decision making. Further, directors of companies will be made aware of the fact that in case of wrongdoing, the courts may hold them personally liable and that they cannot always hide behind the corporate veil. Shareholders and other relevant stakeholders stand to benefit by being aware of the legal recourse available to them in case of misconduct by directors and what it takes to achieve a successful claim.

1.5. Objectives of the research

The research was guided by the below objectives:

1. To explore courts’ decisions where the court has held directors personally liable for misconduct.
2. To examine the reasons given by courts in reaching the decision not to hold directors personally liable for misconduct.
3. To examine the statutory lessons that Kenya can draw from the UK and South Africa on director duties and holding them personally liable for misconduct.

\textsuperscript{19} The consequences of breach (or threatened breach) of the general duties of directors set out in this Division are the same as would apply if the corresponding common law rule or equitable principle applied.

\textsuperscript{20} If the offender is a director or officer of a corporation or company, and the thing stolen is the property of the corporation or company, he is liable to imprisonment for seven years.

\textsuperscript{21} Cap 63 Laws of Kenya.
1.6. Research questions

The study was guided by the following research questions:

1. What reasons are given by the courts in holding directors personally liable for misconduct?

2. What reasons are given by courts in reaching the decision not to hold directors personally liable for misconduct?

3. What best practices can Kenya borrow from UK and South Africa on personal liability of director?

1.7. Hypotheses

The study proceeds from the following hypothesis:

1. In making decisions the directors are guided by a company’s constitution (MemArts), general legal and equitable principles whether codified or not.

2. The legal and regulatory framework of duties of directors is clear but there is need for the courts to be more open-minded and hold directors personally liable for misconduct to achieve justice.

1.8. Theoretical framework

The study relied on the stakeholders and consider-creditors theories.

Stakeholder theory developed from Robert Edward Freeman’s work\(^2^2\) who argued that a company must at all times consider how its operations would affect its stakeholders; he stated that this consideration was the moral thing to do. He further defined stakeholders as “any

group or individual who can affect or is affected by the achievement of the organization’s objectives.”

The Stakeholder theory is anchored on three precepts. The first is concerned with the relationship between management and stakeholders, second is stakeholders interests and the third precept prescribes what managers ought to do. The main consideration of the stakeholder theory is that directors must make decisions that take into account the company’s stakeholders. Stakeholders can be defined to be any persons impacted by the decisions of a company; these include “employees”, “creditors”, “customers” and the general public. Under this theory, directors are given the legal duty to maintain a balance between the interests of the varying constituent groups that can be impacted by the corporation’s actions therefore, directors should ensure that their actions reflect the development of law and social values.

Consider-Creditors theory has its roots from case law and specifically to the decision by Mason J in Walker-vs-Wimborne who stated in summary that the failure by directors of a company to put the interest of its stakeholders and its creditors before their own would lead to adverse consequences for the company. This theory was further highlighted in the case of Nicholson-vs-Permakraft (NZ) Limited where the court held that directors owe their duties to the company.

From the discussions of the two theories above, the most preferred theory is the Stakeholder theory as it shows that the actions taken and decisions made by the directors not only affect

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26 ibid
the company but the stakeholders as well. Further, the Stakeholder theory supports the research topic since it emphasizes the fact that directors of companies in discharging their duties and making decisions should always prioritize first the company and secondly all its stakeholders. It can further be noted that the Stakeholder theory discourages directors from putting their interests first.

1.9. Research methodology

The research was mainly desktop where library materials were used as the main source of information and data. Some of the primary sources used include statute and case law. Relevant additional literature includes textbooks, journals, articles, reports by various regulatory authorities and the internet which provided a large knowledge base.

The research is mainly qualitative with main analysis of cases from four specific jurisdictions i.e. United States, United Kingdom, South Africa and Kenya. The research will concentrate on the analysis of case law and statute regarding the personal liability of directors. The approach the research will take is to first look at the duties of directors as prescribed in statute in each of the four jurisdictions thereafter, the research will delve into issues of personal liability.

1.10. Literature review

This section will be divided into the following thematic areas: evolving nature of the definition of a director and their duties, the corporate principle of a company being a legal person, shortcomings of the regulatory framework and form of mismanagement by directors and the section will conclude by identifying the gap in the literature.
In the early years, the role of directors was symbolic as they were considered “gratuitous mandatories”. Over the years, however, the role of directors has evolved and directors are mandated to put the interests of the company first and act in the company’s best interests. All jurisdictions aspire to encourage directors to comply with the laws and regulations.

Iqbal Tauseef states that English case law placed director as trustee of the company and shareholder by imposing both important duties of diligence and loyalty. In *Charitable Corporations-vs-Sutton* Lord Hardwicke did not absolve directors who were indirectly involved and had merely endorsed such misappropriation. In some occasions and to hold directors liable for misconduct, the courts apply the doctrine of “piercing the corporate veil” to advance justice, in such a case the court will treat the company for purposes of the suit as identical with the controllers of the company. The court goes behind the status of the company being a separate legal entity and will consider who the directing and controlling persons of the company are.

English law categorizes directors into three: “de jure” these are directors who have legally appointed into a company, “de facto” who act as directors despite not being legally appointed and “shadow directors”, who have indirect control in the company and are known to issue

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32 [1742] 26 ER 642


instructions to “de jure” directors.\textsuperscript{35} This shows that there are various categories of directors all of whom are mandated to put the company’s interest at the forefront. Prior to CA 2015, Kenya did not recognize shadow directors, however with the enactment of CA 2015 shadow directors are now recognized in law. CA 2015 recognizes shadow directors by how it defines a director, it provides that “a shadow director is any person in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of the body are accustomed to act”.

The unyielding rock of corporate law is laid in \textit{Solomon-vs-Solomon Co. Ltd}\textsuperscript{36} this unyielding rock protects shareholders’ private assets.\textsuperscript{37} Due to this legal limitation of the corporate form, Carroll Brewster Rhoads\textsuperscript{38} states that the stretch of imposing personal liability on a director is important to the prospective director\textsuperscript{39}, courts\textsuperscript{40} and the investing public.\textsuperscript{41} Courts have continually expanded their jurisdiction of the use of corporate form but abuse remains prevalent and a rigid application of the principle in \textit{Solomon-vs-Solomon Co. Ltd}\textsuperscript{42} may cause damage to the rights of parties since its controllers may be using the company as a façade to perpetuate wrongdoing.\textsuperscript{43}

\textsuperscript{36}(1896) UKHL 1.
\textsuperscript{37} AlekaMandaraka-Sheppard, ‘New trends in piercing the corporate veil – the conservative versus the liberal approaches’ (2014) Business Law Review, Issue 1, 2-14.
\textsuperscript{39} The prospective director is eager to ascertain the possible liabilities to which he may be subjected.
\textsuperscript{40} The courts seek to administer a standard of responsibility calculated to harmonize the individual interests of the directors with the public trust which they have assumed while the investing public.
\textsuperscript{41} The prospective stockholder should be assured that those on whose names he relies for the security of his investment will, in fact, supervise the internal management of the corporation.
\textsuperscript{42} [1896] UKHL 1.
\textsuperscript{43} Aleka Mandaraka-Sheppard, ‘New trends in piercing the corporate veil – the conservative versus the liberal approaches’ (2014) Business Law Review, Issue 1, 2-14.
Kiarie Mwaura points at various shortcomings in the regulatory framework in terms of directors duties in Kenya. Firstly, Mwaura observes the courts assess directors’ liability subjectively as there is no requirement for directors to have expertise in the management of companies and this may have the effect of undermining good corporate governance. Secondly, enforcement of directors’ duties is complex as a company is the one with the legal authority to bring legal action against a miscreant director. Since 2002 when the article by Kiarie Mwaura was published, there has been some significant progress in the law in terms of duties of directors. The duties are now clearly spelled out in the CA 2015. The codification of these duties goes a long way in ensuring that the duties of directors are well defined within the law and if there is breach penalties are prescribed within the law. Michelle M. Harner states that codifying directors’ duties helps foster better director oversight with the primary objective being to improve directors’ performance.

Despite codification and directors being considered as ‘drivers’ of companies, there have been situations where directors have acted contrary to the company’s constitution and the law by abusing their authority. Hans Tjio suggests that the abuse relates to the company being used as unlawful wealth protection as opposed to one carrying on the business of producing goods and services.

The disloyalty of directors manifests itself in managerial misconduct which takes the form of misappropriation of company assets. To enforce a director’s duty of loyalty, criminal sanctions exist to provide the necessary standard of deterrence under which directors can be

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expected to refrain from misappropriation of company assets.\textsuperscript{47} For the longest time, courts have been able to convict miscreant directors’ notwithstanding the fact that companies are limited liability entities. Directors become liable for engaging the company in fraudulent transactions to their benefit or at that of the shareholders.\textsuperscript{48}

In conclusion, it is very clear that the definition of directors and their duties have been discussed at length, however, the authors have not gone into the details of what constitutes personal liability and consequences of breach of directors’ duties. The discussion in the literature review shows that directors in their role as the decision makers of companies, have a huge responsibility to ensure that they perform their duties within the confines of the law. In addition, directors should be aware that in case of misconduct then the courts can hold them personally liable which is the gap identified in this section. The issue of personal liability seems to be left to statute and in the absence of which the courts will be required to make decisions, this gap is the foundation of this research.

1.11. Chapter outline

The research is broken down into five chapters as follows:

**Chapter One: Background to the Study**

This chapter introduces the research by providing a brief background on legal doctrine of separateness. The chapter also details the statement of the problem, objectives, research questions, hypothesis and justification of the research are laid out. In addition, theoretical framework in which the research is based on is discussed.


Chapter Two: Kenyan companies affected by breach of director’s duties

This chapter presents a detailed insight of some of the companies in Kenya where directors’ duties have led to the collapse or near collapse of the companies. In addition, various articles in reference to CMC Holdings Limited, National Bank of Kenya, Chase Bank Limited (in receivership), Dubai Bank Limited (in liquidation) and Imperial Bank Limited (in receivership) all of which are regulated by CMA and CBK are analyzed with the aim of finding out what action was taken against the directors of these companies.

Chapter Three: Analysis of case law on misconduct of directors

Analysis of specific case laws from the United States, United Kingdom, South Africa and Kenya where directors have dealt with claims of personal liability of breach of director duties is presented in this chapter.

Chapter Four: Jurisdictional analysis of the Companies Acts of the UK and South Africa

This chapter presents analyses of companies’ acts of the UK and South Africa and how the courts in these jurisdictions have dealt with misconduct of directors. Specific reference of two jurisdictions cases are analyzed due to their similarity with CA 2015 to see how best practices can be adopted from these jurisdictions.

Chapter Five: Conclusion and recommendations

Based on the overall research findings, this chapter provides a brief recap of the research and conclusions and recommendations for good practice are presented.
CHAPTER TWO
KENYAN COMPANIES AFFECTED BY BREACH OF DIRECTOR DUTIES

2.1. Introduction

The inept of the legal system coupled with corruption and interference from the political class prosecution and investigations into the operations of companies used as instruments of fraud have not borne much fruit.\(^1\) Another major issue that has led to non-prosecution of directors is the fact that CA 2015 does not have express provisions that require directors to have exceptional experience in controlling a company \(^2\) illuminating risks that companies face due to mismanagement. Directors are the heart of the company therefore there needs to be a competent and qualified board of directors in place who have the required skills and expertise in the absence of which the objectives of the company will not be achieved.

Directors are permitted by law to take into consideration the interest of its stakeholders in so far as they have a bearing on the company's interests.\(^3\) In case there is negligence by a director while performing his duties the director may be held personally liable and any damages incurred due to the negligent acts can be regained by the company.\(^4\) There have been several private companies\(^5\) and financial institutions \(^6\) that have collapsed due to misconduct of directors. Some of the companies that were on the verge of collapse have been able to survive through some intervention for example change in management, government

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\(^5\) Nakumatt Holdings Limited, Karuturi Flowers Limited, Akamba Bus Services Limited.

\(^6\) Dubai Bank Kenya Limited, Chase Bank (Kenya) Limited and Imperial Bank Kenya Limited.
intervention, change in directors of the company’s objectives and capital injection into the business.

This chapter presents a detailed insight into some of the companies in Kenya where directors’ duties have led to the collapse or near collapse of the companies. One of the companies looked at is Cooper Motor Corporation (CMC) Holdings Limited due to the attention it drew and the light it shone on the domino effect that the decisions made by directors have on the company at first and later on the stakeholders. The other companies are financial institutions, Chase Bank Limited (in receivership), Imperial Bank Limited (in receivership), Dubai Bank Limited (under liquidation) which have brought forth the rot in the financial sector with cases of mismanagement caused by decisions made by the directors and senior management. In addition, National Bank of Kenya Limited which has been able to stay afloat despite incidences of mismanagement by top officials of the bank will also be part of sampled financial institutions.

The reason for looking into the above referenced institutions is due to the fact that they are highly regulated institutions which beg the question of why there was no proper oversight on the decisions being made by the directors. Further, the discussion will clearly show that despite the institutions being regulated they are still prone to mismanagement by the directors. Further, this research as discussed in chapter one aims to look into circumstances where the courts have held directors personally liable for their misconduct and the reasons given for reaching such decisions. By discussing specific companies in this chapter, the findings show that various actions have been taken against the directors, these include enforcement actions by the relevant regulatory authority and legal proceedings.
2.2. Cooper Motor Corporation (CMC) Holdings Limited

Despite CMC’s success and persuasive influence in the motor industry, the company was faced with one of the biggest corporate governance scandal caused by mis-governance. The investigative reports by Webber Wentzel South Africa and PricewaterhouseCoopers (PwC), which can be obtained on request from the Capital Markets Authority (CMA) noted several inadequacies and failures and the directors were involved in massive misconduct. Peter Muthoka who was the former CMC chairman was accused of having breached the CMA Regulations on Take-over and Mergers of 2002.

The breach was in the fact that the chairman held in excess of 25% of shares of a company listed at the securities exchange. Webber Wentzel South Africa and PricewaterhouseCoopers (PwC) pointed out the following malpractices: the directors allowed borrowing from financial institutions which would then enable them to extend credit to its customers which were not a viable business model, directors would approve credit extension beyond the limit set by the company’s board, directors would overcharge the company’s vehicle imports and remit the surplus to offshore accounts, they would sign sham financial statements and they established a subsidiary company in South Sudan where funds from the fraud were channeled to.

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8 “acquiring effective control” means the acquisition of shares in the offeree which together with shares if any, already held by the offeror or by any other person that is deemed to be associated or a company or by any other company that is deemed by virtue of being a related company to the offeror or by persons acting in concert with the offeror carry the right to exercise or control the exercise of not less than twenty-five percent of the votes attached to the ordinary shares of the offeree provided that such person already holding twenty five percent or more but less than fifty percent of the voting shares may acquire no more than five percent of the shares of a listed company in any one year.

9 Martin Henry Forster-vs-Capital Markets Authority, Petition No. 229 of 2015 (29 November 2017); [2017] eKLR.
In an effort to hold the directors accountable for their actions, CMA took enforcement action against Jeremiah Kireini who was a director at CMC. The director, in turn, sued the CMA\textsuperscript{10} challenging the regulator’s enforcement action. The director complained that the enforcement action and the investigative process were an infringement of his constitutional rights and freedoms which the court acknowledged. CMA filed an appeal\textsuperscript{11} which was dismissed, the appellate court stated that article 47 of the Constitution was breached since the director was not given the opportunity to be heard before sanctions and other penalties were imposed on him.

Further, the CMA also imposed lifetime disqualifications two other directors Peter Muthoka and Joseph Kivai from holding directorships in CMC and imposed a lifetime ban disqualifying Mr. Muthoka from holding directorship position in a public listed company in Kenya. However, in July 2016, the CMA’s board having received petitions for the review of the enforcement action taken against Peter Muthoka and Joseph Kivai, resolved to review the lifetime disqualification for Mr. Muthoka to five years, effective 3 August 3 2012 to 3 August 2017.\textsuperscript{12}

In a recent decision in the case of Martin Henry Forster-vs-Capital Markets Authority,\textsuperscript{13} the court upheld the decision made against Martin Henry Forster Chief Executive Officer of CMC Holdings Limited by stating that from evaluation of the facts of the case, evidence and the law and considering precedent, he had acted within the confines of the law in appointing the forensic investigator Webber Wentzel and the court held that the report prepared by

\textsuperscript{10}Jeremiah Gitau Kiereini-vs-Capital Markets Authority & another Petition No. 371 of 2012 (22 August 2013); [2013] eKLR
\textsuperscript{11}Capital Markets Authority-vs-Jeremiah Gitau Kiereini & another Civil appeal No. 9 of 2014 (7 December 2014); [2014] eKLR
\textsuperscript{12}CMA Reviews Enforcement Action against former CMC Holdings Directors, https://www.cma.or.ke accessed on 17th June 2018.
\textsuperscript{13}Petition No. 299 of 2015 (29 November 2017) [2017] eKLR
Webber Wentzel was valid and legal. Further, the court stated that the appointment of the ad-hoc committee was done in compliance with the law.

2.3. **Chase Bank (Kenya) Limited (in receivership)**

CBK placed Chase Bank under receivership on 7 April 2016 as a result of the bank’s failure to comply with CBK regulations on banking ratios, under-stating insider loans,\(^\text{14}\) opening of bank accounts that were used to channel billions from the bank and lack of separation of assets that belonged to the bank’s chairman from the ones that belonged to the bank.\(^\text{15}\)

To illustrate the severity of management issues at the bank, the bank advanced large amounts of loans to its directors to the tune of KShs.1.35Bn which were not routine staff credit facilities. In addition, the chairman and the managing director had incorporated several companies namely “Camelia Investments Limited”, “Cleopatra Holdings Limited”, “Golden Azure Limited”, and “Colbrook Holding Limited” used to siphon money.\(^\text{16}\)

A forensic report by Deloitte and Touche revealed that the chairman and one of the directors withdrew money and channeled the money to the above referenced companies and CBK firmly took over assets to the tune of KSh7.9Bn.\(^\text{17}\) Three former directors of the bank were charged in criminal court with the offence of conspiracy to defraud which had led to the bank’s collapse.\(^\text{18}\) CBK moved to court in *Chase Bank Limited-vs-Zafrullah Khan & 19 others*\(^\text{19}\) through the receiver KDIC with a view to recovering the deposits which had been

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\(^\text{15}\) Ibid n.14.
\(^\text{16}\) Ibid n.14.
\(^\text{17}\) Ibid n.14.
\(^\text{19}\) HCCC No. 159 of 2017 (30 January 2018); [2018] eKLR
placed at the bank. The court issued orders freezing bank accounts of the former directors. This suit is still ongoing as the bank directors have been charged afresh and the directors are now being accused of stealing KShs. 483,328,000 from Chase Bank Limited on 31 December 2015.\textsuperscript{20}

2.4. Imperial Bank Limited (in receivership)

CBK put Imperial bank under statutory management in October 2015 due to unsafe and unsound business practices. The facts of what transpired at the bank were clearly outlined in \textit{Imaran Limited & Sothers-vs-Central Bank of Kenya & 4 others}\textsuperscript{21}. In summary, the bank’s chairman informed CBK \textit{vide} a letter dated 12 October 2015 that there had been fraud at the bank to the tune of Kshs.38Bn.

In another case, \textit{Imperial Bank Kenya Limited-vs-Janco Investments Limited & 10 others}\textsuperscript{22} it was averred that shortly after the passing away of the chairman, the bank discovered that he, together with other senior officials of the bank and their associates, were responsible for certain illegal and fraudulent activities that resulted in the loss of an amount in excess of Kshs.35Bn. The revelation prompted CBK to place the bank under receivership and appoint KDIC as the bank's receiver, with a view of managing, controlling and conducting the affairs of the bank, to safeguard, not only the interests of its depositors and creditors, but also the wider Kenyan public. The bank filed this suit\textsuperscript{23} on the contention that it had reasons to believe that the deceased chairman’s estate and the deceased's chairman’s Trust were wholly and/or partially comprised of assets that were acquired using funds that were fraudulently

\textsuperscript{20} Dzuya Walter, ‘Ex-chase Bank Chairman, Directors charged afresh’ <https://citizentv.co.ke/news/> accessed on 26 June 2018
\textsuperscript{21} Miscellaneous Civil Application No. 43 of 2016 (4 November 2016); [2016] eKLR
\textsuperscript{22} Civil Case No. 523 of 2015 (19 January 2018) [2018] eKLR.
\textsuperscript{23} \textit{Imperial Bank Kenya Limited-vs-Janco Investments Limited & 10 others} Civil Case No. 523 of 2015 (19 January 2018) [2018] eKLR.
and/or unlawfully obtained from the bank by the deceased. Thus, the bank is entitled to trace the said assets and liquidate the same with a view of recovering the amounts misappropriated from it. The court having satisfied itself confirmed the freezing order that had previously been issued on all the companies that had been incorporated by the chairman and the managing director.

2.5. Dubai Bank Kenya Limited (under liquidation)

The bank was placed under receivership in August 2015 due to capital deficiencies and liquidity issues as reported by CBK during various press conferences and press releases which can be found at the CBK’s website. Another contributing factor of the bank’s demise was that the bank had failed to service a loan it had borrowed from Bank of Africa to the tune of KShs.48M. On 24 August 2015 KDIC made a recommendation to CBK for the bank to be liquidated as it could not be salvaged.24

Five Dubai bank directors and senior officials were charged with the criminal offence of conspiracy to defraud as a result of failing to pay the loan owed to Bank of Africa to the tune of KShs.48M, when the matter came up in court the directors denied the charges25 the suit is still ongoing. In the meantime, CBK got a reprieve from the court when the Court of Appeal allowed liquidation of the bank.26 In making its decision the court stated that CBK was mandated to decide on the decision to liquidate a financial institution and not the courts.27

24 Ibid n.12
26 Richardson and David Limited-vs-Kenya Deposit Insurance Corporation & another Civil suit No. 482 of 2015 (18 November 2015); [2015] eKLR.

A probe by the CMA listed former National Bank directors as architects of an elaborate scam where the directors coerced money deposit-mobilizing consultancies into subcontracting their duties in a scam that cost the bank KShs.1Bn. The directors were accused of aiding Edge Capital Consultancy and Advest Company Limited to illegally collect KShs.991.5M in commissions under the bank’s deposit mobilization program which the bank was to pay commissions to agents that helped drive up money deposits, the two agents were paid huge commissions.

The scam came to light after the bank’s external auditors Deloitte revealed in a 2016 audit that the lender had “cooked” its books to hide a bad debt of KShs.1Bn. Payments made by the bank did not have the required supporting documents to show the source of the deposits, how much was mobilized and the interest rates that had been disclosed in the invoices. CMA, recommended prosecution of the directors and the senior managers involved in the scam but this has yet to be initiated.

Vide a press release dated 4 April 2018, CMA took administrative action against the bank’s directors and senior management for “cooking” financial statements and theft. In addition, CMA disqualified the former chief executive officer from holding a board position and working in a company listed at the securities exchange for three years and imposed a hefty


29 Advest was paid KShs.561.6M while Edge Consulting received KSh.429.9M.

30 Ibid n.25

penalty of Kshs.5M as a result of mismanagement and lack of oversight to ensure that the board was furnished with the accurate financial statement.\textsuperscript{32}

In addition to the enforcement action against the chief executive officer CMA in a letter to the ARA stated that it had identified assets belonging to Mr. Alubala who is the former head of treasury at National Bank. The CMA sought the ARA’s assistance to trace and recover Mr. Alubala’s movable and immovable assets for purposes of protecting the bank’s shareholders. This recent event is in addition to CMA’s ban on Mr. Alubala from holding office in any public listed company besides paying a KSh104.8M fine.\textsuperscript{33}

It has since come to light that the bank has managed to stay afloat due to Kshs. 14Bn released to Teacher Service Commission per month to support its liquidity.\textsuperscript{34}

\textbf{2.7. Conclusion}

From the discussions of the companies herein it is noteworthy that the charges brought against the directors are criminal charges, mostly fraud. None of the incidents have the company directors been charged with misconduct in how they run the companies and the decisions they made that led to the collapse or near collapse of the companies. The regulatory authorities bringing the legal action against the directors are keen to recover what was lost as is the case of Chase Bank and Dubai Bank than make the directors accountable for their actions.

\textsuperscript{32}https://www.cma.or.ke accessed on 17June 2018.
CMA developed the 2002 guidelines “Capital Market Guidelines on Corporate Governance Practices and Disclosures” with the aim of promoting and strengthening self-regulation standards.\(^{35}\) The enforcement action being referenced in this chapter could be construed to mean holding directors personally liable. The fact that the directors are not able to hold positions in companies listed at the securities exchange for a number of years means that action has been taken against them personally. It is evident that the regulatory authorities are firm in imposing sanctions on miscreant directors.

The challenge then is the companies that are not regulated, which are the majority in the country. What is the recourse available for the affected stakeholders is instituting court proceedings against the directors for disqualification. Although creditors and shareholders can make applications for disqualification, their interests might be compromised when their financial resources are constrained.\(^{36}\) Instituting a legal suit requires that the complaint pays for filing fees, legal fees and also the fact that they have to appear in court each time the matter is listed can be time consuming. The backlog in the judiciary does not help the complainant get justice as fast as they would like to. Due to the inadequacies that have been outlined in this chapter that none of the directors in the companies discussed have been held personally liable for their actions by the courts, chapter three will examine case law where directors have been held personally liable for misconduct. Chapter three will also analyze cases where claims to hold directors personally liable have failed with the aim of understanding the reasons given by the courts will be discussed.


CHAPTER THREE

ANALYSIS OF CASE LAW IN MATTERS REGARDING MISCONDUCT OF DIRECTORS

3.1. Introduction

A brief synopsis of the issue of the director’s personal liability as advanced by various authors shall be presented in this chapter in an attempt to better understand this concept. The issue of personal liability herein is limited to cases of breach of director’s duties. The aim of considering the cases from the United States of America, United Kingdom, South Africa and Kenya is to determine whether there are basic common principles relied on by the courts in deciding whether to hold directors personally liable for breach. If there are no basic principles, then what do the courts consider when making the decision on whether to hold a director personally liable or dismiss the claim.

3.2. Brief synopsis on personal liability of directors

The extent of a director’s personal responsibility is important to a prospective director, courts and the investing public. A prospective director is eager to know the extent to which he may be held personally liable, courts seek to balance individual interests of directors with public trust and the investing public are assured that those responsible for the security of their investments are responsible for the supervision of the internal management of the corporation.1

An important consideration is whether direct involvement in matters of personal liability must be proved, and the answer is in the affirmative i.e. participation must be fairly direct.2

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This is illustrated in *Frances T-vs-Village Green Owners Association*.³ The suit was brought against the individual members of Village Green Owners Association for injuries sustained by the complainant after she was attacked while in her house. The complainant stated that the directors had been negligent, were in breach of contract and fiduciary duty. The consideration to be made by the court was whether the individual directors were liable for the injuries sustained by the complainant. The California Supreme Court held that for a claim against a director in his personal capacity to be sustained the complainant must show that the director was directly involved and authorized the tortious conduct. Secondly, it is important to consider whether the directors knew that some hazardous activity which was in their control could harm the complainant and the directors failed to take corrective action to prevent or avoid the harm.

Another illustration to support the above is the decision in *K&G Oil Tool & Service Co. Ltd-vs-G&G Fishing Tool Service*⁴ where the court stated directors are liable for corporate misconduct only if they are personally connected.

Some courts have declined to make decisions that hold directors personally liable for lack of supervision and mismanagement. The reason given by the courts is that failure to supervise or manage does not equate to personal participation sufficient to find a director personally liable.⁵

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³ [1986] 42 Cal.3d 490.
⁴[1958] 314 S.W.2d.
Since the operationalization of CA 2015, there have been several amendments made when it comes to the provisions of duties of directors. The amendments were through the Companies (Amendment) Act of 2017. The amendment act deleted section 146 (3) (a) of the CA 2015 which absolved directors from being held liable for conflict of interest as long as they were not privy to the circumstances that led to the breach. This means that it is no longer a defense for directors to claim that they were unaware of the circumstances which gave rise to a conflict of interest in the company. Another amendment was the deletion of section 162 (6) and (7) of the CA 2015 which exempted persons connected with directors from civil liability for entering into property agreements with the company. The amendment act repealed the above provision and therefore it is no longer a defense for connected persons and directors to claim that they were unaware of the conflicting circumstances when entering into transactions with the company. The above is evident that directors have now been put on a higher pedestal in terms of performance of their duties and feigning ignorance is no defense. It is also important to mention that in addition to civil liability, the Penal Code\(^6\) in section 282\(^7\) provides an adequate remedy for fraud by directors.

Previously, the threshold of skills and expertise required by a director was low as a director did not need to have skills of a competent person in his position; a director was only expected to have skills expected of someone with his knowledge and experience. This became a concern and later emerged that a director was expected to have both general skill and experience similar to that of a person carrying out the function of a director.\(^8\) The courts have

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\(^6\) Cap 63, Laws of Kenya.
\(^7\) If the offender is a director or officer of a corporation or company, and the thing stolen is the property of the corporation or company, he is liable to imprisonment for seven years.
\(^8\) Re D 'Ian of London Ltd [1993] BCC 646.
been instrumental in expounding and explaining what is expected of directors in terms of their duties\(^9\) as will be discussed below.

### 3.3. Jurisdictional analysis of case law

#### 3.3.1. United States of America

This jurisdiction is considered the most democratic country with a very vibrant judiciary, the federal system of government also makes it unique in the sense that each state is considered its own small country. It is therefore important to look at this jurisdiction due to the dynamic nature of its legal system.

The leading case in this jurisdiction is the *Spering Appeal*\(^{10}\) where the directors in an attempt to save the company recklessly channeled the company’s funds to improper investments. The directors expected to make large profits by charging high rates of interest. A suit was brought against the directors to recover damages from reckless investments. The court held that directors are mere mandatories and are only liable in case of breach of trust resulting in gross negligence leading to fraud. The court stated that despite directors being responsible for losses emanating from fraud they are not liable for judgment mistakes as long as they are honest and have acted within the scope of their powers. In this case, the court referred directors as mandataries\(^{11}\) having characterized them as such, the court concluded that directors are only required to have ordinary skill and diligence and nothing more.

The decision in the above case implied that directors’ need only conduct the business of the company in good faith and within their scope of authority; if they do so they are not culpable

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\(^{11}\)Persons who have gratuitously undertaken to perform certain duties
for mistakes made from honest decision making. This may be considered a shield to directors and a disadvantage to stakeholders as directors only need to demonstrate they acted in good faith. The decision in this case supports the research in that there is no universal formula for dealing with cases of personal liability. The case of *Graham-vs-Allis- Chambers*\textsuperscript{12}, further supports the fact that directors may be exonerated of misconduct if there is evidence of good faith. In this case the directors had failed to notice that some mid-level employees had engaged price fixing activities which were deemed illegal. The court held that directors did not need to have in place a system to monitor that the employees were being diligent and duty conscious unless there was an event triggered by their actions.

In yet another case of *Kors-vs-Carey*\textsuperscript{13} the directors were not held personally liable as the facts of the case did not warrant personal liability. In this case, the directors of a company called “Lehn & Fink” noticed unusual transactions in the company’s stocks. This is a result of one of their customers buying up the stocks with the aim of bidding for control. The court held that bidding for control was a threat to the company’s operations therefore there was no claim against the directors of Lehn & Fink that could be sustained.

Despite the above illustrations where directors were not held liable, there are some courts in the United States that have found directors personally liable. The first case is *Omaha Indem Co-vs- Royal Am. Managers Inc*\textsuperscript{14} two of the directors i.e. the chief executive officer and the president were found personally held liable for mismanagement. On 3 April 1986, Mutual of Omaha (Mutual) and the Omaha Indemnity Company (Omaha Indemnity) began litigation against Royal American Managers, Inc. (RAM). Claims for negligence, fraudulent

\textsuperscript{12}[1963]188 A.2d 125
\textsuperscript{13}[1960] 9158 A. 2d 136.
\textsuperscript{14}[1991] 1451 W.D. Mo.
misrepresentation, prima facie tort, civil conspiracy and equitable relief were asserted. All claims against RAM in Omaha Indemnity's original complaint were submitted to arbitration and the arbitration panel returned an award of $225M in favor of Omaha Indemnity and against RAM. In arriving at this decision, the arbitration panel stated that directors were personally liable for tortious corporate conduct in which they knowingly participate. From the facts of this case, it is not in doubt that if directors knowingly participate in misconduct then they will be held culpable. This case demonstrates the need for conducting this research as one of the aim was to understand the reasoning by the courts in holding directors personally liable.

Going back to one of the oldest cases *Hun-vs-Cary*\(^{15}\) where the trustees allowed by way of voting the purchase of a pricy piece of land in New York City for purposes of construction of a bank building. The intention of the trustees in purchasing the land was to build confidence in the bank and increase the number of deposits. The trustees were aware of the bank’s insolvent condition at the time of purchasing the land but there was no ill intent by the trustees in purchasing the land. The court held that the trustees were reckless and extravagant and ought to be held liable for the loss. This is another clear case where directors were held liable in their personal capacity as directors and the court stated that honesty coupled by recklessness is not a defense.

The case of *Smith-vs-Van Gorkom*\(^{16}\) involved a buy-out merger of TransUnion by Marmon Group, at a proposed price of USD55, in coming up with this price however, there was no financial expertise sought. Following the proposed share price, the directors approved the sale of TransUnion as it was experiencing depreciation and reduced income. During approval of

\(^{15}\)[1880] 2 N.Y. 65.
the transaction, some information was not disclosed during the board meeting. In deciding the matter the court held that directors were negligent as they hastily approved the merger without proper expert advice.\textsuperscript{17} What is very clear in this case is that in decision making, directors must at all times consult and disclose to the relevant stakeholders their plans before making a decision. The lack of disclosure can be construed to hiding of critical information which leads to mistrust of directors by the stakeholders.

Another illustration where directors were held personally liable for misconduct is the case of WorldCom and Enron as will be discussed in the subsequent paragraphs. WorldCom started as a provider of long distance phone services both for commercial and domestic purposes. The company grew and became one of the top three telecommunications company in the United States. On 25 June 2002, the company reported that it had been involved in “cooking” it’s financials by reporting a $3Bn profit while the true picture was that the company had made a loss of USD half-a-billion. Investigations into the operations of the company were concluded it was revealed that $11Bn in misappropriation was revealed.\textsuperscript{18} As part of the settlement with the outside directors, the “New York State Common Retirement Fund” insisted directors pay a significant portion of the settlement from their own pockets.

Similarly, the directors of Enron were found personally liable for breach of their duties and paid $13M from their funds to settle with Enron shareholders.\textsuperscript{19} Two of the directors (chairman and the chief executive officer) were charged with conspiracy, securities and wire fraud and insider trading. The court on 25 May 2006 found the two directors guilty.

\textsuperscript{17} This permits Delaware companies (with shareholder approval) to adopt charter amendments that exculpate directors from personal liability for breaches of the duty of care.

\textsuperscript{18}Javiriayah Ashraf, ‘The accounting fraud at WorldCom the causes, the characteristics, the consequences, and the lessons learned’, (2011), HIM 1990-2015.

Previously, mid-level managers would be convicted of white collar crimes while the directors would receive lighter sentences.20

Looking at the cases of WorldCom and Enron, directors paid the stakeholders damages from their own funds which are clear demonstration that directors in the United States can be held liable and required to compensate aggrieved parties from their funds.

From the above cases, it is clear that in the United States, the courts concur that directors should have the interests of the stakeholders in the forefront and ensure that they are at all times protected from losses emanating from fraud, misconduct and breach of what they are expected to do in terms of their duties. Directors only need to demonstrate they acted within their scope of authority and in good faith and in return they cannot be held personally liable. Also for a claim of personal liability to be sustained, misconduct or abuse of discretion must be proved and sustained. On the other hand, where directors have been found culpable, the main consideration has been whether the directors knowingly participated in the breach. In addition, honest but reckless improvidence and fraudulent misrepresentation of company information will also impose personal liability on a director.

3.3.2. United Kingdom

Kenya has heavily borrowed from CA 2006 and therefore it is important to look at how courts in this jurisdiction have handled matters dealing with personal liability of directors. The court in Miles Smith Broking Limited-vs-Barclays Bank Plc21 made some pertinent remarks about the personal liability of a director. A director is not culpable for wrongdoing

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21 [2017] EWHC 3338 (Ch).
due to the mere fact that he is a director, the director is culpable for wrongs personally carried out by a director.

Following the above assertion, it is clear that a company being a legal person in law it also has a “human personality” by the mere fact that it has officers and agents in whom the directing mind and will of the company is located. In *Lennard's Carrying Co Ltd-vs-Asiatic Petroleum Co Ltd*\(^2^2\) the court held that a company has no mind or body of its own as individuals within the company have the directing mind. The court in making its decision made it clear that Mr. Lennard was the directing mind of the company and was capable of giving evidence.

Still on the issue of human personality, the court in *Botton Engineering Company Ltd-vs-Graham and Sons*\(^2^3\) observed that a company may be equated to a human body in the sense that a company is considered to have a brain, nerve center and hands. Servants and agents may be equated to hands that do the work and directors and managers are the nerve center representing the directing mind of the company.

The cases of *Lennard's Carrying Co Ltd-vs-Asiatic Petroleum Co Ltd*\(^2^4\) and *Botton Engineering Company Ltd-vs-Graham and Sons*\(^2^5\) evidence the fact that directors cannot hide behind the doctrine of separateness as the courts have made it clear that companies are controlled by humans as they have no minds of their own. The two cases are important in this research as they highlight the issue of companies having a controlling mind who are directors of companies.

\(^{2^2}\) [1915] AC 705.
\(^{2^3}\) [1957] 1 QB 15 9 CA.
\(^{2^4}\) [1915] AC 705.
\(^{2^5}\) [1957] 1 QB 15 9 CA.
The decision in *Lexi Holdings PLC (In Administration)-vs-Said Luqman and others*\(^2\) signifies the power courts in England have against fraudulent directors. The company’s core business was provision of bridging loans to persons interested in acquiring the property. The allegation against the director of the company was that he had transferred money to the tune of GBP 53M from the company’s bank accounts to his personal accounts. Mr. Luqman was found to be in contempt and imprisoned for eighteen months. The main issues that led to the conviction of the director were that he had taken money from the company’s accounts and transferred to his own personal accounts, misuse of bank accounts belonging to the company, creating false loans to directors and forging loan facility letters.

From the above discourse, it is clear that in the UK courts are keen at looking at the controlling mind of the company before making a decision since a company is incapable of making its own decisions without human intervention. The issue of direct involvement is key in the UK as a director is not guilty for the wrongdoing of his company just because he is a director. A director is culpable for wrongs personally carried out by himself.

### 3.3.3 South Africa

The reason for discussing cases in this jurisdiction is because chapter four will look into CA 2008 with an aim of showing how elaborate South Africa is when dealing with personal liability matters. CA 2008 has had a significant impact on issues of directors’ duties since it became fully operational on 1 May 2011.

Breach of director duties is now coupled with numerous and far-reaching personal liability provisions. A director who has no reason to suspect his officials is justified in believing that

\(^2\)[2009] EWCA Civ 117.
the officials performed their duties honestly as was held in *Fisheries Development Corporation of SA Ltd-vs-Jorgensen*. In this case, the court summarized the duty of care and skill as pertains to a director as follows: a director is only expected to exercise care which can be expected from a person with his knowledge and experience.

A director cannot be held liable for offences that were committed during his tenure as was decided in *Rainham Chemical Works Limited (in liquidation) & others-vs-Belvedere fish Guano Company Limited*. Dinitrophenol (DNP) was a chemical used for the manufacture of dyes which did not explode easily. These chemicals were not dangerous unless stored in close proximity of each other. During the hearing it was proved that the storage of the chemicals in close proximity was the cause of an explosion to the adjoining property. The complainant relied on the rule in *Rylands-vs-Fletcher*. The fact that it was not known to the defendants that the storage of the two chemicals in close proximity was a danger did not amount to a defense. From the holding of this case it is evident that should the breach be committed by such director during his term of office, or where he or the employee or other officer committed, authorized or participated in the act amounting to breach of his duties, he may incur personal liability in breach.

Section 77 of CA 2008 penalizes and “holds directors personally liable to the company for any loss incurred through knowingly carrying on the business of the company recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose”.

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28 [1921] 2 AC 465 (HL).
29 [1868] UKHL 1.
30 The Act defines what is meant by a person “knowing” of such prohibited conduct. “Knowing” when used with respect to a person, and in relation to a particular matter, means that the person either had actual knowledge, or such person reasonably ought to have had actual knowledge or acquired it by having investigated the matter or by having taken other measures which would reasonably be expected to have provided the person with actual knowledge of the matter.
Additionally, section 77(2) provides that “a director of a company may be held liable in accordance with the principles of the common law relating to the breach of fiduciary duty”.

Further, section 214 of CA 2008 “provides for criminal liability if an act of fraud has been perpetrated by any person in relation to a company, its creditors or employees”. The court in Strut Ahead Natal (Pty) Limited-vs-Burns\(^{31}\), held that despite the fact the defendant was not registered as a director at Companies and Intellectual Property Commission (CIPC) he was responsible for the management of the company like a director should be. The court held that the defendant was liable in his personal capacity as a director for being reckless in managing the company. The court’s decision was premised on the fact that the director was the only person that knew the true position of the company’s financials and therefore was in a position to keep proper books of account.

The defendant in Heneways Freight Services (Pty) Limited-vs-Gregor\(^{32}\) was the sole director of a company called “The House of Sports Cars”. This company was in the business of importing luxury cars into South Africa. The defendant applied for credit from the complainant in this suit which was advanced. The defendant did not service the credit facility and there was a debt of R 309,734.36, he further issued a post-dated cheque to clear the debt but he later stopped the cheque. The defendant’s company was liquidated after which the complainant sued the defendant in his personal capacity as director of The House of Sports Cars for reckless trading in contravention of section 424(1)\(^{33}\) of CA 2008.

\(^{31}\) [2007] 3 All SA 190 (D).
\(^{32}\) [2006] ZASCA 158.
\(^{33}\) “Where it appears that the business of the company is being carried on recklessly or with the intent to defraud creditors of the company, the Court may, on application, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without limitation of liability for all or any of the debts or other liabilities of the company as the Court may direct”. 
The main ground for the claim of reckless trading is based on the fact that the defendant was privy of the company’s financial position when he applied for credit and that he knew that there would be challenges in repaying the credit facility. The court in making its decision applied the reasonable man test. The court asked itself if a reasonable businessman in the defendant’s position with similar knowledge would have no reason to believe that when default in repayment of the credit facility occurred the company would have funds available to settle the debt. The fact that the defendant’s company was going through financial difficulties was not in doubt and the defendant prioritized payment of debts depending on their urgency. Evidence was also adduced to the effect that the defendant’s company was due for a buyout by an investor and the proceeds from the buyout would be used to settle the debt. The court ruled in favor of the defendant by stating that any reasonable man would have acted like the defendant he was therefore innocent of reckless trading.

A contrast can be drawn in Strut Ahead Natal (Pty) Limited-vs-Burns34 and Heneways Freight Services (Pty) Limited-vs-Gregor.35 In Strut Ahead Natal (Pty) Limited-vs-Burns36 where the court looked into the conduct of the director and made a conclusion that the director was not interested in the success of the company. The director of this company was the only one with information regarding the company’s financial position and hence his action was considered reckless and he was held personally liable. On the other hand in Heneways Freight Services (Pty) Limited-vs-Gregor37 the court acknowledged that Mr. Grogor’s conduct amounted to negligence but did not constitute recklessness. In this case also, Mr. Grogor knew the financial status of his company yet he was not held personally liable. This

34 [2007] 3 All SA 190 (D).
35 [2006] ZASCA 158.
36 [2007] 3 All SA 190 (D).
37 [2006] ZASCA 158.
just cements the fact that the courts make discretionary decisions when faced with matters dealing with breach of director duties.

The cited case law discussed in this section provides evidence that South African courts do not have a clear formula in making the decisions on the liability of directors as the facts of the case are a key consideration.

3.3.4. Kenya
In *National Social Security Fund Board of Trustee-vs-Ankhan Holding Limited & two others*\(^{38}\) the plaintiff sued the defendants for fraud. The fraudulent misrepresentation is said to arise from the fact that in the grant which the 1\(^{st}\) defendant transferred to the plaintiff, specifically stated that the property could only be used for residential purposes. However, it later turned out that the said piece of land was an integral part of the Ngong road forest reserve, upon which no residential or other development could be undertaken or entertained.

The defendants’ position was that they could not be personally liable to the plaintiff because they were all agents of a disclosed principal, one Jonathan K. Toroitich Arap Moi. The court was convinced that there was a cause of action against the second and third defendants, not because they were directors of the 1\(^{st}\) defendant, but because they committed acts of false misrepresentation or of fraud on the plaintiff.

In reaching its decision, one of the issues considered by the court was whether or not the notion of a “nominee director” is acceptable within Kenya. The court held that upon appointment as director the appointee’s rights and obligations are as defined by the MemArts of the company and Kenyan law. In making its decision, the court held that there was no

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\(^{38}\) Civil Case No. 268 of 2004 (26 April 2006) [2006];eKLR
dispute about the fact that both the second and third defendants were directors of the first defendant. This gave rise to a very fundamental question; can the directors of the company which sold the land which is the subject matter of this suit, be liable alongside the company itself? The second and third defendants stated that they cannot be held liable in their personal capacity as directors. Plaintiff submitted that when there is deceit and fraud, which is perpetuated by directors, directors’ stand on the same footing as the company itself.

The second and third defendants cited the following authority, in which the second defendant was sued on the basis of the contract; *Fursys (K) Limited vs the De Gama Rose Group of Companies & another*[^39], where Hon. Mwera J. stated that the well-known principle of separate legal personalities in company law as set out in *Salmon vs Salmon*[^40] still holds good therefore suing the two defendants in such circumstances is simply groundless and fanciful (i.e. frivolous) and/or lacking in bona fides, hopeless and oppressive. The learned judge went ahead to strike out the defendants from the suit, and consequently, the suit stood dismissed.

The court asked itself the following question: in view of the very clear legal position, should not the plaint against the second and third defendants be struck out? The plaintiff asserted that even though the general rule is that an agent of a disclosed principal cannot be held personally liable, there are deviations from the rule. One such exception arises when fraud and deceit are alleged. So, in this case, even though the contract was signed in the name of the first defendant, the plaintiff believed that the second and third defendants cannot escape personal liability, simply because directors were distinct from their company. The plaintiff’s belief is said to arise from the fact that the second and third defendants were actively involved in the transaction. The court found that there was no merit in the defendants’ application and it was dismissed.

At all times, “a director is bound not only to exercise proper care and diligence but ordinary skill and judgment”\textsuperscript{41}. In \textit{Ajay Shah-vs-Deposit Protection Fund Board as Liquidator of Trust Bank Limited (In Liquidation)}\textsuperscript{42}, the appellant and second respondents were directors of Trust Bank Limited. It is the first respondent’s claim that the appellant and second respondent in their capacity as directors of Trust Bank Limited were guilty of misfeasance. The legal issue was the nature of duty that the appellant and second respondent in their capacity as directors owed Trust Bank Limited as a company. The relevant legal question was whether directors owe a duty to the company in which they are a director in and the nature the duty. It was found that the appellant and second respondent as directors of Trust Bank Limited were agents of the bank and owed the bank fiduciary duties of loyalty, good faith, care and skill in discharging their duties as directors of the bank. The court in making its decision relied on the following cases: \textit{Re Land Allotment CO}\textsuperscript{43} and in \textit{Belmont Finance Corporation-vs-Williams Furniture Limited}\textsuperscript{44} where it was held that trustee includes directors. In \textit{Jetivia S.A. & another-vs-Bilta (UK) Limited (in liquidation) &Ors}\textsuperscript{45}; the court held that directors of a company are liable if they have committed a fraud which leads to a loss. In dealing with the concept of the separateness of a company and directors, it was held that there are cases where the minds of the company are not the mind of the directors.

In \textit{Joel Ndemo Ong’au & another-vs-Loyce Mukunya}\textsuperscript{46}, the court relied in the decision by Mabeya J. in the case of \textit{Multichoice Kenya Ltd-vs-Mainkam Ltd & another}\textsuperscript{47}, wherein he

\textsuperscript{41} Leonard Adkins and Donald Jams, ‘Some observations on liabilities of corporate directors’ (1965), the Business Lawyer, Vol. 20, No. 4, 817-831.
\textsuperscript{42} Civil Appeal No. 158 of 2013 (17 June 2016); [2016] eKLR.
\textsuperscript{43}[1894] 1 Ch. 616.
\textsuperscript{44}[1890] (No. 2) 1 All E.R.
\textsuperscript{45}[2015] UKSC 23.
\textsuperscript{46} Civil Appeal No. 416 of 2012 (20 February 2015); [2015] eKLR.
\textsuperscript{47}Civil case No. 492 of 2012 (12 April 2013); (2013) eKLR.
admitted that directors are not usually personally liable on documents that bind the company, they are only liable if they have authority to make a binding document only then will the company be liable on it. He further stated that ever since the decision in Salomon-vs-Salomon\textsuperscript{48} courts have been known to apply the doctrine of corporate personality to the letter but exceptions to this doctrine exist. Since there was a claim for dishonesty and fraud on the part of the appellant which claim was not sufficiently controverted, the trial court was correct in its holding and the appeal was dismissed.

In the case of \textit{Mwaura Karuga t/a Limit Enterprises-vs-Kenya Bus Services Ltd & 4 others}\textsuperscript{49}, the plaintiff had obtained judgment against the defendant (KBS) for Kshs. 2,619,292. On 29 July 2005, the plaintiff through Whitestone Auctioneers (K) Ltd proclaimed five vehicles in execution of the decree. The directors went further to state that on 30 August 2005, parties reached a compromise on the settlement of the decretal amount and this was reduced into writing. The settlement contained the following details: the decree-holder would lease five vehicles to facilitate generation of daily income for settlement if the decretal sum, the defendant company which was experiencing liquidity problems was to enlist the assistance of its sister company Bus Track Ltd, to provide cheques to cover the decretal amount and the defendant was to review the payment of the decretal sum if its liquidity improved.

The defendant’s problems arose from the heavy cost in implementing the transport safety rules popularly known as the \textit{Michuki Rules} through Legal Notice No. 161 of 2003. The rules adverse effect were two-fold, first, the defendant incurred substantial/massive expenditure in implementing them and secondly the defendant incurred massive losses from reduced

\textsuperscript{48}[1897] A.C. 22.
\textsuperscript{49}Civil case No.106 of 2005 (19 March 2015); [2015] eKLR.
carrying capacity. Despite the director’s demonstration of no fraud on their part, the court in its ruling of 7 October 2014 found directors of the defendant personally liable for the plaintiff’s decree. The directors filled an appeal against the court’s order and ruling of 7 October 2014. The directors argued that the decree was against the defendant not the directors. The peculiar circumstances of this case were that judgment was obtained against the defendant but the deputy registrar directed that the directors of the defendant (the applicants herein) be held personally liable to settle the decree/judgment. An appeal was filed where the directors of the defendant contested the deputy registrar’s finding on the grounds, *inter alia*, that it was against the principle of corporate personality of companies and there was no fraud on the part of the directors.

The application was opposed by the respondent by asserting that it was not correct for the directors to state that the court was wrong in granting orders to hold directors personally liable as fraud was not proved. This assertion was based on the following; the directors knowingly secured release of the five buses by drawing an agreement they knew could not be honored, issued cheques which they knew could not also not be honored as the accounts were frozen. These things are conclusive evidence of fraud by the directors and an ideal situation for lifting the corporate veil as the so rightly ruled. The argument that some of the buses belonged to another company Bustract Ltd, a complete legal entity from themselves is a façade. This again was indicative of fraudulent act.

The directors of the defendants/applicants obtained release of the buses by fraud and with intent to defeat the plaintiff’s/respondent’s execution of the decree and can therefore not ask to hide behind the corporate veil. The transport safety rules came into effect in 2003, and the plaintiff/respondent services were retained in 2004. This begs the questions, why did they
knowing that they could not pay, engage the services of the plaintiff/respondent? Why did they record a consent judgment knowing they could not honor it? Why did they issue cheques against a frozen account? This points to fraud on the part of the directors. The court ordered that the directors/applicants deposit the entire decretal sum including interest on the decretal sum as awarded by the court, in an interest earning account in the joint names of the advocates for the directors/applicants and the respondent.

In Kenya it is again evident that the courts will look at the specifics of the matter before making a decision on whether to personally hold a director liable. If for example a complainant brings an action on fraud against the directors, then the complainant must be proved. In addition, the courts require directors to be loyal, exercise good faith, care and skill while undertaking management duties.

3.4. Business judgment rule

One of the defenses to personal liability claims is the “business judgment rule”. This was clearly illustrated in Smith-vs-Van Gorkom. The court found the directors negligent hence they could not defend themselves by using the protection accorded by the business judgment rule. The court in making its decision stated that the rule is based on the presumption that in managing the company directors acted on an informed basis and in the best interests of the company. The rule shall be discussed in detail below.

The business judgment rule is a doctrine that protects directors from claims of personal civil liability based on the decisions they make while running the company. The aim of the rule is “strike a workable balance between directors’ need to exercise authority in running the

enterprise on one hand, while allowing some accountability on the other, in order to prevent the diversion of corporate agendas or assets to serve personal interests”.

3.5. Conclusion

From the analysis of the above cases, courts have the discretion in making decisions on personal liability claims. As discussed, it is evident that courts critically take into consideration the facts before making a decision. In the four jurisdictions discussed in this chapter, it can be deduced that if a claimant is able to prove its case against miscreant director the courts will not hesitate to render a guilty verdict. It can be noted that the common denominator in the cases where directors have been held liable is where the complainant has been able to prove that he has been aggrieved by the directors’ decisions.

It is also clear that there is no clear formula or set guidelines available for the courts to rely on, the courts will look at the facts on the case before it exercises its wisdom in making the decisions. For example in South Africa, two different courts faced with almost similar facts regarding two different companies made different decisions on the issue of personal liability.

The United States has some good examples where directors were found guilty of breach and were ordered to pay compensation from their own pockets; this was the case in WorldCom and Enron. This jurisdiction is however very particular, the decision in the Spering Appeal clearly stated that directors should not be “held liable for mistakes of judgment provided they

52 In Strat Ahead Natal (Pty) Limited-vs-Burns the court looked at the conduct of the director and concluded there was a lack of concern for the success of the company which ultimately prejudiced the creditors of the company. In Heneways Freight Services (Pty) Limited-vs-Gregor however, the court acknowledged that the respondent’s conduct amounted to negligence as it may have put creditors of the company at risk but did not constitute recklessness hence the directors were not held liable for their misconduct.
are honest and fairly within the scope of the powers”. Still in United States the case of Smith-vs-Van Gorkom\textsuperscript{54} brought forth the concept of the business judgment rule which has been discussed herein above.

There is still a lot that the courts can do to ensure that stakeholders’ interests are protected. One of the options would be to impose criminal sanctions against directors can help in deterring misconduct. This suggestion is based on the fact that one of the government’s mandate is to ensure that all stakeholders are protected from fraudulent activities that may be perpetuated by managers. There is no doubt that a company’s success is a matter of public interest that should be protected through regulation by the government.\textsuperscript{55} In chapter four analysis of CA 2006 and CA 2008 will be presented to see what best practices Kenya can adopt.

\textsuperscript{54} [1988] 488 A.2d 858.
CHAPTER FOUR


4.1. Introduction

In this chapter CA 2006 and CA 2008 on personal liability of directors to see which best practices can be adopted into the Kenyan legal regime are presented. The reason for looking into these two jurisdictions is based on the fact that CA 2015 heavily borrows its provisions from CA 2006 and CA 2008 has express provisions of personal liability of directors.

With regards to the two jurisdictions, this chapter will first look at the prescribed duties in the statutes with the aim of understanding the reasoning of the court’s interpretation of duties and issues of breach of these duties. Insights on the provisions of personal liability of directors in the two jurisdictions will be presented in this chapter as well. The focus will be on whether the statutes have express provisions on personal liability and if there are none how the courts have handled personal liability claims brought against directors. A brief synopsis of the findings and best practices can be adopted in Kenya are presented in the conclusion of this chapter.

The words of Judge Purle QC in Kohli-vs-Lit & Ors\(^1\) at paragraph 6 are befitting for this chapter:

“Being a director is not an easy matter, and requires a responsible approach. The degree of regulation can catch even the most sophisticated of directors unawares, and most directors do not have the requisite level of sophistication and skill to cope unaided with the extensive statutory framework to which they are subject, or the niceties of the company's constitution. Many become directors of companies to take advantage of limited liability, so as to exploit the entrepreneurial skills and instincts, and may not be temperamentally suited to statutory control or constitutional restraint.”

\(^1\) [2012] EWHC 1338 (Ch).
In addition to considering the interests of the shareholders, directors must also consider the interests of stakeholders; these are persons employed by the company, persons to whom the company owes money to, consumers of the company’s goods and services, suppliers of goods and services, the environment and the community at large.\(^2\) Often times, actions of a director are treated as being actions of the company as directors provide the human personality to a company to enable it comply with legal requirements. CA 2015 has codified directors’ duties at division three sections 140 to 147 with the aim of improving corporate governance of companies.

It is increasingly becoming popular for aggrieved stakeholders to seek redress against directors for compensation due to losses occasioned by their misconduct. The issue of the form of redress defers from one jurisdiction to another due to the different legal systems. Some jurisdictions are keen to hold directors personally liable to compensate for losses occasioned by noncompliance and breach of duties, other jurisdictions are hesitant to make such decisions.\(^3\)

Directors should be aware that shelter from personal liability is not absolute and they should be aware that there may be both criminal and civil consequences where they are found to be in breach of their duties. It is therefore important that in cases where a director believes that


decision made by the board would lead to company directors being held personally liable; their opposition of the decision must be recorded in the board minutes.⁴

4.2. United Kingdom

4.2.1. Brief history of CA, 2006

Review of company law in the UK begun in 1998 with the main objective being to simplify the structure of companies’ law. The final report by the Company Law Review was presented to the Secretary of State and Trade on 20 July 2001 with the most notable recommendation being to make the law as simple and accessible as possible especially to the small firms. Two “white papers”⁵ were drafted and presented following consultations with the government.

The Companies Bill made it to parliament for debate on 4 November 2005 and Royal Assent received on 8 November 2006. The government’s intention was to bring the act in force by end of 2008, however, owing to challenges of the numerous proposed changes and full implementation was achieved on 1 October 2009.⁶

The following was emphasized in the 2005 white paper as the need for introducing legislative reforms on the issue of directors duties “the general duties which directors owe to the company are at the moment found in case law i.e., decisions in individual court cases over the years rather than in the Companies Act. As a result, those who become company directors may do so without understanding their obligations under the law. Those obligations may also not be understood by the members of the companies, in whose interests the directors could be

⁵ Modernizing Company Law (July 2002) and Company Law Reform (March 2005).
⁶ Ibid.
acting”. The director is considered as the internal manager of a company who is bound by the company’s constitution and decisions of shareholders.

Section 170 of the act spells out the duties of directors that already exist; these duties are not meant to replace common law but are meant to be enhanced through codification. What this means is that common law is still remains the source of interpretations duties of directors as set out in sections 171-177 of the act. The duties in the act are listed as the following: “duty to act within powers”, “promote the success of the company”, “exercise independent judgment” “exercise reasonable care, skill and diligence”, “avoid conflicts of interest”, “not to accept benefits from third parties” and “duty to declare interest in proposed transaction or arrangement”.

The duties above are discussed in detail below.

4.2.1.1. **Duty to act within powers (section 171)**

A director must be bound by the constitution of the company and act within the powers conferred to them. *Eclairs Group Ltd vs JKX Oil & Gas plc* represents the leading judgment on the duty set out in section 171(b) of the act. This section provides that “directors must exercise their powers whether conferred under the company’s constitution or under statute only for the purposes for which they are conferred.” This is referred to as the proper purpose rule which is mainly concerned with what would be considered abuse of power which is occasioned by a director performing acts that are within his scope of authority but the said acts are done for an improper purpose.

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JKX Oil and Gas plc shares were listed in the London Stock Exchange, the company dealt with oil and gas. Two of its shareholders were Eclairs (27%) and Glengary (11%). In 2013, the directors of JKX were of the opinion that the majority shareholders were in the process of acquiring joint control JKX without following the correct procedure which included making a formal bid. A general meeting was called by Eclairs to appoint new directors after removal of the existing ones. Disclosure letters were then issued in March and May of 2013 to Eclairs and Glengarry requesting for the following information number of shares held, beneficial owners of the shares and whether there were agreements between the shareholders. The shareholders responded and provided the information requested for. In April 2013 the board of JKX had issued a notice of AGM scheduled for June whose agenda was to reappoint the chief executive officer, approve directors’ remuneration and allow the company to allot shares. A week before the AGM the board held a meeting where they the disclosure letters were deemed inadequate since there were agreements among the shareholders. The board then made a resolution to issue restriction notices on the shares by suspending the voting rights attached to the shares and restrict transfers of the shares meaning Eclairs and Glengarry would not prevent passing of resolutions proposed at the AGM.

Eclairs and Glengarry brought proceedings for restriction notices to be brought down before the Chancery Division. Their application was allowed on the ground that the board had acted in breach of section 171(b) as they had exercised their power to issue the notices for an improper purpose. When the matter went to the appellate court, the Court of Appeal reversed the decision of the Chancery Division. On further appeal to the Supreme Court, Lord Sumption pointed out the proper purpose rule is not concerned with acting beyond the scope of authority it is more concerned with doing acts that are within the scope of the directors
authorities but are done for an improper purpose. He further added that the duty is broken if directors make decisions influenced by improper purpose.

4.2.1.2. Duty to promote the success of the company (section 172)
This section requires a director to act in good faith and promote the success of the company. This is done by considering the consequences of long terms decisions, interests of stakeholders like employees, suppliers, customers, impact of the company’s operations on the community and the environment and maintenance of high standards of business conduct.

The issue before the court in *Re Item Software (UK) Ltd-vs-Fassini* was for determination of compensation for loss incurred by the company as a result of breach of duty to disclose. The court held that the duty to disclose misconduct does not prohibit legitimate entrepreneurial activity. The court was firm in pointing out that the consequence of non-disclosure may lead to the company making business decisions that are not beneficial due to lack of critical information.

4.2.1.3. Duty to exercise independent judgment (section 173)
Directors must exercise independent judgment as this ensures that that their decisions are made independently with the interests of the company being on the forefront. In *John Crowther Group Plc-vs-Carpets International Plc and others*, the court held that the directors were not liable for breach of an agreement as they acted *bonafide* for the interests of the company. The issue for determination by the court was whether the directors were in breach for accepting a higher bid for shares from a third party instead of recommended bids.

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10 [1990]BCLC 460.
4.2.1.4. **Duty to exercise reasonable care, skill and diligence (section 174)**

This duty requires a director to exercise care, skill and diligence that would be exercised by an ordinary person with general knowledge, skill and experience reasonably expected from an individual being in the same position of a director.

In *Dorchester Finance Co-vs-Stebbing*¹¹ involved a claim against two directors who held the position of non-executive directors qualified as chartered accountants. These directors would in the course of their duties sign blank financial instruments like cheques on request from an executive director of the company. In holding the directors liable the court held that directors must at all times act in good faith and put the interests of the company before their own. They must also have skills expected of persons with their knowledge and experience.

The issue of duty of care was highly deliberated in the case of *Re City Equitable Fire Insurance Company*¹² where the court stated that there is no need for a director to exhibit a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. This protected directors from misconduct and the decision was criticized as it was inadequate. Despite the criticism the decision in *Re City Equitable Fire Insurance Company*¹³ was for almost 70 years the benchmark for the duty of care in the United Kingdom.¹⁴ However, cases such as *Re D’Jan of London Limited*¹⁵ and *Norman-vs-Theodore Goddard*¹⁶ swayed from the decision in *Re City Equitable Fire Insurance Company*¹⁷ by

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¹² [1925] Ch 407.
¹³ [1925] Ch 407.
¹⁷ [1925] Ch 407.
making decisions that strengthened the duty of care. In *Re D’Jan of London Ltd*\(^{18}\) the plaintiff made changes to an insurance policy erroneously completed by his broker. The plaintiff did not review the insurance form before signing and he only noted the mistake after the company had gone into liquidation. The court held that failure to read the form was negligent.

In *Norman-vs-Theodore Goddard*\(^{19}\) Hoffman J was asked to consider circumstances which a director, should be held liable in respect of his decision to place company money in the hands of Mr. Bingham, a fraudster. Bingham was a tax law specialist who proposed investing the company’s money in Isle of Man. Bingham led him to believe that this company was controlled by Theodore Goddard; however, it was in reality controlled by Bingham, who stole the money. The company subsequently sued Theodore Goddard for breaching his duties as a director. Hoffman J held that the standard by which a company director should be judged was the degree of care and skill both as in fact possessed by the particular director and that of an ordinary person in in that position.

### 4.2.1.5. Duty to avoid conflicts of interest (section 175)

A director must not place himself in a situation where he has direct or indirect interest that conflict with those of the company for example if a director leaves the company and thereafter takes up an opportunity that the company would have gained then the director would be in breach of this duty.\(^{20}\) Even if it can be shown that a director acted in good faith in obtaining a business opportunity for himself, he will be liable.\(^{21}\)

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\(^{21}\) *Tower-vs-Premier Waste Management Ltd* [2011] EWCA Civ 923.
The plaintiff in *Regal (Hastings) Limited-vs-Gulliver*\(^{22}\) was in the business of operating a cinema. In an effort to expand its business the plaintiff was to acquire in a company that enjoyed benefits of leases of cinema premises. There was a shortfall in financing of the money needed to buy shares in the leasing company so the directors of Regal contributed money from their own pockets to enable completion of the transaction. However the leasing company was sold and shares sold at a profit. Regal on the other hand appointed new directors who sued previous directors for profits made on the sale of their shares. Lord Russell of Killowen stated that “directors were fiduciaries of their company and that they had acquired the opportunity to acquire shares by virtue of their directorships of Regal. Thus, they were liable to account to the company for their profits. A director will therefore be in breach of this duty if he is in a situation, or allows a situation to arise which involves a conflict”.

### 4.2.1.6. Duty not to accept benefits from third parties (section 176)

This section provides that “a director of a company must not accept a benefit from a third party conferred by reason of his being a director, or his doing (or not doing) anything as director.” A third party has been defined to include “a person other than the company”, an “associated body corporate or a person acting on behalf of the company or an associated body corporate.”

This duty continues to subsist even after a director leaves the company. In the case of *Northamption Regional Livestock Centre Co. Limited-vs-Cowling*\(^{23}\) a director was held liable after the court found that there was a conflict since the director acted for both the seller and the purchaser in the sale of a property.

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\(^{22}\) [1967] 2AC 134.

\(^{23}\) [2014] EWHC 30 QB.
4.2.1.7. Duty to declare interest in proposed transactions or arrangements with the company (section 177)

This duty requires that a director declares the extent to which he is either directly or indirectly interested in a proposed transaction with the company. The disclosure can be made at a director’s meeting or by a notice in writing before the company enters into the transaction. If however the director is not aware of the transaction, a declaration need not be made.

The case of *IDC.*-vs-*Cooley* the defendant in this case was an architect employed as managing director of IDC. One of IDC’s clients “The Eastern Gas Board” had a project to design a depot. The Eastern Gas Board informed Mr. Cooley that it wanted to contract him directly. Instead of Mr. Cooley disclosing this to the board, he informed the board that he was ailing and needed to resign from the company and the company accepted his resignation. He subsequently commenced working on the depot, IDC became aware of this fact and institute legal proceedings against him. The court held that despite there being no chance for IDC to get the depot contract, if they were made aware of the transaction they would have let Mr. Cooley go so he was found liable as all information he had received from IDC should have been disclosed to IDC.

4.2.2. Consequences of breach of director duties

Breach of duty often leads to sanctions whether civil and criminal and it is even worse for small companies as it could be the demise of the company. Section 178 of CA 2006 provides for consequences of breach of general duties.

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25 The consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied. The duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.
An aggrieved party therefore has the following options: “seek to recover any of the company’s property which has been misapplied by the director”, “make the director account to the company for the profit he or she has made in breach of the fiduciary duty” and/or seek “an injunction to prevent the act complained of from being committed.”

4.2.3. Provisions of the act on directors duties personal liability
CA 2006 has no express provisions on personal liability for directors. However, section 1187 makes reference to personal liability for debts of company. Director’s liability is an issue of huge concern in company law as there has to be a correct balance between lifting the corporate veil and holding directors personally liable for breach of their duties. Directors must ensure that they are aware of the affairs of the company and supervise the operations of the business. In carrying out their duties, directors have the authority to delegate their duties but they have overall responsibility for the delegated functions.

Personal liability in the United Kingdom is mostly decided by the courts due to the gap in the law. The most famous case against directors for misconduct is Re Safeway Stores vs Twigger. Safeway brought the suit in an effort to recover £10.7M fine imposed by the Office of Fair Trading (OFT) from former directors who admitted participation in a cartel.

The main question before the court was whether the company could recover the penalties

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26 (1) The Secretary of State may provide by regulations that a person who, at a time when he is subject to foreign restrictions— (a) is a director of a UK company, or (b) is involved in the management of a UK company, is personally responsible for all debts and other liabilities of the company incurred during that time. (2) A person who is personally responsible by virtue of this section for debts and other liabilities of a company is jointly and severally liable in respect of those debts and liabilities with— (a) the company, and (b) any other person who (whether by virtue of this section or otherwise) is so liable. (3) For the purposes of this section a person is involved in the management of a company if he is concerned, whether directly or indirectly, or takes part, in the management of the company. (4) The regulations may make different provision for different cases and may in particular distinguish between cases by reference to— (a) the conduct on the basis of which the person became subject to foreign restrictions; (b) the nature of the foreign restrictions; (c) the country or territory under whose law the foreign restrictions were imposed. (5) Regulations under this section are subject to affirmative resolution procedure.


from the directors. In making its decision the court held that the company having violated the Competition Act could not seek redress against its own directors and emphasized that the claimants were personally liable.

Section 1157 of the act provides for a defense in that “in proceedings for negligence, default, breach of duty or breach of trust against an officer of a company, or a person employed by a company as auditor it appears that he acted honestly and reasonably, and that having regard to all the circumstances of the case he ought fairly to be excused, the court may relieve him, either wholly or in part, from his liability on such terms as it thinks fit.”

It is evident from the discourse above that the UK act places more emphasize on the duties but not so much on the consequences due to the director upon breach of a particular duty. This is a major flaw that Kenya inherited by adopting part of the UK law.

4.3. South Africa

4.3.1. Brief history of the act

South African just like Kenya has been influenced to a great extent by English company law. Cape Stock Companies Limited Liability Act of 1862 was the first companies act which was based on the early English company legislation. South African Act 46 of 1926 became the main legislation that regulated companies.29 On 1 May 2011 the Companies Act, 2008 came into effect.

4.3.2. Provisions of the act on directors duties

Section 76 (2) states as follows; “a director of a company must not use the position of director, or any information obtained while acting in the capacity of a director to gain an advantage for the director, or for another person other than the company or a wholly-owned

subsidiary of the company.” Section 76 (3) further provides that “when acting in that capacity, a director must exercise the powers and perform the functions of director in good faith and for a proper purpose; in the best interests of the company; and with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director; and having the general knowledge, skill and experience of that director.”

Further it is required that a director manages business affairs without being reckless, keep company and accounting records, prepare annual financial accounting records and facilitate shareholders meeting.

4.3.2.1. Duty to act with the degree of care, skill and diligence

Historically, this duty has been interpreted in a very conservative manner. The benchmark for this duty is the decision in Fisheries Development Corporation of SA Ltd v Jorgensen\(^{30}\) where the court held that “the extent of a director’s duty of skill and care depends on the nature of the business the company is engaged in and that the law does not require the director to have special business acumen.”

The court in the case of Daniels-vs-Anderson\(^{31}\) held that duty of care and skill should be determined in an objective manner, the decision in this Australian case influenced the understanding of this in South Africa. King II Report of South Africa identified the low standard of this duty creating problems and consequently recommended a more objective standard. The court in Visser Sitrus (Pty) Ltd-vs-Goede Hoop Sitrus (Pty) Ltd and Others\(^{32}\) held that the duty to act within the scope of authority by a director is similar to principles of exercising public power.

\(^{30}\) [1979] (3) SA 1331 (W).
\(^{32}\) [2014] ZAWCHC 95.
4.3.2.2. Duty to act in the best interest

Under this duty, directors are mandated to “act in good faith in the interests of the company as a whole.” The court in *Minister of Water Affairs and Forestry-vs-Stilfontein gold mining* found that directors guilty of breach of their duty to act in the best interest of the company as they abandoned the company since it was convenient for them.

4.3.3. Consequences of breach

Directors should at all times refrain from fraudulent management of companies since there is a likely chance for them to face either criminal or civil sanctions. Provisions of breach of duties in South Africa are under section 77 of CA 2008 which is very elaborate and will be discussed in the subsequent section on personal liability of directors. Section 218(2) is also important, it provides as follows “any person who contravenes any provision of the act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.” This section allows for institution of civil actions against a director if the aggrieved stakeholder incurs loss or damage reasonable enough to warrant filing of a suit.

4.3.4. Provisions of the act on personal liability

CA 2008 has high standards for compliance for directors as the controlling minds of companies having provisions on duties of directors and how they ought to exercise their mandates as directors. CA 2008 introduced the phrase “prescribed officer” to include directors. The act further provides that a director shall be held personally liable for damages and losses incurred as a consequence of a director taking or failing to act against the making of unlawful decisions.

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33 [2006] (5) SA 333 W.
Section 22 of CA 2008 prohibits reckless trading by the company. The section specifically states that “a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person, or for any fraudulent purpose. If the commission has reasonable grounds to believe that a company is engaging in conduct prohibited by section 22 the commission may issue a notice to the company to show cause why the company should be permitted to continue carrying on its business, or to trade.”

Further, “if a company to whom a notice has been issued fails within twenty business days to satisfy the commission that it is not engaging in conduct prohibited the commission may issue a compliance notice to the company requiring it to cease carrying on its business or trading, as the case may be.”

The case of *Blue farm fashion limited-vs- Rapitrade 6 (pty) ltd and others*36 is a good illustration of how the courts have applied the section 22 and 218 of the act. In December 2013, Plaintiff and first defendant concluded an agreement that the plaintiff deliver the clothing ordered to the first defendant in one shipment in Cape Town in January 2014. On conclusion of the agreement, plaintiff delivered the clothing in Cape Town whereupon the purchase price of USD 414,665.90 became due and payable. First defendant breached the agreement by failing to pay the purchase price despite demand on numerous occasions. Plaintiff proceeded filing summons on 12 December 2014 against first defendant and its four (4) directors being second to fifth defendant. Second to fifth defendant were sued on the basis that they knew that the first defendant had no cash or liquid assets with which to pay the debt it would incur by procuring clothing from the plaintiff. According to defendants, the appropriate route for a third party creditor to follow in circumstances where the act, finds

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36 [2016] ZAWCHC 35.
application is to rely on the provisions of Section 218 of CA 2008 read with Sections 22 and 76 of CA 2008, rather than section 77(3)(b) of CA 2008. In essence, section 22(1) prohibits a company from conducting its affairs in a reckless or fraudulent manner, and section 76(3) provides that “the director of a company must exercise the powers and perform the functions of a director in good faith and for proper purpose, in the best interest of the company as directors manage the company.” Should the directors allow the company to conduct its affairs in a reckless or fraudulent manner such directors would be breaching section 76. That would allow the third party creditor who have suffered loss to institute action against the directors through section 218(2) of CA 2008. It was the plaintiff’s submission that the defendant’s argument on section 218(1) is without merit. On proper interpretation and construction of the section, it is nothing more than an enabling section which allows third parties such as a creditor (in this case, the plaintiff) from instituting civil proceedings to recover monies. It cannot be involved in order to have a director held personally liable. It was plaintiff’s contention that in its particulars of claim, it has instituted a civil action against the directors, and claims that they be personally held liable for a loss or damage (US$414,665.90).

In the alternative, plaintiff argued that section 218 need not be expressly relied upon because it is simply an enabling provision allowing for the institution of civil actions and not a section in terms of which the personal liability of directors is expressly provided for. So, defendants’ reliance on section 218 as a basis of exception must fail as plaintiff’s interpretation of the section is a reasonably possible one. The court held that that a company is a legal person thus it is not possible for it to incur losses, damages or cost without the actions of its directors. In this case, orders for clothing were made by directors, accepted delivery of the same and thereafter did not pay. The non-payment in the view of the court was considered to be directors were reckless and intended to defraud the plaintiff and thus cannot escape liability
for their actions. The court concluded that the directors were culpable for allowing the company to operate with the knowledge that section 22(1) prohibited such acts.

Sections 76 and 77 provide for “standards of conduct, and liability of directors.” Section 76(3) specifically states “that a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director; in good faith and for a proper purpose; in the best interests of the company and with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director; and having the general knowledge, skill and experience of that director.”

In Chemfit Fine Chemicals (PTY) Ltd vs Mokhutamane Kenneth Maake & 4 others37, the applicant a business entity that conducts trading as a supplier of medicated and nutritional feed additives. The respondents are individual directors of Mike’s Chicken which is involved in poultry farming. Mike’s Chicken was on 4 July 2016 placed under business rescue. Mike’s Chicken had applied for credit facilities for the applicant on 9 May 2014, the credit limit of R1.5M payable thirty days after invoice date. It appeared from the credit application that Michael John Nunes, Christian Jacobus Albertus Kristen the latter having resigned on 29 March 2016 were then the shareholders or members of Mike’s Chicken and also the parties who applied on its behalf for the credit facilities. Mike’s Chicken again on 12 November 2014 sought an increase of their credit facility to R 4M on the usual terms and conditions as the previous credit facility, the total debt stood at R 3,126,334.41. As matters stood Mike’s Chicken was trading under insolvent circumstances in that it was allegedly unable to settle its debts when they became due.

37 [2017] ZALMPPHC 27.
The applicant contended further that had it known of Mike’s Chicken’s financial distress prior to its extension of application for a credit facility, it would not have granted its extension in the circumstances. The issue for inquiry in this application was whether the respondents contravened any the act and if they were they liable for any loss incurred by the aggrieved party for infringement. The court opined that it is this alleged contravention that one must consider whether it is Mike’s Chicken as a separate juristic person or the natural which are organs of control and management of the company that are civilly liable to the applicant. The court’s answer was positive, that is, it is the latter who should incur personally liability. On a semblance of the facts in this application and taking into account the trading history by the company it follows that the directors on its behalf or its agents, have since May 2014 been trading under insolvent circumstances. That notwithstanding the directors on or about 12 November 2014, despite being financial distress went to seek to increase its already strained liquidity by borrowing against their credit facility an amount of R4 million, which swelled their indebtedness to the applicant. In doing so, needless to say, the company did so through its directors who in dealing with a third party did so as its agents, for a company cannot act on its own unassisted by its agents. It is contraventions of these or other nature that invariably attracts personal liability of the directors within the meaning and purport of Section 218(2) and ancillary provisions.

In addition, section 77 creates liability in relation to loss incurred by the company. Here, liability arises in event of an infringement of the common law principles. The court found refuge from the dictum of Du Plessis AJ in Rabinowitz-v-Van Graan and Others38 at paragraph 21 where the learned Judge stated:-

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38 [2013] (5) SA 315 at 320 G – I.
“Bearing in mind that the act specifically contemplates that the business and affairs of a company are to be managed by or under the direction of its board, it is hard to conceive of any basis upon which the legislature intended to prevent a company from acting in the manner provided for in section 22, but did not intend to prevent the directors responsible for the management of the company from acting in that manner. The court went on to state in paragraph 22 that: I agree with these submissions and find that a third party can hold a director personally liable in terms of the Act for acquiescing in or knowing about conduct that falls within the ambit of section 22 thereof.”

The court concluded that any conduct that contravenes a provision of the act, catapults a directors to personal liability.

Section 76(4) provides that, “in respect of any particular matter arising in the exercise of the powers or the performance of the functions of a director, a particular company director will have satisfied the obligations set out in section 76(3), if that director has taken reasonably diligent steps to become informed about the matter.” This means that a director is entitled to rely on information provided by his delegates having authority to perform some of the board’s functions. This information to be relied includes financial statements and date prepared by the delegates or external professionals retained by the company.

In terms of consequences for breach of duties, section 77 is very elaborate. The subsequent paragraphs enumerate various breaches described in CA 2008. Section 77 provides that “a director may be held liable for breach of a fiduciary duty, loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty.” It further provides that “a director is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acted in the name of the company. A director is also liable if they signed anything on behalf of the company or purported to bind the company or authorize the taking of any action on behalf of the company, despite knowing that the director lacked the authority to do so.”
In addition to the above “a director is liable if they have acquiesced in the carrying on of the company’s business despite knowing that it was being conducted in a manner prohibited by the act, been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company.”

“A director is also liable if they signed, consented to, or authorized, the publication of any financial statements that were false or misleading. If a director validates a statement to the effect that a person had consented to be a director of the company, when no such consent had been given, despite knowing that the statement was false, misleading or untrue a director may be held liable.”

Lastly, if a director is involved in the issuing of any unauthorized shares, provision of financial assistance to a director despite knowing there exists inconsistencies a director maybe held personally liable.

CA 2008 is very specific and elaborate as evidenced above. The advantage of having the above provisions clearly spelt out in the act is that the courts will not have a difficult time in making decisions on whether to hold a director personally liable or not.

Natal Joint Municipal Pension Fund vs Endumeni Municipality\(^{39}\) paragraph 18 of the judgment stated as follows:

‘Interpretation is the process of attributing meaning to the words used in a document having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. A sensible meaning is to be preferred to one that leads to insensible or unbusiness like results or undermines the apparent purpose of the document.’

\(^{39}\) [2012] (4) SA 593 (SCA).
By applying the above reasoning, the court held that holding directors’ personally liable as per section 77(3) results to a sensible outcome.

The claim in *Sanlam Capital Markets (Pty) Ltd-*vs-Mettle Manco (Pty) Ltd and Others* was based on reckless trading by the directors and participating in operations of the company with the knowledge that it was insolvent. The claim was premised on section 77(3) (b). The main allegation against the plaintiff was that the defendant directors ought to be held personally. The court did not allow the claim by the plaintiff as they did not disclose a cause of action.

From the above, it is evident that the reliance of case law is also not necessary in this instance as the act takes precedent over court decisions. The other advantage is that there is going to be uniformity in the decisions made as there is a foundation of such matters which is the companies act. The act also provides for a defense which a director can rely on. The act states that “in any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that the director is or may be liable, but has acted honestly and reasonably; or having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.”

From the above it is clear that section 77(3) (b)* read with section 22 penalizes directors personally for “losses incurred through knowingly carrying on the business of the company

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40 [2014] 3 All SA 454 (GJ).
41 Section 77 (9).
42 A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acquiesced in the carrying on of the company’s business despite knowing that it was being conducted in a manner prohibited by section 22(1).
recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.” Furthermore, the act defines what is meant by a person knowing\textsuperscript{43} of such prohibited conduct. For example a director who in the course of conducting the affairs of the business permits his company to accept goods or services on credit having full knowledge of the fact that the company has no funds to pay for the goods and services is liable personally as such actions are considered reckless trading practices.

If a director has knowledge of the company’s insolvent condition and continues to trade CA 2008 allows a claimant to file civil proceedings against the director. To note is that the CA 2008 does not confine the application of section 77 to directors, the section applies “an alternate director, a prescribed officer (as designated by the Minister) and a person who is a member of a committee of a board of a company.” With regards to criminal sanctions, section 214 of CA 2008 for situations where an “act of fraud has been perpetrated by any person in relation to a company, its creditors or employees.”

To conclude this chapter, the legal position of directors’ personal liability in CA, 2008 can be summarized as follows: nonpayment of what is owed to a creditor without a valid reason is contravention of section 22(1) since this is considered as an act of reckless trading with the intention to defraud. Contravention of section 22(1) leads to breach of director’s fiduciary duties set out in section 76. Breach of fiduciary duties lead to contravention of section 77 which automatically leads to personal liability.

\textsuperscript{43} Knowing means that the person either had actual knowledge, or such person reasonably ought to have had actual knowledge or acquired it by having investigated the matter or by having taken other measures which would reasonably be expected to have provided the person with actual knowledge of the matter.
4.4. Conclusion

The major similarity in the companies acts discussed in chapter four is the codification of duties of directors. The acts are very clear on what is expected from each director upon taking up the role of director. It is also evident that the courts are always in support of the provisions of the acts and rarely do they give contradictory opinions than what is stated in the acts.

Besides the codification, CA 2006 has made a deliberate effort to expound on each of the duties, each in its own section. CA 2008 has lumped all the duties in one section and no further details have been stated. Where CA 2008 has made tremendous strides, is the fact that it has express provisions on a director’s personal liability. Kenya would have greatly benefitted by bench marking with this act.

From the above discourse it is clear that Kenya having borrowed heavily from CA 2006, failed to make improvements while developing CA 2015 this implies that Kenya has an uphill task due to lack of codification and is left to rely on the decisions made by the courts, which has been discussed in the previous chapters and they are very diverse and there is no uniformity.

Having looked into CA 2008 it is clear that the legislature in South Africa was very intentional in expressly providing that which would lead to a director being held personally liable for breach. This jurisdiction has resolved the issue of not having to rely on court decisions when dealing with claims of personal liability but instead on the Act.

The advantage of having such clear legal provisions, is that the directors are well informed of their responsibilities, duties and the consequences of not complying with the law and
therefore cannot feign ignorance. Kenya would have really benefitted from borrowing or looking into CA 2008 when CA 2015 was being drafted. Following the various companies that have gone under in the recent past, Kenya would have really taken advantage of having express legal provisions in CA 2015 to deal with rogue directors. Unfortunately, Kenya still has to rely on court precedent to decide on personal liability claims. Chapter five will present the conclusions and recommendations of the research.
CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Summary and conclusion

At the end of the research, the aim was to find answers to three questions, namely: what reasons are given by the courts in holding directors personally liable for misconduct? What reasons are given by courts in reaching the decision not to hold directors personally liable for misconduct? What best practices can Kenya borrow from the UK and South Africa in terms of director duties?

In undertaking the research all the above questions were answered and this will be summarized in the ensuing paragraphs. The research project is divided into five chapters, the key issues considered and the finding of each of the chapters will be discussed as herein below. In chapter one, background of the legal doctrine of entity separateness is presented. The recurring theme in looking at the reasons for collapse of companies was attributed to the role played by directors in running the companies and their decision making. Directors have always found a shield in the legal doctrine of separateness of the company due to the legal rule that a company is a legal person distinct from its members. The key findings presented in chapter one were that courts have made decisions holding directors personally liable, notwithstanding the nature of companies being limited liability entities and directors become liable for engaging the company in fraudulent transactions.

Chapter two sampled private companies and financial institutions that had collapsed or came near to collapsing with the aim of finding out what action was taken against the directors of these companies with particular reference to CMC Holdings Limited, and financial institutions like National Bank of Kenya Limited, Chase Bank Limited (in receivership),
Imperial Bank Limited (in receivership) and Dubai Bank Kenya Limited (under liquidation).

The reason for looking into the financial institutions was the fact that financial institutions are highly regulated which begs the question why there was no proper oversight on the decisions being made by the directors. From the findings in the research, it is clear that various actions had been taken against the directors such as enforcement actions by the relevant regulatory authority and also legal proceedings.

Sampled case law in matters regarding misconduct of directors from four jurisdictions namely; the United States, UK, South Africa and Kenya were analyzed and presented in Chapter three. The aim of analyzing these jurisdictions was to determine whether there are basic common principles relied on by the courts in deciding whether to hold directors personally liable for breach. From the discussion in chapter three, courts have discretion on whether to hold directors personally liable or not for their actions by looking into the facts of the claim before making a decision. There seems to be no clear formula or set guidelines available for the courts to rely on, instead the courts look at the facts on the case before exercising its wisdom in making the decisions.

In Chapter four, the companies acts of the UK, South Africa and Kenya with regards to duties of directors as provided for in the acts and how the courts have interpreted the duties and dealt with issues of breach of these duties is presented. Information in chapter four is based on insights of the provisions of personal liability of directors with the focus on whether the companies’ acts have express provisions on personal liability and if there are none how the courts have handled personal liability claims brought against directors. The findings reveal Kenya having borrowed heavily from the UK’s Companies Act, failed to make improvements while developing the Companies Act, 2015.
This last chapter gives answers to the three research questions which guided this study are provided. Serving as a director of a corporation should not be taken lightly as being a director is a position of significant responsibility and there are several duties imposed upon the director. In the case of Kenya, directors’ duties have been codified in CA 2015 but there are no express provisions on personal liability of directors. Company directors hold a position of power and trust and from the discussions in this research it has emerged that the risk of personal liability is real but avoidable if directors follow the law. The assumption by most directors is the belief that being part of a limited company protects them against personal liability. While a limited company does offer an element of protection, there are no guarantees and there have been many instances as evidenced in the various chapters in the research where directors have been sued in their personal capacity for actions they carried out on behalf of a company.

The legal foundation of “corporate law is that a company is considered a legal person distinct from its members.” The statement of problem the research looked into circumstances where the courts have held directors personally liable for their misconduct and the reasons given by the courts for reaching such decisions. Rationale of doing research was advanced by the fact that while most directors act and make decisions as provided by the company’s constitution and stature, there are those who act rogue to the detriment of the company and its stakeholders.

5.2. Research Findings

Ultimately, the aim of the research was to get answers to three pertinent questions which in the course of the research the questions have been answered as follows:
5.2.1. What reasons are given by the courts in holding directors personally liable for misconduct?

This question was answered in chapter three and four of the research project. The two chapters provided details of case law while trying to explore the reasons given by the court when making decisions of personal liability claims as summarized herein. In looking at the cases, one of the key considerations of personal liability is direct participation or negligence as a key ingredient.¹ Another factor that the courts look at is that a director will not be personally liable by virtue of holding the position of a director but personal connection to the act must be present.² Further, directors can held personally liable if they inadequately manage the affairs of the company or fail to supervise the assignments done by their juniors.³

Another consideration by the courts is that a director will incur personal liability if it is proved that the directors knowingly participated in the misconduct.⁴ The courts are keen at looking at the controlling mind of the company before making a decision, since a company is incapable of making its own decisions without human interference.⁵ In support of this assertion the court in Blue farm fashion limited-vs-Rapitrade 6 (pty) ltd and others⁶, held since a company in law is not a natural person it is impossible for it to incur losses, damages or cost without the actions of its directors. In making its decision, the court found that the directors acted recklessly with the possibility of intent to defraud plaintiff and cannot escape liability for their actions. Courts have also found directors culpable where a director has procured or directed the company to commit the wrongful act.⁷ Further, if a claimant is able

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² K&G Oil Tool & Service Co. Ltd-vs-G&G Fishing Tool Service[1958] 314 S.W.2d.
⁶ [2016] ZAWCHC 35.
to prove fraud then the court will hold a directors personally liable.\textsuperscript{8} The courts also look at the conduct of the director and it can be shown that directors were not concerned with the ensuring that the company succeeded leading to the company’s stakeholders being prejudiced directors will be held personally liable.\textsuperscript{9}

In chapter four, CA 2008 has been discussed which brought forth the elaborate provisions on personal liability of directors. In South Africa, the court will upon considering the facts of the case determine if there has been a contravention of the provisions of CA 2008. The court has directed its mind to the fact that any conduct that contravenes a provision of the act, catapults any person, including the directors to personal liability.\textsuperscript{10}

\textbf{5.2.2 What reasons are given by courts in reaching the decision not to hold directors personally liable for misconduct?}

In an attempt to answer this question, information presented in chapter three on case law, shows that each jurisdictions looked at deal with claims on misconduct the best way it knows looking into the details or facts of a claim. In United States the leading case is the \textit{Spering Appeal}\textsuperscript{11} where the court was of the opinion that that directors are indeed personally responsible to the stakeholders for losses as a result of fraudulent transactions, misappropriation of companies’ funds, misconduct and breach of duties, lack of attention to companies operations and engagement in negligence. However, if directors are honest, act within their scope of authority and exercise discretion they cannot be held personally liable. In addition, the court referred to directors as mandatories\textsuperscript{12} and concluded that “directors are bound to apply ordinary skill and diligence but no more.” If in analyzing a claim, the court

\begin{itemize}
    \item \textsuperscript{8} \textit{National Social Security Fund Board of Trustee-vs-Ankhan Holding Limited & two others} Civil Case No. 268 of 2004 (26 April 2006) [2006]; eKLR .
    \item \textsuperscript{9} \textit{Strut Ahead Natal (Pty) Limited-vs-Burns} [2007] 3 All SA 190 (D).
    \item \textsuperscript{10} \textit{Chemfit Fine Chemicals (PTY) Ltd-vs- Mokhatamane Kenneth Maake & 4 others}[2017] ZALMPPHC 27.
    \item \textsuperscript{11}[1872] 10 Am. Rep. 684.
    \item \textsuperscript{12} Persons who have gratuitously undertaken to perform certain duties.
\end{itemize}
forms the opinion that a director in conducting his duties acted in a manner similar to that of a reasonable person in a similar position as the director and did what exactly what the director would have acted then he is not personally liable.\textsuperscript{13}

\textbf{5.2.3 What best practices can Kenya borrow from the United Kingdom and South Africa?}

In Chapter four, details CA 2006 and CA 2008 in terms of what the director duties, consequences of breach and provisions of personal liability were presented and discussed. The findings reveal that in the UK, common law provisions are still key in determining duties of directors in the UK which have been elaborately discussed in chapter four. Consequences of breach are provided for under section 178 of CA 2006.\textsuperscript{14} An aggrieved party has various options; “seek to recover any of the company’s property misapplied by the director”, “make the director account to the company for the profit” and “seek an injunction to prevent the act complained of from being committed.” This is a provision which can be adopted into the Kenya legislation to inform an aggrieved stakeholder of the legal remedies available to them for reprieve. The main finding in analyzing CA 2006 was that emphasis has been placed on the duties but no emphasizes is placed on noncompliance with the duties. CA 2008 is a sharp contract from CA 2006 and CA 2015. CA 2008 has express provisions on director’s personal which prevents lacuna in law dealing with personal liability.

Some of the well spelt provisions that can be adopted in Kenya are listed in the subsequent paragraphs. Section 76 (2) which provides that “a director of a company must not use the position of director or any information obtained while acting in the capacity of a director to gain an advantage for the director.” Section 76 (3) is also a good provision that provides that

\textsuperscript{13} \textit{Heneways Freight Services (Pty) Limited-vs-Gregor[2006]} ZASCA 158
\textsuperscript{14} The consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied. The duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.
“when acting in that capacity, a director must exercise the powers and perform the functions of director in good faith, for proper purpose and the best interests of the company and with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director.”

Section 218(2) which states that “any person who contravenes any provision of the act is liable to any other person for any loss or damage suffered by that person.” Section 22 “prohibits reckless trading by the company by stating that a company must not carry on its business recklessly with gross negligence, with intent to defraud any person, or for any fraudulent purpose.”

In terms of consequences for breach of duties, section 77 of CA 2008 is very elaborate. The section states in summary that: “director of a company may be held liable for breach of a fiduciary duty, loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty.” “A director is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acted in the name of the company.”

A director is also liable if they appended their signature on a document “on behalf of the company despite knowing that the director lacked the authority to do so.” “A director is liable if they have acquiesced in the carrying on of the company’s business despite knowing that it was being conducted in a manner prohibited by the act.”

“A director is liable if they signed, consented to, or authorized, the publication of any financial statements that were false or misleading.”
All the above are very specific instances that will lead to personal liability and are clearly prescribed for in the law. In conclusion therefore, the major similarity in the companies’ acts of the UK, South Africa and Kenya is the codification of duties of directors. In the three jurisdictions directors’ duties are clearly provided for in the law. The acts are very clear on what is expected from each director upon taking up the role. Besides the codification, the CA 2006 has made a deliberate effort to expound on each of the duties, each in its own section.

CA 2008 on the other hand has lumped all the duties in one section and no further details have been stated. CA 2015 has merely listed the duties without expounding on them. Kenya having borrowed heavily from CA 2006, failed to make improvements while developing the CA 2015. Kenya would have really benefitted from borrowing or looking into CA 2008 when CA 2015 was being drafted.

Following the various companies that have gone under the recent past, Kenya would have really taken advantage of having express legal provisions in CA 2015 to deal with rogue directors and specifically personal liability. It is evident from the findings of this research that instances of breach of director’s duties is prevalent in the commercial law stratosphere. This therefore means that the law needs to be very clear on how to deal with such matters by having clear provisions.

5.3 Recommendations for policy and practice

The recommendations to be discussed in this section are immediate, short and medium term and long term. From the research findings there is evidence to show that it is possible for directors to be held personally liable for their actions. The immediate recommendation would therefore be for directors to protect themselves from personal liability claims by taking out
Directors’ and Officers’ Liability Insurance. This insurance cover provides funds to cover legal costs and damages awarded to the complainant in case of a successful personal liability claim. The directors should ensure that Director’s liability cover is able to cover the company adequately in case a claim is against the company. Premiums to be paid for such covers would vary on the exposure which the directors would like to protect themselves from.

The medium and short term recommendation would be for the directors to appraise themselves through training on the issues of director duties and personal liability. The assumption made by most directors is that they are protected by the corporate shield, what they do not know is that any aggrieved stakeholder can institute a civil or criminal claim against a director for personal liability. This recommendation shall be implemented by the directors by getting an experienced trainer to take them through issues of personal liability. Another short and medium term recommendation is conducting of further research on the issue of directors’ personal liability especially on the recourse available to aggrieved stakeholders, from the research it is clear that criminal sanctions against the directors are not enough as stakeholders are not compensated. In addition, more research is required on what entails breach of director duties, since it has been observed that breach is defined by the facts of a matter. At times an action by a director maybe considered as breach but upon review of the facts at hand the court finds there is no breach by a director.

The long term recommendation is amendment of CA 2015 to ensure that all stakeholders’ interests are considered and protected. The amendment of the CA 2015 requires input from various stakeholders’ to ensure their interests have been factored into the amendments therefore public participation is very important. The implementer of this recommendation can be a private citizen or the legislature. One of the key findings of this research is that it is
evident that there is need to have express provisions of holding directors personally liable in CA 2015. As discussed in chapter three, South Africa has resolved this area of corporate law by having express provisions in CA 2008. CA 2015, needs to be amended to somewhat emulate CA 2008 as the lack of express provisions on personal liability poses a huge challenge in the corporate world. With express provisions directors are aware of what constitutes breach of their duties and the consequences they stand to endure in case of breach and courts have clear direction on how to handle matters of personal liability since it is enshrined in the law.
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