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DISQUALIFICATION OF COMPANY DIRECTORS: SAFEGUARDING THE PUBLIC INTEREST IN THE KENYAN INVESTMENT MARKET

*Kiarie Mwaura**

I. INTRODUCTION

Over the last two decades, Africa has gone through tremendous economic transformation. It was only in 2004 when the Prime Minister for the United Kingdom, Tony Blair, described Africa as the “scar on the conscience of the world” when he was establishing the Commission for Africa.¹ A decade later, he described Africa as “the most exciting continent on the planet because of its opportunities.”² Within less than twenty years, the continent has become the world’s most rapidly growing economic region. This economic growth has been attributed largely to the active private sector. Kenya, for example, has realized the highest growth rate in the East African region due to its private sector, which makes a major contribution to the country’s GDP.³ For this growth rate to continue, African countries need to create competitive legal frameworks that continue to attract investors and protect their interests.

One example is the disqualification framework for company directors which seeks to protect the public by placing a prohibition on a miscreant director from being involved, for a specific period, in the management of companies.⁴ An efficient disqualification framework also prevents people

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¹ See Tony Blair, *Africa is the Most Exciting Continent on the Planet*, TONY BLAIR INST. FOR GLOBAL CHANGE (Apr. 29, 2015), <https://institute.global/insight/governance/africa-most-exciting-continent-planet>.

² *Id.*

³ See *Ease of Doing Business Survey Kenya*, THE WORLD BANK GROUP, <http://www.doingbusiness.org/data/exploreeconomics/kenya> (last visited Mar. 11, 2019).

⁴ STEPHEN GRIFFIN, PERSONAL LIABILITY AND DISQUALIFICATION OF COMPANY DIRECTORS 131 (1999).

without the necessary qualifications from managing companies, and deters those who might be tempted to engage in fraudulent activities.⁵ Investors are unlikely to be attracted to a country without a strict disqualification framework because they risk losing their investments when their companies are managed by incompetent, negligent, and/or fraudulent directors, especially by those with a track record of mismanaging companies. This philosophy was captured clearly by the Kenyan Government when it enacted the Companies Act 2015, which stated that one of its key objectives was to facilitate commerce, industry, and other socio-economic activities.⁶ It is against this backdrop that this Article examines whether the disqualification framework under the Companies Act 2015 is adequate to protect investors' interests. This framework is then contrasted with the one that existed under the repealed Companies Act 1962 in order to assess whether the reforms are likely to bring about the desired changes.

II. GROUNDS FOR DISQUALIFICATION

The repealed Companies Act 1962 required directors to cease serving as directors in the event that they failed to take up any prescribed shares within two months of their appointment.⁷ It also provided that a director would become automatically disqualified if he was declared bankrupt or made any arrangement or composition with his creditors.⁸ Other grounds for disqualification of directors, included: whether he was prohibited from being a director by reason of fraud;⁹ where a director was of unsound mind;¹⁰ where he resigned his office by notice in writing to the company;¹¹ or he was absent for more than six months without permission of the directors from meetings with the directors held during that period.¹²

⁵ *R v. Kazmi* (1984) 7 Cr. App. R. 115, 116.

⁶ The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 2.

⁷ The Companies Act (1962) Cap. 486 § 183 (Kenya).

⁸ *Id.* § 188(1).

⁹ *Id.* § 189(1)(b)(ii).

¹⁰ *Id.* at tbl.A § 88(d).

¹¹ *Id.* at tbl.A § 88(e).

¹² *Id.* at tbl.A § 88(f).

A. Bankrupts

Persons who were undischarged bankrupts were barred from acting as directors under the Companies Act 1962.¹³ As people who had failed to manage their finances, bankrupt individuals were automatically disqualified from taking part in the management of companies. As such, their disqualification was not dependent upon wrongdoing, negligence, or the making of a disqualification order by the court. However, they were entitled to apply to court for leave to act as a director.¹⁴ For leave to be granted, the bankrupt needed to show that he or she could be safely involved in the management of companies.¹⁵

Acting as a director whilst disqualified resulted in criminal penalties¹⁶ and personal liability for the debts and other liabilities of any company in whose management a disqualified person was involved.¹⁷ The personal liability extended to any person involved in the management of the company who knowingly acted on the instructions of a disqualified person.¹⁸ Disqualifying bankrupt persons from managing companies was helpful in protecting the interests of shareholders and creditors.

Similar to the Companies Act 1962, bankrupt individuals are disqualified from being involved in the management of companies under the Companies Act 2015. Thusly, it is an offense for an undischarged bankrupt to directly or indirectly participate in the promotion, formation or management of a company.¹⁹

B. Fraud and the Management of a Company

The Companies Act 1962 provided for disqualification of directors on the basis of fraud. A court could disqualify²⁰ a person from taking part in the management of a company if the person was “convicted of any offence in

¹³ *Id.* § 188(1).

¹⁴ *Id.*

¹⁵ *Id.* § 188(2).

¹⁶ *Id.* § 188(1).

¹⁷ *See id.* § 323(1)(a).

¹⁸ *Id.*

¹⁹ *Id.* §§ 223(1), (4).

²⁰ *See Andrew Hicks, Making and Resisting Disqualification Orders*, 8 Co. L. 243 (1987).

connection with the promotion, formation or management of a company.”²¹ A person could also have been disqualified if, in the course of winding up of a company, it appeared that he, while an officer of the company, had been guilty “of any fraud in relation to the company or of any breach of his duty to the company.”²²

This provision was thought to have been narrow in scope, as it only covered offences that were connected with the promotion, formation, and management of the company. It did not extend to other offences, such as economic crimes, which could also make a director unsuitable to serve.

The provision was also somewhat vague, as it extended liability to a wide range of persons, including employees in the lower cadre of the company, who often get involved in the indirect management of a company. As a result, this made it difficult for a disqualified person to ascertain what role he ought to have assumed once employed by a company.²³ For example, since the concept of management involves policy-making and decision-making activities which affect the company as a whole, or a substantial part of it, and which may affect its financial standing,²⁴ a management consultant advising on financial management could have been said to be concerned in the management of the company for the purposes of disqualification.²⁵ As a result of this, full disqualification posed the risk of not only removing a person from the board,²⁶ but also making him unemployable.²⁷

This ground was also thought to be limited, as it did not allow for disqualification of directors on the grounds of breach of duty when a company was a going concern. Disqualification for breach of duty was only triggered when a company was in the process of being wound up. Therefore, this meant that many miscreant directors who had breached their duties escaped liability, especially when it was difficult to prove fraud when a company was a going concern. The difficulty in proving fraud was illustrated in the case of *Kassam Ebrahim v. Tait*,²⁸ where the Chief Judge Sir Charles

²¹ See The Companies Act (1962) Cap. 486 § 189(1) (Kenya).

²² *Id.* § 189(1)(b)(ii).

²³ *Re Altim Pty Ltd* [1968] 2 NSWLR 762 (Austl.).

²⁴ *Commissioner for Corporate Affairs v. Bracht* [1989] V.R. 821 (Austl.).

²⁵ *R. v. Campbell (Mary)* [1984] BCLC 83 (Eng.).

²⁶ See Companies Code Act 179 of 1963 § 186(1)(b) (Ghana).

²⁷ L.H. Leigh, *Disqualification Orders in Company and Insolvency Law*, 7 Co. L. 179, 183 (1986).

²⁸ *Kassam Ebrahim v. Tait* (1935) CA 2 (Eastern Afr.).

Law followed the judgment of Lord Halsbury in *Ex parte Barnes*²⁹ to hold that “facts must be found . . . against the person incriminated and that there must be an individual person incriminated . . . it is not enough that there is a general finding that fraud must have existed somewhere, which would mean nothing.”³⁰ As a result of the onerous burden of proving fraud in Kenya, the disqualification regime was largely ineffective in deterring misconduct on the part of directors.

The obstacle of proving fraud has now been removed by Sections 214 and 216 of the Companies Act 2015, which allows for disqualification on the grounds of fraud and breach of duty.³¹ The disqualification under Section 214 extends to the misconduct of a director when a company is a going concern. Section 214 is similar to Section 8 of the UK’s Company Directors Disqualification Act 1986 (CDDA), which allows for disqualification of a director for being unfit when the company is a going concern.³²

For a director to be declared unfit under Section 214, the court must be satisfied that the director has exhibited gross incompetence or conduct in breach of commercial morality that constitutes a danger to the public.³³ This may arise, for instance, where a director conducts business in total disregard of the interests of creditors. In *Re Ipcon Fashions Ltd*,³⁴ knowledge by the director that the company was insolvent when he siphoned off its business to another company, thus incurring liability to the old company, was held to be a ground for disqualification. Similarly, in *Re McNulty’s Interchange Ltd*,³⁵ a director who had no new ideas about improving the business of a company, which was continuously accumulating debts, was liable for disqualification.³⁶

²⁹ *Ex parte Barnes* [1896] AC 146 (appeal taken from Eng.).

³⁰ *Id.* at 152.

³¹ See The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 214(4) (providing that “disqualification order may be made on grounds that are or include matters other than criminal convictions, whether or not the person in respect of whom it is to be made may be criminally liable in respect of those matters”).

³² Company Directors Disqualification Act, 1986, c. 46, § 8 (U.K.).

³³ *Dawson Print Group Ltd* [1987] 3 BCC 322 (Eng.). See also Andrew Hicks, *Disqualification of Directors-Forty Years On*, J. BUS. L., 1988, at 27, 42.

³⁴ *Re Ipcon Fashions Ltd* [1989] 5 BCC 733 (Eng.).

³⁵ *Re McNulty’s Interchange Ltd* [1988] 4 BCC 533 (Eng.).

³⁶ See also *Re Douglas Construction* [1988] 4 BCC 553 (Eng.) (holding that the director, who had put a lot of his own money into the company in order to keep it going, was held not to have contravened the principles of business morality); *Dawson Print Group Ltd* [1987] 3 BCC 322 (Eng.) (finding a director not liable for failing to pay debts due to the Crown and continuing to trade when he ought to have known

As to what makes a person unfit in the United Kingdom, Browne Wilkinson VC provides a meaningful explanation, “Ordinary commercial misjudgement is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity although I have no doubt that in an extreme case of gross negligence or total incompetence disqualification could be appropriate.”³⁷

Therefore, courts have refused to disqualify directors for mere mismanagement, as the aim of disqualification is to protect the public and not punishment of directors.³⁸ It follows that despite the mandatory nature of Section 214 of the Companies Act 2015, courts may decline to disqualify a director in the absence of sufficient evidence to prove unfitness.³⁹ Furthermore, while the courts assess whether a director should be disqualified on the balance of probabilities, the amount of evidence required to find a director liable is often more onerous than that,⁴⁰ extending the standards of proof beyond the civil one. Given that the application of the balance of probabilities test would lead to disqualification of many directors, the onerous standard of proof is thus applied in favour of directors to ensure that they continue to run companies where risk is not apparent.⁴¹

Section 214 makes the disqualification regime more stringent, as a company does not have to be in the course of winding up for the unfitness ground to be applied. The unfitness ground introduces a desirable application of objective standards,⁴² such as breach of commercial morality, gross

that the company was insolvent). *Contra Re Stanford Services Ltd* [1987] 3 BCC 326 (Eng.) (rendering the commercial test unhelpful and disqualified a director for two years for using money collected as VAT or PAYE as part of their cash flow needs).

³⁷ *Re Lo Line Electric Motors Ltd* [1988] 4 BCC 415 at 419 (Eng.).

³⁸ *Re Grayan Building Services Ltd* [1995] BCC 554 at 557 (Eng.).

³⁹ *Re Arctic Engineering Ltd* (No. 2) [1985] 1 BCC 99563 (Eng.) (holding persistent defaults by an accountant in making necessary returns did not result in disqualification since there was no dishonesty).

⁴⁰ See *Re Living Images Ltd* [1996] BCC 112, (Eng.) (favoured the view that the evidence against a director ought to be overwhelming of the directors' wrongdoing).

⁴¹ Stephen Griffin, *Standards of Proof Applicable to S6 of the Company Directors Disqualification Act 1986*, 18 Co. L. 24, 26 (1997); Amanda Hoey, *Disqualifying Delinquent Directors*, 18 Co. L. 130 (1997).

⁴² See *AB Trucking and BAW Commercials* (Ch D June 1987, Unreported) (holding respondent incapable of understanding the commercial reality of accounts and thus incapable of discharging his duty to the public. Harman J disqualified the respondent for four years for falling below an objective standard). See also Janet Dine, *Disqualification of Company Directors*, 9 Co. L. 213 (1988).

incompetence, recklessness, and being a danger to the public, by which to judge the conduct of directors.⁴³

Section 215 widens the scope within which one can be disqualified by extending liability to offences that are not in the Companies Act 2015. This follows the approach adopted by the Ghanaian Companies Code as well as the Singapore's Companies Act, which provide for disqualification on the basis of conviction of any offence (not necessarily relating to a company) involving fraud or dishonesty.⁴⁴

Section 218(1) of the Companies Act 2015 allows for the disqualification of a director of a company that has at any time become insolvent and the conduct of the director makes him unfit to take part in the management of a company.⁴⁵ Matters that might render a director unfit include: breach of fiduciary or other duty; any conduct giving rise to an obligation to account for money or other property of the company; failure to prepare financial statements and directors' reports; failure to keep a register of members, directors, and secretaries; failure to keep proper accounting records; and submitting annual returns to the Registrar.

Broadening the scope of disqualification to provide for disqualification arising from offences outside the Companies Act 2015 as well as breaches of duty when a company is a going concern has made the disqualification framework more of a deterrent, as directors can be disqualified on the basis of their unfitness to act in the management of companies.

C. Filing Returns

Under the Kenyan Companies Act 1962, failure of filing annual returns by a director made him liable to a fine,⁴⁶ but it was not a ground for disqualification. Some commentators, however, felt that disqualifying directors for failure to file returns was desirable, as it could improve the level of compliance.⁴⁷ This would, in turn, raise directors' accountability to

⁴³ See Dine, *supra* note 42.

⁴⁴ Companies Act 2017, c. 50, § 154 (Sing.).

⁴⁵ The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 218(1).

⁴⁶ The Companies Act (1962) Cap. 486 § 125(3) (Kenya).

⁴⁷ Kiarie Mwaura, *Disqualification of Company Directors in Kenya*, 54 N. IR. LEGAL. Q. 118, 129 (2003).

shareholders, as the latter would be able to keep track of the affairs of the company.⁴⁸

Section 217 of the Companies Act 2015 now provides for disqualification as a result of conviction for failure to file returns.⁴⁹ For such an order to issue, the person needs to have been convicted for no fewer than three such offences within the five years ending with the date of the last conviction.⁵⁰ This approach is similar to that of the United Kingdom⁵¹ and Australia,⁵² where courts can disqualify a director for up to five years for being in default of filing returns with the Registrar of Companies. However, the Kenyan approach is more similar to that of Australia, as it captures a scope that covers breaches of all companies' legislation and those that go beyond.⁵³

III. ENFORCEMENT OF DISQUALIFICATION ORDERS

The implementation of a disqualification framework would hardly be effective without reliable enforcement mechanisms. To satisfy the objectives of disqualification orders, Section 244 of the Companies Act 2015 makes a disqualified person who gets involved in the management personally in contravention of a disqualification order responsible for the relevant debts of a company incurred while he was so involved.⁵⁴

IV. THE LENGTH OF DISQUALIFICATION ORDERS

Section 189 of the Companies Act 1962 provided that a disqualified director was prevented from being involved in the management of companies for a period not exceeding five years.⁵⁵ This was thought to have been less of

⁴⁸ *Id.*

⁴⁹ The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 217.

⁵⁰ *Id.*

⁵¹ Company Directors Disqualification Act 1986, c. 46, § 3 (Eng.).

⁵² *Corporations Act 2001* (Cth) pt I §§ 4, 10, 285 (Austl.).

⁵³ See The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 215(4).

⁵⁴ The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 244.

⁵⁵ The Companies Act (1962) Cap. 486 § 189 (Kenya).

a deterrent than intended and proposals were made to lengthen the period of disqualification.⁵⁶

This was enhanced by the Companies Act 2015, which now provides for a maximum of five years imposed by magistrates and fifteen years by judges.⁵⁷ This follows the approach adopted in other jurisdictions, such as Australia, that recognise the need for longer periods of disqualification. The Australian courts can disqualify a person from managing corporations for a period that the Court considers appropriate.⁵⁸ Similarly, the United Kingdom's CDDA imposes a minimum disqualification for unfitness of two years and a maximum of fifteen years.⁵⁹

V. LIMITED AND CONDITIONAL ORDERS

Section 229 of the Companies Act 2015 enables a disqualified person to apply to court for permission to act in a way that would otherwise be a breach of the disqualification.⁶⁰ This is a departure from the approach taken by the repealed Companies Act 1962, which did not have the same flexibility. In the old regime, the courts either imposed absolute disqualification orders or made no disqualification orders.

Limited and conditional orders may be useful in instances where the courts feel that it may, for instance, be appropriate to disqualify a director from a public company and not a private one⁶¹ in order to safeguard national commercial interests.⁶² Therefore, where damage to the company is not apparent, conditional disqualification orders are useful because they allow the courts to balance the interests of the public, employees and the director in question and, in turn, promote enterprise and protect creditors at the same time. Thus, where the courts are reluctant to impose absolute disqualification

⁵⁶ Mwaura, *supra* note 47, at 125.

⁵⁷ See The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 215(2).

⁵⁸ *Corporations Act 2001* (Cth) ch 2D pt 2D.6 ss 206C, 206E (Austl.).

⁵⁹ See Hicks, *supra* note 20, at 245 (assessing the appropriate length of the disqualification order, the court considers: the nature of the offence, whether it was closely connected with management, the nature of the person's involvement in the offence, his general character and reputation, etc.).

⁶⁰ The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 229.

⁶¹ Hicks, *supra* note 33, at 42.

⁶² *Re Majestic Studios* [1988], 4 BCC 519 (Eng.) (allowed a director to continue trading after a disqualification order on condition that he was accountable to an independent assessor. In so doing the court was able to save fifty jobs which were at risk).

due to their harsh consequences, they might be far more amenable to making limited and conditional orders.⁶³ It is possible for the leave-to-act to be utilised as a limited disqualification order where a director is allowed to serve in certain capacities only.⁶⁴ Similarly, Australian courts may impose such conditions or limitations as they think fit.⁶⁵ Thus, the courts can protect creditors effectively by use of conditional orders rather than the far-reaching absolute disqualification orders.

VI. UNDERTAKINGS

Section 220(1) of the Companies Act 2015 allows the Attorney General to accept a disqualification undertaking by any person.⁶⁶ In such circumstances, a director undertakes not to be involved in the management of companies for a specific period of time. The maximum period is fifteen years and the minimum is two years. This is a new development that was not catered for under the old regime. In view of delays in court proceedings, the undertakings are likely to help in decongesting the courts, as they enable disqualification proceedings to be settled out of court. Such undertakings have already been adopted in the United Kingdom, where the Insolvency Act 2000 empowers the Secretary of State to accept the undertaking of a director without requiring him to admit the actual basis of disqualification. While such undertakings might be expedient and cheaper on the public purse, they

⁶³ See *Re Lo-Line Electric Motors Ltd* [1988] 3 WLR 26 (Eng.) (a director was disqualified for a three-year period but permitted to remain as a director of two companies so long as a named qualified accountant remained a director of the company). See also *Re Majestic Studios* [1988] 4 BCC 519 (Eng.) (allowed a director to continue trading after a disqualification order on condition that he was accountable to an independent assessor. Such conditions are not different from the conditional orders given in other jurisdictions). See generally Hicks, *supra* note 20, at 247.

⁶⁴ See Hicks, *supra* note 20, at 247.

⁶⁵ See *Corporations Act 2001* (Cth) ch 2D pt 2D.6 ss 206G(1), 206G(2) (Austl.) (Section 206G(1) of the Corporations Act 2001 enables the courts to grant leave to manage "corporations, particular class of corporations or a particular corporation." Under Section 206G(2) the court determines the conditions and exceptions to accompany the leave). See also *Re Magna Alloys & Research Pty Ltd* (1980) FCA 150 (Austl.) (a person was given leave to take part in the management of three specified companies when their boards were controlled by independent non-executive directors). See also *Re Leomond Properties Pty Ltd* (1983) 1 ACLC 1370 (leave to be a director of seven companies was given following conviction for handling stolen crucifixes). See also *Re Minimix Industries Ltd* (1982) 1 ACLC 511 (Austl.) (a New Zealand court gave a person leave to be a manager of a specified company so long as he would not be signing cheques on behalf of the company).

⁶⁶ The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 220(1).

might pose a problem in that directors might accept a period of disqualification to avoid the cost burden for defending disqualification proceedings.⁶⁷ Besides, the Registrar might be tempted to accept undertakings so as to achieve the policy objective of disqualifying many directors.⁶⁸

VII. REGISTER OF DISQUALIFIED PERSONS

Whilst Kenya had no provision for a register of disqualification orders under the old regime, Section 227 of the Companies Act 2015 now requires the Registrar to maintain a register of disqualification orders.⁶⁹ Without a register, it was not possible to enforce disqualification orders adequately, a director could secretly continue to act without being noticed. The introduction of a register of disqualification orders follows trends in other commonwealth countries, such as Ghana,⁷⁰ United Kingdom,⁷¹ and Australia,⁷² where the register is mandatory.

VIII. CONCLUSIONS

Under the Companies Act 1962, the disqualification framework failed significantly to deter directors who were tempted to engage in activities that were detrimental to the well-being of a company. The disqualification

⁶⁷ See Adrian Walters, *Directors Disqualification: The Vice-Chancellor's Address to the Chancery Bar Association*, 21 COMPANY LAW. 90 (2000).

⁶⁸ See Adrian Walters, *Bare Undertakings in Directors Disqualification Proceedings: The Insolvency Act 2000, Blackspur and Beyond*, 22 COMPANY LAW. 290, 297 (2001).

⁶⁹ The Companies Act, No. 17 (2015) KENYA GAZETTE SUPPLEMENT No. 158 § 227.

⁷⁰ Companies Code Act 179 of 1963 § 186(7) (Ghana) ("Where any order is made or leave is granted under this section the court making the order or granting leave shall forward a copy to the Registrar who shall cause a summary thereof to be published in the Gazette. The Registrar shall maintain a register of orders made under this section and shall enter thereon particulars of each order and any leave granted and such register shall be open to the inspection of any person.").

⁷¹ The UK Secretary of State maintains a register of disqualification orders. This was introduced in the UK by the Companies Act 1976, which is open to inspection free of charge. Company Directors Disqualification Act 1986, § 18 (Eng.). Similar provisions exist in Australia. See *Corporations Act 2001* (Cth) § 1274AA (Austl.). The register can be inspected at Companies House in London within fourteen days of making a disqualification order. The court sends the particulars of the order to the Secretary of State for entry in the register. In addition, any variation and grant of leave to act must be communicated to the Secretary of State. S MAYSON ET AL., COMPANY LAW, 727 (Blackstone, 17th ed. 2000).

⁷² See *Corporations Act 2001* (Cth) § 1243 (Austl.) (requires the Australian Securities and Investments Commission to keep a publicly available register of disqualified company directors).

framework only enabled a director to be disqualified on the basis of fraud when a company was a going concern. Thus, a director could not be disqualified on the basis of breach of duty, unfitness, and failing to file returns. A director could only be disqualified, under Section 189, for breach of duty when a company was in the course of winding up. This did little to raise the standards of the conduct of directors and to protect the public from miscreant directors. The Companies Act 2015 has broadened the scope of provisions, offences, and grounds for disqualification in order to prevent errant directors from finding their way to boardrooms. It is expected that these new developments shall be more protective of shareholders and creditors and shall, in turn, play a part in attracting more investors into the country. It, however, remains to be seen how efficiently these provisions will be enforced.