MANAGEMENT OF COMPANIES

THE LAW REGULATING DIRECTORS' POSITION AND CONDUCT IN KENYA.

A DISSERTATION SUBMITTED IN PARTIAL FULFILEMNT OF THE REQUIREMENTS FOR THE AWRD OF BACHELOR OF LAWS (LL.B) DEGREE OF THE UNIVERSITY OF NAIROBI.

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LIST OF CASES:

Case	Citation
Salomon & Co. Ltd. v Salomon	(1897) A.C 22
Feurgson v Wilson	(1886) L.R. 2 Ch.77
Grant v U.K Switch Back Ry.	(1886) 40 Ch. D 135
Munster v Camell Co.	(1882) 21 Ch. D. 187
Holmes v Kyes	(1958) 2 W.LR 722
R v Camps	
Arche's Case	[1892]1 Ch. 322
Dawson v Consolidated Land & Trading Co.	[1898] 1 Ch. 8
British Asbestos Co. Ltd. v Boyd	[1903] 2 Ch. 439
Re Straffordshire Gas Co.	(1892) 66 L.T. 413
Morris v Kanssen	[1946] A.C 459
Craven v Ellis canon	[1936] 2 K.B 403
Holds Worth & Co. (WakeField) Ltd. v Caddies	[1955] 1 W.L.R 352
Latch Ford Premier Cinema v Ermian	[1931] 2 Ch. 409
Mc Connell v Prill	[1916] 2 Ch. 57
Eyre v Milton Proprietary	[1936] Ch. 719
Mosely v Koffy Fontein Mines Ltd.	[1901] 2 Ch. 382
Bushell v Faith & Another	[1970] A.C 1099
Ebrahim v Westbourne Galleries	[1973] A.C 360
Re Duomatic Ltd.	[1969] 2 Ch. 365
Burland v Earle	[1902] A.C 83
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Moriatty v Regent Garage Co.	
Emco Plastica Inc. Ltd. v Freeberne	[1971] E.A 432
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Automatic Self-Cleaning Filter Syndicate	[1906] 2 Ch. 34
Co. Ltd. v Cunnighame	[1906] 2 Ch. 34
Regal (Hastings) Ltd. v Gulliver	[1967] Ch. 212

Case	Citation
Percival v Wright	[1902] 2 Ch. 407
Re City Equitable Fire Insr. Co. Ltd.	[1925] Ch. 407
Re Brazilian Rubber Plantations	[1911] 1 Ch. 42
Re Derham & Co. Ltd.	[1946] Ch. 31
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Flagship Carriers Ltd. v Imperial Bank Ltd.	Unreported
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Re Neptune (Vehicle Washing Equipment) Ltd.	[1995] BCC 228
Industrial Development Consultants Ltd. v Cooley	[1972] 2 ALL ER 162
Peso Silver Mines Ltd. v Crooper	(1965) 56 DLR (2d) 117
Queens Land Mines Ltd. v Hudson	(1978) 18 ALR 1
Cook v Deeks	[1916] 1 A.C 554
Bray v Ford	[1896] A.C 44
Punt v Symmons & Co. Ltd.	[1903] 2 Ch. 506
Pacifia Shipping Co. Ltd. v Anderson & Others.	2 NZCLC 96-040
Coleman & Others v Mayor & Others	[1997] 2 N.Z.L.R 298
Piercy v Mills & Co.	[1902] 1 Ch. 77
Hogg v Cramphorn Ltd.	[1967] Ch. 254
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CHAPTER ONE

INTRODUCTION:

1.0 BACKGROUND OF THE STUDY:

A company has been recognized at common law as an artificial person with an existence of its own. This is known as the concept of legal personality by which a company is treated as a separate entity from its members in law. The fundamental principle was explained and emphasised by the House of Lords in the case of **Salomon & Co. Ltd.**[1] and since the decision in this case, the separation of the company from its members has never been doubted**.** The company however remains an artificial person and can only act by agents. Palmer's[2] in his book, on management of the company states as follows,

> "A company can only act by agents and usually the persons by whom the business of the company is carried on or superintendent are the directors."

This role of directors as company agents has thus its premise on the provisions Companies Act[3] herein after called the "Act" and on case law. The directors of the company are deemed to be agents of the company for running of the company's business and affairs. Lord Cairns on the same stated as follows in the case of **Feurgson Vs Wilson**[4],

> The company itself cannot act on its own person for it has no person, it can only act through directors and the case as regards these directors is merely the ordinary case of principal and agent.

[1] (1897) A.C 22
[2] Palmer's on Company Law pg 513
[3] Cap 486 Laws of Kenya.

The company directors therefore occupy a unique position in company law and in the management of the company as a whole. It would seem therefore that they have a special position over other company employees and to this end are vested with wide powers for the management of the company. Since the policies of the company can only be formulated and decided upon by individual human beings who put them into effect, it is important that they do so in accordance with the law.

Directors owe their companies a duty to manage them in accordance with the provisions of the Act and the constitution of the companies, which are the Memorandum and Articles of Association. The directors as such can do nothing which the company itself, their principal, cannot do under its Memorandum of Association. In the same manner when acting within the powers of the company, the directors are limited to the powers, which the company has delegated to them. If they act *ultra vires* their own powers, but *intra vires* the company's they may ratify their acts in the general meeting.[5]

The dissertation will seek to examine the law that governs the position, conduct and powers of directors with special regard to how this affects the management of companies and more so in the Kenyan context. The research will examine the regulatory framework governing the directors from their appointment, to their duties and conduct as managers of the company with particular interest to reviewing the law in Kenya for better management.

Companies are critical actors in the development of all countries and are a source of livelihood for many. The continued prosperity of nations, communities and individuals is closely linked to their ability to create and maintain profitable, competitive and sustainable enterprises. This can only be achieved if there are strict laws that govern the company management and hence the purpose of this dissertation.

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[4] (1886) L.R. 2 Ch. 77 at pg 89

[5] Grant Vs U.K Switchback Ry. (1886) 40 Ch. D 135.

1.1 STATEMENT OF THE PROBLEM:

The purpose of this study is to investigate the management of companies for effective, efficient and sustainable companies in Kenya and the extent to which company directors influence and affect the performance of corporate entities. Tendencies to mismanage companies have increased which in turn hinder the in-flow and out- flow of investment funds. The crisis caused by companies can be avoided if directors of companies have proper regard for their responsibilities.

There exists a real threat to management through abuse of office by directors, misappropriation of company property and infringement of shareholders rights if the law is not set straight. There are certain loopholes left behind by the law that can result in mismanagement and abuse of powers by company agents especially the directors.

1.2 JUSTIFICATION FOR THE STUDY:

By realizing the special position that is accorded to the men and women entrusted to run a company (directors), an undertaking to examine the law that regulates their conduct is worthwhile. In order to achieve a greater level of efficiency and effectiveness of corporate governance, it is vital to set out straight the laws that need to be adhered to and their effectiveness or inadequacy to this end. This dissertation will seek to highlight areas that need to be reviewed and to establish the adequacy or inadequacy of the law.

1.3 OBJECTIVES OF THE STUDY:

The objectives of this study are as hereunder outlined namely:

a) To establish the importance of effective management of companies in so far as it contributes to growth of the corporate sector.
b) To establish the need for company directors to appreciate and understand the key role they play in facilitating growth of companies.

c) To find out the adequacy or inadequacy of the current legislation and common law governing company management.
d) To propose and recommend possible solutions and reform in the area of company management.

1.4 HYPOTHESIS:

This dissertation will assume that proper corporate management is an integral part of the growth of the economy of any country. It is becoming increasingly important that companies be managed in an efficient manner that will encourage their growth and sustainability. It will be assumed in this study that a large part of our corporate entities especially public companies are not well managed. The reason for slow growth and liquidation of our companies has its roots in poor management and abuse of office by directors. Misappropriation of company property and breach of fundamental rules by the governors themselves has contributed a lot to the state of the present corporate state. This dissertation will also assume that the Act has not taken into consideration changing times and that both directors and shareholders are naïve of their contribution to proper growth and management.

This study is targeted to companies in Kenya and therefore will be based largely on the provisions of the Companies Act with regard to registered companies within the meaning of section 2 of that Act.

1.5 RESEARCH QUESTIONS:

The research questions are as hereunder outlined namely:

a) Does the current regulatory framework for directors and companies have any general adverse effects on the performance of company directors?
b) Does the regulatory framework for directors protect the interests of the company as well as the shareholders?

c) Is the law restrictive in so far as it regulates the conduct, roles and powers of directors?
d) Is there a need to review the law regulating management of companies?
e) What measures or reforms can be undertaken to ensure proper management of companies?

1.6 LITERATURE REVIEW:

A lot of material on company management has been written on which highlight the key role played by directors in the governance of the company in textbooks, articles, journals and the Internet.
This research intends to deal with the Kenyan environment. The researcher acknowledges other authors works that will be used as a base for reference of this proposed research. One cannot simply address the regulation of directors in the Kenyan context without making a cross-reference to the other jurisdictions; therefore the works of scholars from such jurisdictions will be worthy of close attention.

Text Books:

1) Ogola on Company Law.[6]
2) The Company, the Shareholders, the Directors & the Law.[7]

The above textbooks are written with regard to the Kenyan context and the Company Law of Kenya. Both authors have analysed what the Act says and have pointed out the particular provisions of Chapter 486 regulating directors.
However they are very brief in what they state and they do not attempt to recommend possible solutions or reform. This dissertation proposes to recommend reform and review of the law to suit the modern times of the country.

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[6] Ogola. J. J 'The Company Management' (1997) *Company Law* Kenya: Focus Publications Ltd. 173.

3) Palmers On Company Law.[8]

4) Gower's Principles of Modern Company Law.[9]

The above textbooks have stated the administration of Companies in detail and they bring out the position of directors quite clearly than the Kenyan books. However their work is based purely on the English Company Law and English Companies Act and for this reason is limited in addressing our own Kenyan system. This research intends to base its discussion the Kenyan Companies Act.

Articles:

a) Kiaria M. Regulation of Directors in Kenya an Empirical Study.[10]

b) The OECD Principles on Good Corporate Governance 2004.[11]

The above articles are useful in highlighting how good governance can improve performance of companies. The article by Kiaria is especially important as it addresses our Kenyan situation. However it is very general as it touches on all corporations in general including parastatals and state corporations. The interest of this dissertation is companies within the ambit of Chapter 486. The OECD Rules are only but a set of rules binding upon members of the Organisation. They provide important rules of corporate Governance but the fail to address our Kenyan context.

Dissertations by other Students in Parklands Campus:

1) Role of the Chairperson in Good Corporate Governance.[12]

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[7] Irukwu J.O 'The Directors- their general legal position in Company Law' The *Company, the shareholder, the director and The Law* 4th Dimension Publishers 59.

[8] Palmer F. B 'Administration of the Company' (1959) *Palmer's Company Law* 20th Ed. Stevens &Sons Ltd.

[9] Paul L.D *Gower's Principles of Company Law* 6th Ed. Sweets & Maxwell.

[10] Kiaria, M. "Regulation of Directors in Kenya an Empirical Study" (2002) *ICCR Issue 12 Sweet & Maxwell.*

[11] The Organization for Economic Cooperation Development <www.oecd.ord>.

[12] Masinde J.S 2003 "Role of the Chair person in good Corporate Governance"

2) A discourse in to the role and legal status of the Company Secretary in Kenya.[13] 3) The director and Personal Liability in Civil Cases.[14]

The above dissertations have attempted to highlight key issues of management and touched on directors and their duties to a large extent. However none of them has looked into the regulatory framework-governing directors specifically and this dissertation will attempt to cover this area in-depth.

1.7 CHAPTER BREAKDOWN:

a) Chapter one will contain the introduction and proposal for the study.
b) Chapter two will address the Directors; it will consider issues of definition, appointment, retirement, removal, categories, powers and roles of company directors.
c) Chapter three will examine the duties of directors to the company, the common law duties, statutory duties and fiduciary duties. Issues of competing with the company and conflict of interest will also be addressed.
d) Chapter four will look in to liability of directors and enforcement of their duties to the company and to the shareholders.
e) Chapter five will contain the summary, recommendations and conclusion.

[13] Njiru E.M 2003 "A Discourse into the Role and Legal Status of a Company Secretary in Kenya"
[14] Aketch N.S 2003 "The director and personal liability in civil cases"

CHAPTER TWO

DIRECTORS:

2.0 Appointment of Directors:

First directors;

First directors are usually named in the companies articles of association if there are any, but the articles may instead of naming them, contain a power for the subscribers, or the majority of them to appoint them by writing.

Section 177 of the Act[15] provides that every company other than a private company shall have at least two directors, and every company registered before 1962 and every private company shall have at least one director.

Under Table A Article 75[16], the actual number of directors would initially be decided upon by the subscribers to the memorandum of association or a majority of them, and until so determined all of them shall be first directors.

Further article 94 of Table A empowers the company to increase or reduce the number of directors from time to time by ordinary resolution.

Therefore from the above provisions, it seems that if no articles are registered or if the directors are not appointed under them, it rests with the majority of the subscribers of the memorandum to appoint them in writing. In such a case, the signatories of a majority to the appointment will be sufficient.

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[15] Cap. 486 Laws ok Kenya.

Subsequent Directors:

Subsequent directors are appointed by the members in the general meeting, from the first annual general meeting at which all first directors retire from office and the members are given the first opportunity to elect directors of their own choice.

The retiring directors are however eligible for re-election under Article 91 of Table A. At the second annual general meeting one-third of the directors are to retire from office, the ones to retire being the ones who have been longest in office since their last election. As between persons who became directors on the same day those to retire shall (unless otherwise agreed among themselves) be determined by lot. Thereafter one third of the board shall retire annually.

Section 183 requires that a motion for appointment of two or more persons as directors by a single resolution must not be made at a general meeting unless a resolution that it shall be so made has been agreed to by the meeting *nemine dissentiete,* i.e. without anyone dissentient vote.

The purpose of this prohibition of a composition motion is to enable the shareholders to reject a particular director without compelling them to reject others. A resolution moved in contravention of section 183 is void except under the operation of section 180.[17]

Casual Appointments:

Under article 95 the board is permitted to fill a vacancy in the board or to get an additional director to join the board for practical purposes provided that the appointment does not cause the number of directors to exceed the limit imposed by the articles. Such a situation appears to include any vacancy other than one caused by effluxion of time or a director retiring by rotation.[18] A vacancy caused by retirement by rotation has

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[16] (note 1 above).
[17] This section validates acts where defects are afterwards discovered.
[18] Munster v Cammell Co. (1882) 21 Ch.D. pp.187,188

normally to be filled by the annual general meeting[19] and such a vacancy cannot be called a casual one.

A person appointed director in this way shall hold office until the next annual general meeting. He will then be eligible for re-election but his appointment will not be taken into account when deciding the directors who shall retire form office.

Publication of Directors' Names:

In the absence of other provisions in the companies articles, the directors of the company would be appointed in accordance with the provisions of Table A. Once appointed the company must publicise their names at the Companies Registry, its registered office and on its letterheads.[20]

2.1 Restrictions on Appointment:

The act imposes the following restrictions on appointment of Directors;

a) Appointment by the Articles:

S.182 (1) provides that a person shall not be capable of being appointed director of a company by the articles unless before the registration of the articles, he has by himself or by his agent authorised in writing, signed and delivered to the Registrar for registration a consent in writing to act as such director and either;

- signed the memorandum for a number of shares not less than his qualification shares if any; or
- taken from the company and paid or agreed to pay his qualification shares if any; or

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[19] See p. 22 *post.*
[20] S. 201

- signed and delivered to the Registrar for registration an undertaking in writing to take from the company and pay his qualification shares, if any, or the statutory declaration that a number of shares not less than his qualification, if any are registered in his name.

The above provisions do not apply to:

- a company not having a share capital; or
- a private company; or
- a company, which was a private company before becoming a public company.

b) Qualification Shares:

S. 183 (1) provides that it shall be the duty of every director who is by the articles of the company required to hold a specified share qualification, and is not already qualified, to obtain his qualification within two (2) months after his appointment, or within the shorter time (if any) fixed by the articles.
For this purposes, the holding of a share warrant payable to bearer would not be regarded as a holding of the shares specified in the warrant. In ***Holmes v Kyes,***[21] it was explained that the two-month period begins to run from the declaration of the result of the vote electing the director.

Section 183 (3) further provides that the director shall vacate his office if he fails to obtain his share qualification or ceases to hold the required number of shares. In the case of ***R v Camps,***[22] it was explained that if the director does not vacate office but continues to act as director, he ceases to be a *dejure* director and becomes a *defacto* director.[23] The *defacto* director is further incapable of being reappointed director until he is duly

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[21] [1958] 2 W.L.R. 772; [1958] 2 ALL E.R. 129.
[22] [1962] E.A. 235.
[23] See p. 9 *post*

qualified[24] and he will be liable to a fine not exceeding one hundred shillings for everyday that he acts as a director of the company.[25]

The object of requiring directors to hold qualification shares has generally been thought to be, to ensure that directors have a personal interest in the company[26] but since this qualification is not bound to be held beneficially, it is doubtful whether the object is achieved and moreover, the qualification holding is usually so small as to make no difference to a director's action.

It is indeed often a considerable disadvantage for directors to have a large holding as their dividend, policy and other decisions may well be coloured by the effect upon their own position as shareholders.

Moreover a high qualification may unreasonably restrict persons able to take up office and for this reason the modern tendency is to exempt from the requirement of qualification shares directors who are employees of the company.

c) Age limit:

Section 186 provides that no person shall be capable of being appointed a director of a public company or a private company, which is a subsidiary of a public company, if at the time of his appointment;

- he has not attained the age of 21; or
- he has attained the age of 70.

However this provision will not apply where;

- the company articles provide otherwise; or
- special notice of the resolution to appoint the director was given to the company.

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[24] S. 183 (4).
[25] S. 183 (5).

The company must have given this special notice to its members and stated the age of the proposed director. Special Notice is defined as a notice given to the company not less than twenty-eight days before the meeting at which the relevant resolution is to be moved.[27]

A person appointed or proposed to be appointed a director and who is affected by the age limit provisions, must give notice of his age to the company but this does not apply to reappointments.

As a result of the above exceptions and saving clauses in the articles the provisions do not appear to have much practical effect.

d) <u>Undischarged Bankrupts:</u>

Under S.188 if a person has been declared bankrupt or insolvent by a competent court in Kenya or elsewhere, and who has not received his discharge acts as a director of any company without leave of court he shall be liable to imprisonment for a term not exceeding two years or to a fine not exceeding Kshs. 10,000 or to both.

This is a statutory ground of disqualifying a person form being a director of a company in Kenya.

e) <u>Fraudulent Persons:</u>

The court is empowered under section 189 (1) to make an order restraining a person from being appointed or acting as a company director for a period not exceeding five years if; -

- the person is convicted of any offence in connection with promotion, formation or management of a company; or
- in the course of winding up, it appears that the person has been guilty of fraudulent trading[28] or has otherwise been guilty while an officer of the company of any fraud or breach of duty to the company.

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[26] Arche's case [1892] 1 Ch. 322.
[27] S. 142
[28] S. 323 provides for responsibility for fraudulent trading.

f) Individual Voting:

Section 184 (1) provides that the appointment of directors of a company, which is not a private company, is to be voted on individually, unless a motion for the appointment of two or more persons as directors by a single resolution was agreed upon by meeting without any vote.

2.2 Defects in Appointment:

Section 181 provides that a director's acts shall be valid despite any defects that may afterwards be discovered in his appointment or qualification. This provision therefore applies to technical defects in appointment or qualification such as failure to obtain the director's share qualification within the prescribed time.[29]

Under this section, the acts of a director are valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification. A stranger or a member to the company is thus entitled to assume that a person who appears to be a duly appointed and qualified director is so in fact.

In the case of ***Dawson v Consolidated Land & Trading Co***.,[30] a director had ceased to hold his qualification shares but had shortly afterwards reacquired them. His parting with qualification technically caused him to vacate office and had not been formally reappointed but the other directors who had the power to reappoint him had accepted him as a director. The court held that an article in terms similar to section 181 validated the acts of the directors. Lindley M.R at p.12 observed as below:

> "If that is not an irregularity in his appointment such as was intended to be cured by the articles, I cannot conceive what irregularities were aimed by that article."

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[29] R v Camps [1962] E.A see also p. 3 supra
[30] [1898] 1 Ch.8

Two propositions emerge out of this observation, namely; –

i) acts of *de facto* directors are effective both *vis-à-vis* outsiders and *vis-à-vis* members; and

ii) even if the public documents of the company and the facts which are apparent would make it clear that a director was not qualified to act, this will not oust the effect of the section.

An interesting summary of this position was made by Farwell J. in ***British Asbestos Co. Ltd. v Boyd***[31] as follows –

> In my opinion, the words 'notwithstanding that it shall afterwards be discovered that there is some defect,' and so on, do not mean …that the facts are afterwards discovered, but that the defect is afterwards discovered; the acts in a case like the present to the mind of any person to whom it is material at what time to know it.

This section has been used in the past by directors to escape liability. For example this section was held to validate the acts of a director appointed at a meeting of which insufficient notice had been given.[32]

However the section will not protect a person who knows of the invalidity such as in ***Re Straffordshire Gas Co.***[33] and neither can a person take advantage if he has notice of some probable defect or if he knows that the irregularity of the appointment has been challenged and takes no steps to ascertain the facts.[34] Greene M.R in ***Morris v Kanssen***[35], concerning whether one can be put on inquiry or not, made the following propositions as having been established by the authorities: -

i. A party to the transaction may be able to rely on the section, if he does not know of an irregularity, even though other parties know that the appointment was irregular.

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[31] [1903] 2 Ch. 439,444.

[32] Briton Medical, general & Life Assurance Association v Jones (1869) 61 L.T 384.

[33] (1892) 66 L.T. 413.

[34] Morris v Kanssen [1946] A.C. 459.

[35] (note 20) above.

ii. The section may apply though the parties concerned know the facts, if the defect is not present to their minds at the time.

iii. Where a person is put on inquiry and makes no inquiries, it is no answer for him to contend that, if he had made inquiries he would have had false statements made to him.

iv. A person who takes an interest as transferee from one of the parties to the transaction is not protected by the section; and, if the transferor could not rely on the section, the transferee is in no better position.

2.3 Categories of Directors:

a) Managing Directors:

Companies which have adopted Table A[36] are empowered under article 107 to appoint a managing director 'for such period and terms as they think fit.' The article refers to appointment by *de jure* directors and consequently a purported appointment by *de facto* directors would be null and void.[37]

In many large companies the day-to-day activities are normally left to one or more managing directors. For this reason a managing director has no specific powers or duties recognised by law and his powers and duties are thus derived from the company itself.

His terms of employment are as set out under the articles and the directors cannot exclude termination of his employment if the company were to remove him from office of director under section 185.[38]

Subject to the articles, the powers and duties of a managing director are defined by his contract with the company. However, the provisions of the Act do not prevent the company from reserving the right to limit his functions and the scope of his appointment will accordingly depend upon the terms of his contract with the company.

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[36] See section 11 of the Act on Adoption and application of Table A.

[37] Craven-Ellis v canon [1936] 2 K.B. 403

The case of ***HoldsWorth & Co. (Wake Field), Ltd. v Caddies***[39] illustrates this point, where the House of Lords held that neither the provisions of the Act nor the first part of the operative clause (whereby Caddies was appointed as managing director), prevented the company form limiting his activities to the subsidiary.

The powers of the managing director are set out under article 109 and his remuneration and removal is provided for under articles 108 and 107 respectively.

b) <u>Executive, Assistant or Special Directors:</u>

Companies tend to include as a matter of practice in their articles of association an article or articles empowering the directors to appoint a person as a "special", "executive" or "assistant" director. The rights and liabilities of such a person would therefore be limited as the directors may determine.

The article or articles so empowering directors to make such appointments would authorise the directors to define and limit the powers, authorities and discretions of the person so appointed, provided that any executive director shall not be so deemed to be a member of the board or of any committee thereof, that he shall not be deemed to be a member of the board and when present at board meetings by invitation, he shall not be entitled to vote.

The purpose of such appointments is to enhance the status of the person so appointed in relationship with other members of the company's staff or customers in that in these relationships he can call himself a director e.g. a sales director. Further the executive director becomes a trainee for eventual recruitment to fill directorial status.

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[38] See p.22 *post*

[39] [1955] 1 W.L.R. 352

c) Alternate Directors:

An alternate director may be described as a person appointed by a director to attend and vote at any board meeting, which the director himself is unable to attend. The alternate director may be another director or an outsider. If a director, he would have the vote of the absentee in addition to his own vote. A director has no authority to appoint an alternate because of the common law rule of "*delegates non potest delegare.*" A director can only delegate where the articles empower him to do so and the power must be exercised within the strict limits of the articles.

This power to appoint alternate directors is not conferred by Table A and must therefore be contained in the articles, which need to be carefully worded as to make it clear in what circumstances the alternate director has power to act.

Although there appears to be no authoritative exposition on the status of an alternate director, it is suggested that he is also a director within the statutory definition of section 2 of the Act.

d) Corporate Directors:

The statutory restrictions on appointment of directors tend to suggest that only a natural person can be appointed as director.[40] This is not the case in practice because holding companies invariably appoint themselves directors of their subsidiary companies with a view to securing and maintaining complete control of their subsidiaries.[41] This has been made possible by the fact that there is no provision in the Act that which prohibits the practice.

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[40] See section 2.

[41] See section 154 on meaning of holding company and subsidiary.

A body corporate once appointed director would act through a natural person whom it has formally authorised to attend board meetings on its behalf. Pursuant to section 201(2)(b), its name, registered or principal office and postal address must be entered in the Register of Directors and Secretaries which is kept by the company of which it is a director.

e) Associate Directors:

A company may appoint one or more of its employees to its board of directors. Such appointments are primarily intended to provide the employees with a forum where they can express their views on the company's operations, programmes or policies. Employees who are appointed are usually called 'associate' directors. However it is not clear whether such employees owe the company the duties that are owed to it by its other directors since their position is largely ceremonial.

2.4 Disqualification of Directors:

Article 88 of Table A provides for disqualification of directors and under this article the office of the director shall be vacated if the director; -

i. ceases to be a director by virtue of section 183 or 186 i.e. failure to obtain a share qualification or attaining the age limit respectively; or
ii. becomes bankrupt or makes any arrangement or composition with his creditors generally; or
iii. becomes prohibited from being a director by reason of any order made by the court under section 189 of the Act; or
iv. becomes of unsound mind; or
v. resigns from his office by notice in writing to the company; or
vi. for more than six months has been absent without permission of the directors from meetings of directors held during that period.

As regards resignation, it was held in the case of ***LatchFord Premier Cinema Co. v Ermion***,[42] that a verbal notice of resignation, which is given to and is accepted by the general meeting, is effective and cannot be withdrawn. This is so because the general meeting would be deemed to have amended the company's articles by deleting the words 'in writing.' By implication, a purported oral notice of resignation, which is given to, and accepted by, the board of directors, would be invalid since the directors cannot legally alter the company's articles of association.

As far as absence from meetings is concerned, the provision does not say that, a director in question shall vacate office if he 'absents himself.' Such a provision would have disqualified the director only if the absence in question was voluntary, as in the case where the director was ill and decided not to attend the board meetings. On the other hand, the office would be vacated if the director was absent because his doctor had advised him to go abroad on medical grounds as in the case of ***Mc Connell v Prill***.[43]

2.5 Retirement by Rotation:

Article 89 provides that a proportion of the directors, usually one-third shall retire by rotation year by year but these provisions are often omitted or considerably qualified in the case of private companies.

Where the articles provide that the number nearest to but not exceeding one- third shall retire and the number of directors is reduced to two neither need retire.[44] It was held in ***Eyre v Milton Proprietary***,[45] that temporary directors, who must retire at the next general meeting, should not be counted.

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[42] [1931] 2 Ch. 409.
[43] [1916] 2 Ch. 57
[44] Re Moseley & Sons Ltd. [1939] Ch. 719.
[45] [1936] Ch. 719.

Under article 91 a retiring director may offer himself for re-election and he is deemed to be re-elected unless-

a) the general meeting resolves not to fill the vacated office; or
b) a resolution for the re-election of such director has been put to the meeting and lost. Normally directors have to submit requests for re-election individually (s.184).

2.6 Resignation:

A director may at any time resign his office, and usually the articles make express provisions accordingly. If he communicates his resignation to the company for example by notice served in the manner provided under article 88 (e), his resignation is effective. A resignation made cannot be withdrawn except with consent of the company. Where a director who was both a permanent and an ordinary director resigned it was held that the resignation applied to both offices.[46]

2.7 Removal of Directors:

The Act provides under section 185(1) that a company may by ordinary resolution remove a director before the expiration of his period of office, notwithstanding anything in the articles or in any agreement between him and the company.

This is one of the most important principles of modern company law and applies to all types of companies, public and private. At the first glance this power appears to be a statutory authority licensing contract breaking on the part of the company. This may be the case but it merely places the company into the same position as every employer by giving it discretion of removing a manager and of accepting the consequences of his act by paying compensation or damages to him.

[46] Mosely V Koffy Fontein Mines Ltd. [1901] 2 Ch. 382

Similarly the shareholders under this section have the power to intervene in the management of the company affairs and it enables them to control the directors' activities by removing them from office.

Special notice must be given under S. 185 (2) of any resolution to remove the director or to appoint another director in his place. On receipt of this special notice the company must send the representations to the members with notice of the meting unless the representations are received by it too late for it to do so. In such a case the representations would be read out at the meeting at which the director would also be entitled to be heard. The representations need not be sent out by the company or read out at the general meeting if the appointment on the application to the court, either of the company or of any person who claims to be aggrieved, the court is satisfied that they have been made in order to secure needless publicity for defamatory matter and restrains their publication (section 185 (3)).

The removal will be effective if it is decided on by an ordinary resolution. In the case of ***Bushell v Faith & Another,***[47] Harman L.J defined an ordinary resolution as a resolution depending for its passing a simple majority of votes cast in conformity with the articles

Compensation for Removal:

Section 185 (6) provides that nothing in that section should be taken as depriving a removed director of compensation or damages payable to him in respect of the termination of his employment as a director or of any appointment terminating with that as director.

This position, which restates the common law rule, would enable a managing director to sue the company for wrongful dismissal if the effect of his removal as director was to prematurely terminate his appointment as managing director and was inconsistent with the contract. The director might also if he is a member of the company, be entitled to an

[47] [1970] A.C 1099; [1970] 2 W.L.R272.

order for the winding up of the company on just and equitable ground as in the case of ***Ebrahim v Westbourne Galleries***.[48]

2.8 Remuneration of Directors:

Directors are not regarded as servants or employees of the company of which they are directors for technical reasons. Directors therefore have no right to be paid for their services unless there is a provision for payment in the articles. For companies which have adopted Table A, article 76 provides that the "remuneration of directors shall from time to time be determined by the company in general meeting". The amount of remuneration to be paid to directors is thus a matter of internal management.[49]

In the case of ***Re Duomatic Ltd***.,[50] it was explained that a provision in the articles authorizing payment of directors remuneration, does not *per se* give the right to be paid any specific amount. There must also be a resolution passed by the company in the general meeting authorising the payment.

Provided the resolution has been passed, the remuneration is payable whether profits are earned or not.[51] Article 76 provides that the remuneration shall be deemed to accrue from day to day. This means that the director who vacates his office before completing a year or month in office is entitled to a proportionate part of his yearly or monthly salary.[52]

Section 190 provides that "it shall not be lawful for a company to pay a director remuneration (whether as director or otherwise) free of income tax or surtax except under a contract which was in force two years before the commencement of the Act on 1 Jan 1962 which provides expressly and not by reference to the acts for payment of tax- free payments.

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[48] [1973] A.C 360; [1972] 2W.L.R 272.
[49] Burland v Earle [1902] A.C. 83.
[50] [1969] 2 Ch. 365.
[51] Re Lundy Grante Co.
[52] Moriatty v Regent Garage Co.

Any provisions in the articles regarding tax-free payments "shall have effect as if it provided for payment, as a gross sum object to income tax and surtax of the net sum for which it actually provides."

2.9 Conclusion:

The following issues addressed in this chapter are worth noting; -

- Firstly, as regards directors' qualifications, the Companies Act makes the director the Company's *alter ego* and the courts concerning this have said as much as was held in the case of ***Emco Plastica Inc. Ltd. V Freeberne.***[53] However, all this having been said, it is surprising that this is the very officer whom the Act makes no demand as to the academic and professional qualifications he must bring to office.

The Act only makes a provision for a list of disabilities from, which he must not suffer in order for him to be appointed. The stress is more on the disabilities rather than professionalism.

The present company form inherited this phenomenon from practices of the Joint Stock Companies of the 17th and 18th centuries.[54] At that time valor and capacity to bring primary products back home from "discovered lands" were considerations in winning both directorship and membership of the company.

Should this continue to be the position? Should companies not require the right academic and professional qualifications backed with the relevant experience? How will an illiterate corporate director in Kenya make competitive decisions to enable the company compete efficiently in the local and global market? What does the next millennium portend if we do not?

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[53] [1971] E.A . 432 (CAEA).
[54] Palmer F. B "History; Interpretation of Companies Act", Stevens & Sons Ltd. (1959).

t is contended that even in major economies, academic and professional qualifications ıave not been called for. For example France still draws a bulk of its directors from etired civil servants, Japan relies on old and experienced retired businessmen and vorkers to manage their companies through maintenance of family and business ıssociation links. Germans on the other hand find assurance in their two-tier system of lirectors. The question that arises is whether there should be a minimum statutory ·equirement as to academic and professional qualifications.

- Secondly concerning directors' remuneration packages and other financial awards, the Act has made a commendable effort in ensuring some offences in the 'fixation' of certain payments to directors .For example, section 190 prohibits paying any remuneration to directors tax-free, issuing loans to directors or using the companies as guarantors for loans elsewhere, section 191. There is also a prohibition for payment of other kinds e.g. compensation for loss of office. These have to paid on the basis of strict rules and procedures.
- Concerning the issue of salaries and pensions, all the Act does it to require that they be reflected in the accounts of the company. It does not regulate their 'fixation,' a point which the Green Bury Report[55] could be handy in accountability and transparency e.g.

    a. Large companies (particularly those listed on the NSE should form a Remuneration Committee to discuss and fix directors' remuneration to avoid conflict of interests that is visibly present when directors themselves so fix.
    b. The Committee should make a report each year to the shareholders regarding the matter so that the members know about the packages and have an opportunity to discuss them.

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[55] The Green Bury Report; Directors Remuneration: Reporting a Study group Chaired by Sir Richard Green Bury, July 1995 (unpublished).

c. The committee must develop a clear policy to govern the fixation of remuneration packages taking into account the company's performance and the need to attract and motivate directors.

d. The committee should consider other aspects of payments e.g. allowances, compensations and fringe benefits.

e. The foundation must develop a Code of Best Practice for the companies which must over and above what has been stated above incorporate provisions for disclosure, points of action (CMA, NSE) performance criteria and the re-alignment of the articles of association to internally embody the remuneration regulations.

- The issue of directors' age has already been discussed in detail and the saving clauses that has been used to go round the statutory provision.[56]

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[56] See page 14 *supra*

CHAPTER THREE:

DUTIES OF DIRECTORS:

3.0 Introduction:

The duties of directors can be analysed against a general understanding and appreciation of the position that directors occupy in the company. It is important to appreciate the general principle of law, that the board of directors is granted practically unlimited management powers.

The board of directors, which is elected by the general meeting, is recognised as one of the organs of the company entrusted with the management of the company together with the general meeting (shareholders). The division of power between these organs is fundamental in understanding the operations of the company. A body of case law has explained this division due to any differences that may arise.[57]

It is therefore only necessary that the legal system should device some means of controlling directors in the exercise of their powers to the company. A balancing act is required, management must not be stifled; but neither can unfettered, unsupervised, absolute discretion be permitted.

The law's response has been to categorise directors as fiduciaries and to apply strict fiduciary principles to them, which are designed to ensure certain minimum standards of behaviour from directors backed up by potentially severe penalties in the event of a breach.[58]

This response by the legal system can be seen as the means by which the law fills in the otherwise standard contract, which is commonly adopted as between the directors and

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[57] Shaw v Shaw [1935] 2 K.B 113, Automatic Self-Cleaning Filter Syndicate Co. Ltd. V Cunighame [1906] 2 Ch 34.

[58] Regal (Hastings) Ltd. V Gulliver [1967] 2 A.C 134n, [1942] 1 All ER 378.

shareholders. It has been proposed that the duties of directors should be set out in a statutory statement in forth coming company Bills.[59]

The duties of directors can be discussed in the light of three fundamental observations:

1. Firstly, that although the directors act collectively as a board to bind the company, their duties to the company are owed by each director individually.
2. Secondly, that the duties of directors are owed to the company alone and not to individual shareholders, which is the principle enunciated in the case of ***Percival V Wright***.[60]
3. The duties unless where stipulated by the Act are not restricted to directors alone, but they apply to any other officials of the company who are authorised to act as agents of the company.

Categories of Directors' Duties:

The duties of directors can be divided in to the following broad categories;

a) **Common Law duties of Care and Skill;**
b) **The Fiduciary Duties as enunciated by the Courts of Equity.**

3.1 The duty of Care and Skill:

The directors' duties of care and skill have been formulated in a series of cases, which were brought against directors in order to make them liable in negligence for the manner in which they conducted the companies' affairs. The *locus classicus* of illustrating the duty of care and skill required of a director was the case of ***Re City Equitable Fire Insurance Co. Ltd.***[61]

[59] Modern Company Law Cmnd 5553-1, (2002), Para 3.5
[60] [1902] 2 Ch 421, [1902] 18 TLR, 697.
[61] [1925] Ch 407.

In this case, a chairman of an insurance company whom the judge described as "a daring and unprincipled scoundrel" had swindled it of large sums of money. He concealed the frauds for a number of years by manipulating the figures for short-term investments before and after the balance sheet date of each year. The frauds were facilitated by the fact that the other directors had left the affairs of the company in his hands and had not found it necessary to raise any questions on the accounts. The board of directors had a finance committee which never attended to the investment of surplus funds but left the matter to the general manager who acted as instructed by the Chairman.

The company went into liquidation and the liquidator sued the directors for the losses on the ground of negligence. The action would have succeeded, but failed because of the provisions in the company's articles, which exempted the directors from liability from losses caused, by their own willful neglect or default. Such provisions were valid until they were invalidated by the Companies' Act of 1948 under section 205, which became section 206 of our Cap 486.

Justice Romer J. in this case established three fundamental rules that elaborate on the duty of care and skill for directors as follows; -

1. **A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.**

This preposition prescribes the standard of skill to be exhibited by a director in his undertakings towards the company. The test here is partly objective, (the standard of a reasonable man) and partly subjective (the reasonable man is deemed to have the knowledge and experience of the particular director). This rule may in essence, be taken to mean that if a foolish director makes foolish decisions resulting in loss to the company, he cannot be liable for negligence, because it would be unreasonable to expect a foolish director to make wise decisions.

However, if the director made very foolish decisions resulting in loss to the company, he will be liable since it is not reasonable to expect a foolish director to make very foolish decisions. On the other hand, a wise director will be liable if he makes unwise decisions, since it is unreasonable to expect him, a wise man to make unwise or foolish decisions.

In ***Re Brazilian Rubber Plantations***,[62] the directors of the company caused the company to enter into a contract with a certain Syndicate for purchase of Rubber Plantations in Brazil and were negligent in the manner in which they carried out the contract. It was held that the directors did not act negligently and that as long as they acted honestly, they could not be made responsible. Justice Neville stated as follows,

> … a director's duty requires him to act with such care as is reasonably expected from him having regard to his knowledge and experience. He is not bound to bring any special qualification to his office. He may undertake the management of a rubber company in complete ignorance of anything to do with rubber without incurring responsibility from the mistakes, which may result from such ignorance. While if he is acquainted with the rubber business, he must give the company the benefit of his knowledge…he is not bound to take any definite part in the conduct of the company business but so far as he undertakes it, he must use reasonable care. Such reasonable care must be measured by the care an ordinary man may be expected to take on his own behalf.

The two cases above summarise the standard of care required to be exhibited by directors in the performance of their duties to the company.

2. **A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is however not bound to attend to all such meetings though he ought to attend whenever, in the circumstances, he is reasonably able to do so.**

[62] [1911] 1 Ch 42.

In the case of ***Re Derham & Co. Ltd.***,[63] the directors of the company left the management of the company to one of the directors who did not consult with the others in affairs of the company. The company went into liquidation and it emerged that that dividends had been paid out of capital and not out of profits. The creditors sought to recover from one of the directors who was not bankrupt and who had attended only one board meeting.

It was held in this case that, a director is not bound to attend every board meeting and is not liable for misfeasance committed by his co-directors at board meetings at which he was not present.

Similarly in ***Re Marquis Bites,***[64] a director had attended only one board meeting in thirty eight (38) years. He was exonerated from liability for alleged negligence on the ground that " neglect or omission to attend meetings is not, in my opinion, the same thing as neglect or omission of a duty which ought to be performed at those meetings." (Per Justice Stirling).

This position notwithstanding, a company is free to impose a duty on its directors to attend board meetings within a certain period of time and to prescribe the consequences of a breach of the duty, for example by application of Article 88 (f) of Table A. This Article provides for disqualification of directors where a director has been absent for more than six months without permission of the directors from meetings of directors held during that period.

3. **In respect of all duties that, having regard to the exigencies of business, and the Articles of Association, may properly be left to some other official, a director, is in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.**

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[63] [1946] Ch 31.
[64]

If a director is to be made liable, it can only be on the basis of his personal negligence, and it is not negligence to delegate some responsibilities to officials or employees of the company whose previous conduct has given no grounds for distrust or suspicion.

In ***Dovey V Cory,***[65] a director failed to verify false information regarding the company's accounts which had been given by the company's manager and managing director. He was not held liable for negligence for not having discovered the fraud, as he was not in the circumstances of suscipicion, bound to examine the entries in the company's books. The reliance he had placed on the on the general manager and the chairman was reasonable. The court stated that,

> Business cannot be carried on upon principles of distrust. Men in responsible positions must be trusted by those above them, as well as by those below them, until there is a reason to distrust them. We agree that care and prudence do not involve distrust.

From the above discussions, it appears that the duties of care and skill are negative duties thus the standard is rather subjective, leaving a lot of room for abuse.

3.2 The limitations or problems of the Application of the English Common Law:

Kenya's Judicature Act permits the application of the common law and doctrines of equity in force in England as at August 12, 1897.[66] As such, the Kenyan courts apply English common law principles and have hardly adopted a Kenyan approach to the interpretation of the Companies Act.[67] Whilst decisions of English courts given after the above date are not of binding authority in the courts of the territory, they are entitled to the highest respect if the English law has not been subsequently modified.[68] The current English judiciary pronouncements on company law are, therefore highly persuasive in

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[65] [1901] AC 477.
[66] Cap. 8 Laws of Kenya, s.3 (1) (c).
[67] For example in Flogship Carriers Ltd. V Imperial Bank Ltd. High Court Civil case No. 1643 of 1999 (unreported). Mr. P.J.S Hewett indicated that a subjective test, as laid down by Romer J. in Re City Equitable should be applied to assess the standards of directors duties of care and skill.
[68] Amollo, "Reviewing 100 years of common law in Kenya" (January 1999) The Advocate, 16 at 17.

interpreting the Kenyan provisions. It is notable that the duties of directors are not codified in the Act.[69] The common law principles applicable to Kenya are largely inaccessible since directors and practitioners have to search "through a maze of case law"[70] to understand their responsibilities.

3.3 Fiduciary Duties of Directors:

Millett L.J defined a fiduciary in ***Bristol & West BS v Mothew***,[71] as someone who has undertaken to act for or on behalf of another in a particular matter in circumstances, which give rise to a relationship of trust and confidence. Given that typically directors have all powers of management over the company and its assets, directors are indisputably fiduciaries,[72] and while there is no single set of fiduciary duties which apply to all fiduciaries, the fiduciary duties applicable to company directors are well developed and revolve essentially around the core fiduciary obligation of loyalty.

The fiduciary duties to which directors are subject are:

- A duty to act *bonafide* in the interests of the company and not for any collateral purpose (personal/ sectional) and;
- A duty not to profit secretly from their positions.

Fiduciary duties place directors in the shoes of an agent or trustee and enjoin them: -

a. To always act *bonafide* in what they consider, and not what the courts consider to be the best interests, and for the benefit of the company and not for third parties or for themselves.

[69] The duties of in the U.K re also not codified.
[70] J. Birds, "Making Directors do their duties." (1980) Co. Law 67 at 67.
[71] [1996] 4 All ER 698 at 711, Millett, Equity's Place in the Law of Commerce (1998) 114 LQR 214.
[72] Regal (Hastings) Ltd. *Supra* at 395

Directors must for example, not use their position to make secret profit from the company.[73] Regard should be had to the present and future members of the company, while at the same time balancing the long term and short-term interests of the existing members.

As trustees of the powers conferred upon them, directors have a primary duty to act in the best interests of the company for which they are directors and not for any collateral purpose. When directors enter in to transactions for the benefit of the company, they must be entered into as a whole, honestly and in accordance with their duties. They must show that relevant factors were made showing the reasons and factors taken into account.

When making decisions, the interests of their stakeholders must be taken into consideration. The duty to act in the best interests of the company extends to information obtained while in office, even beyond the period of office as director, and must be kept confidential.

Where in a serious disagreement with a decision made at a meeting a director must insist that this be recorded in the minutes. Similarly, where a director feels that a bad policy or decision is illegal, unethical or commercially unwise, but does not remedy the irregularity or illegality, the resignation of the concerned directors is called, failing which liability for any loss suffered by the company will attach.

They may also be liable to make good any loss suffered by the company when their acts are motivated by personal interests or are undertaken for a collateral or improper purpose.

b. **Not to place personal interests in conflict with the interests of the company. Directors must not place themselves without the consent of the company in a position of conflict between their duties to the company and their personal interests. In the exercise of their powers,**

[73] Parker v McKenna (1874) 10 Ch App 96, Boston Deep Sea Fishing & Ice Co. v Ansell (1888) 39 Ch D 339.

directors must not only act in good faith and honestly but also in the best interests of the company without any ulterior motive.[74]

S.200 (5) of the Act adopts this rule by providing that,

"Nothing in this section shall be taken to prejudice the operation of any 'rule of law' restricting directors of a company from having any interest in contracts with the company".

Section 200 requires a director who is in any way interested in a contract with the company to declare the nature of his interest at a board meeting. He must disclose the interest at the first board meeting at which the contract is to be discussed or, if he did not have an interest at that time, at the first board meeting after his interest arose. This provision is supplemented by Article 84 of Table, A which provides that

- The director shall not vote in respect of the contract. If he does vote, his vote shall not be counted; and
- The director shall not be counted in the quorum present at the meeting.

In the case of ***Guiness Plc V Saunders & Another,***[75] a director declared the nature of his interest to a committee of the board, which consisted of him, and two other directors. He was held not to have complied with the necessary statutory provisions, which require the declaration to be made "at a meeting of the directors of the company". The disclosure must be to the whole of the board of directors. The director was therefore liable to the company as a constructive trustee of the 5.2 Million Pounds, which the company had paid to him under a contract he had entered into during a take over bid.

[74] Aberden Rly. Co. V Blaike Brothers {1843-60] All ER Rep 249.
[75] [1988] 2 All ER 940

Similarly, in ***Re Neptune (Vehicle Washing Equipment) Ltd.***,[76] it was held that a sole director was under the same duty of disclosure and must hold a meeting for that purpose, either alone or with another officer of the company, such as the company secretary. The declaration must be a formal one, which is minuted.

The effect of this decision is to compel a sole director to spend some time meditating seriously on the possible consequences of the proposed contract. In such a case, there would at least be some hope that might be restrained by his conscience from entering into the contract.

In the case of ***Industrial Development Consultants Ltd. V Cooley***,[77] a director became personally interested in a contract, in which he had been assigned to negotiate for the company. The court made the order despite the defendant's contention that the plaintiff's had suffered no loss since they would not have obtained the work for themselves.
The fact is that, having become personally interested in the contract, he totally forgot or disregarded the fact that it was his duty to do everything possible so that his employers got the contract. That included refusing completely to accept the offer, which had been made to him as a person. Indeed, he let down his employers at the most critical time.

Had he refused the offer, there was a possibility- even if a remote one- that the Gas Board might after all have changed their mind and awarded the contract to his employers on his assurance that he would personally be in charge of the work. In the event that his efforts failing to achieve the desired results he would have been at liberty to inform his employers about what had transpired. They might have decided to release him from his contract with them so that he could take up his new job.

The other case in which some of the directors of a company were held liable to account to the company although the profit they had made was one, which the company itself would

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[76] [1995] BCC 228
[77] [1972] 2 All ER 162

not have made, is ***Regal (Hastings) V Gulliver.***[78] It appears that the directors might have retained their profit if:

i) It had been approved by the company in general meting irrespective of whether the approval had been procured through the votes of the said directors as the majority shareholders since the transaction was not a fraudulent one or,
ii) The board of directors had considered the prospective investment and had *bonafide* concluded that it was investment, which the company ought not to make.

The latter proposition appears to be the basis of the decision of the Supreme Court of Canada in ***Peso Silver Mines Ltd. v Cropper.***[79] What appears to be a similar decision was reached by the Privy Council in the Australian case of ***Queens Land Mines Ltd. v Hudson,***[80] in which it was held that, since the company had known all along of the benefit which was accruing to its managing director as a result of his position as director, and had decided not to obtain it itself, he would not account for the benefit.

In ***Cook v Deeks,***[81] some of the company's directors diverted to themselves a contract that was intended to be for the company. It was held that they had to surrender the benefit of the contract to the company, which the directors had formed for obtaining the contract but in equity, the contract belonged to the company for which it was intended.

In ***Bray v Ford,***[82] Lord Herschell concerning this principle enunciated in the above discussion observed as follows;

> This principle is not founded upon principles of morality but it is based on the consideration that human nature being what it is, there is danger in such circumstance, of the person holding a fiduciary position being swayed by interest rather than by duty and thus prejudicing those whom he was bound to protect.

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[78] *supra*
[79] (1965) 56 DLR (2d) 117
[80] (1978) 18 ALR 1
[81] [1916] 1 AC 554
[82] [1896] AC 44

The case of ***Boston Deep Sea Co. V Ansell*** [83] restated the fundamental rule of the law of the agency that an agent must not make a secret profit. These cases in company law are just examples of how a particular agent (the company director) committed a breach of his duties to a particular principal (the company).

In ***Percival V Wright***,[84] it was held that the directors owe their fiduciary duties to the company alone and not to the members.[85] The decision raises a problem that has become known as "insider dealing".[86]

Under the no-profit principle, acts and decisions by directors must be accounted to the company. This means that directors can contract with their company but must not make the contract unconsciable as against the company.

They must act in accordance with the requirements of section 200 of the Act and the rules laid down in decided cases.[87] In this regard, any commission or benefit received under an arrangement in which they are interested in because of their position must be accounted for. A director can only legitimately retain such profit with the authority of the shareholders at the general meeting.

Under the no- conflict principle, directors must not allow themselves to be put in a position where their personal interests conflict with their duties towards the organization. The common law duty to disclose includes the following; -

- Any interest in a proposed contract to which the company is or may become a party.

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[83] (1888) 39 Ch D 339

[84] *supra*

[85] *post* Chapter 4

[86] "Insider Dealing is understood broadly to cover situations where a person buys or sells securities when he, but not the other party to the transaction, is in possession of confidential information which affects the value of those securities." *The Conduct of Company Directors* (Cmnd 7037) 1997; S.33 of the Capital Markets Authority Act (Cap 485A) prohibits insider dealing.

[87] Aberdeen Rly. Co. V Blaike Bros. *supra,* or Eastern Insurance Co. Ltd [1919] 1 Ch. 198.

- A position occupied or duty owed to a third party that may conflict with the duties owed to the organization.
- Confidential information or available opportunities by virtue of their office even where the company is unable to take advantage of the opportunity itself.

c. **To exercise the discretion given to them by the company's constitution faithfully. They must not, for instance, alter the same to the detriment of the company.**

Discretion is usually exercised when directors vote one way or the other, decline, or accept a negotiated offer on behalf of the company. The directors must not fetter their discretion to act for the company for instance; they cannot contract either among themselves or with third parties as to how they will vote at future board meetings, unless they have entered into a contract on behalf of the company.

d. **To take care of the company's property including its confidential information and trade secrets.**[88]

e. **To exercise powers conferred upon them for the proper or intended purpose. As such, directors must not engage in insider trading and other self-seeking transactions or in "rigging the market."**[89]

Directors must exercise their powers for the particular purpose for which they were conferred and not for extraneous purposes even if the latter are considered to be in the best interests of the company.

In ***Punt v Symons & Co. Ltd.***,[90] directors issued shares with the object of creating a sufficient majority to enable them pass a special resolution depriving the other shareholders of some special right conferred upon them by the company's articles.

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[88] Pacifia Shipping Co. Ltd. V Anderson & Others, [1958] 2 NZCLC 96-040
[89] Percival v Wright, *supra* ; Coleman & Othrs V Myers & Othrs, [1997] 2 N.Z.L.R. 298.
[90] [1903] 2 Ch 506

It was held in this case that a power of a kind exercised by the directors in this case, is a power that must be exercised for the company's benefit. Primarily, this power is given to them for the purpose of enabling them raise capital for the company's purposes and therefore a limited issue of shares to persons who are obviously meant and intended to secure the necessary statutory majority in a particular interest was not a fair and *bonafide* exercise of power.

The same reasoning was followed in ***Piercy V Mills & Co.***[91]

3.4 <u>Limitations of Directors' Fiduciary Obligations:</u>

Despite the law laying down such stringent rules to regulate directors as fiduciaries, corruption still poses a great problem. Instance of breaches of fiduciary duties are ever on the increase. When directors abuse the resources of a company through corruption, they not only threaten the liquidity of the company, but also contribute to stagnation of the economy, inadequate physical and social infrastructure and poorly functioning political systems.

In fact, corrupt practices of great magnitude can also threaten international peace and prosperity, facilitate drug trafficking, money laundering and distortion of international trade.[92] In Kenya corrupt practices abound within Government offices, corporate bodies and private institutions.[93] In Kenya, it is not uncommon for company directors to finance political parties by giving donations in order to get political favours[94] and to preserve a market they have created or to gain access to a market offered by politicians.[95]

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[91] [1902] 1 Ch 77, Hogg V Cramphorn Ltd. [1967] Ch 254, Bamford v Bamford [1966] 3 ALL ER 420.

[92] A.E Kimberly. " The problem of Corruption: A Tale of Two Countries (Kenya, Uganda)", (1998) 18.

[93] K. Kibwana, *The Anatomy of Corruption in Kenya: legal, political and Socio-Economic Perspectives* (Clari Press, 1996), p.34

[94] The fact that many directors of KCC (Kenya Co-operative Creameries formerly in receivership) became Members of Parliament illustrates how good KCC was a springboard for political positions.

[95] " Fighting Corruption in developing Countries and Emerging Economies: The Role of the Private Sector" Summary of the OECD Development Center Conference Washington D.C, February 22-23, 1999, p.5.

3.5 CONCLUSION:

As already discussed in this Chapter, there is no statutory provision requiring directors to have expertise and experience in the management of companies in Kenya. Instead, directors are expected to exhibit a degree of care and skill that can be reasonably expected from persons of their knowledge and experience. Thus the courts assess their liability subjectively. Their skill, experience and knowledge are taken into account when considering their liability. It is therefore, possible or directors to go unpunished as a result of negligence arising form their ignorance or inexperience.

Directors are also not required to give continuous attention to the affairs of the company. Instead, competent performance by them or their delegates suffices.
There is therefore a need to reform the general regulatory framework for directors' duties in order to improve their performance in order to encourage economic growth, investment and stability in Kenya.

As far as their fiduciary duties are concerned, the company law in Kenya recognises the onerous duties of directors as fiduciaries and obliges them to act in good faith, for the benefit of the company and to avoid conflict of interest situations.

There is however the challenge of corruption against which directors must avoid falling in to. Perhaps educating directors on their role in social responsibility would help reduce these instances of corruption. Directors ought to understand that, although they owe their duties of good faith to the company alone, they have a greater role to play in the society and to take into consideration the interests of their employees or other stakeholders.
Focus should be had not only to the narrow interests of members but rather the long- term interests of the enterprise. It is for the general benefit of the corporate entity to consider itself a citizen with a role to perform in a social as well as in an economic context.[96]

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[96] P.A Thomas, *Private Enterprise and East African Company* (Tanzania Publishing house Ltd., 1996), p. 14.

The following are the recommendations for the law regulating directors' duties of care and skill as well as their fiduciary duties:

a. A director should have good knowledge of what the company does to justify his appointment.
b. Directors need not to be forgiven for errors of judgment simply because they did not posses skills and experience that could make them avoid errors.

   Directors should therefore be subjected to an objective standard of quality performance, the diversity of the companies notwithstanding. The application of both the subjective and objective standards has been favoured in some jurisdictions as it raises the standards expected from directors.[97]
c. Performance must place an obligation on directors to acquire all the knowledge and skills necessary to carry out their assignment to the highest standard expected from a person of this position.
d. Directors do not exercise a reasonable amount of care if they blindly accept all documents placed before them for example, when signing a cheque a director is required to ensure that the cheque has been authorised by the board and that the money expended is for the specified purpose. Signing of blank cheques is considered negligent.
e. In order to dispel liability, it is expected that a director understand the organization's affairs in order to exercise judgment based on knowledge and experience as well as information and advice given by company officials.

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[97] Re D' Jan of London Ltd. [1993] B.C.C 646 (U.K, Norman v Theodore Goddard [1992] B.C.C 14 at 15 (U.K) and Daniels v Anderson (1995) 37 N.S W.L.R 438.(Australia).

f. Neglect of duty can be curbed by the courts finding liability for non-attendance of board meetings and entrusting delegates to carry out the affairs of the company.[98]

g. The duty of directors should be broadly expressed to include employees and the public interest. This is the case in (Germany).[99]

h. Companies can take into consideration the interests of their employees for instance by encouraging them to purchase shares, offering gratuities and medical attention.[100]

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[98] Bowerman v Hammer (1919) 250 U.S. 504; Kavanaugh v Gould (1918) 223 N.Y. 103, 199 N.E 237; E.M. Church, *Business Association of France Law*; Nigeria Law Reform Commission, *Working papers on the Reform of Nigerian Company Law* Vol 1. Review and Recommendation 1987.

[99] The U.K 1989 companies act s.309 also obliges directors of a company to have regard to the interests of company employees.

[100] K. Kibwana *supra* p.29.

CHAPTER FOUR:

ENFORCEMENT OF DIRECTORS' DUTIES TO THE COMPANY:

4.0 Introduction:

This chapter will investigate on the various remedies and measures available under the law for enforcement of directors' obligations.

The general rule is that a company is a distinct entity from its members and directors owe their duties to the company alone and not to individual shareholders. Consequently an action for breach of these duties can be brought only by the company and not by the individual shareholders.[101]

4.1 The Rule in Foss V Harbottle:

The company and the company alone is the proper plaintiff and this is generally referred to as the Rule in ***Foss v Harbottle***.[102] The rule is based on the following statement of Vice-chancellor Wigram in that case who stated as follows,

> In law the corporation and the aggregate members of the corporation are not the same thing for purposes like this; and the only question can be whether the facts alleged in this case justify a departure from the rule, which *prima facie,* would require that the corporation should sue in its own name and in its corporate character or in the name of someone whom the law has appointed to be its representative.

The defendants in this case were the directors and promoters of a company. They sold the company property at an undisclosed profit. Two shareholders brought an action on behalf of themselves and other shareholders against the offending directors. It was held that the

[101] Percival V Wright *supra*

[102] (1843) 2 Hare 461; 67 ER.189 (ch).

breach of duty (if any) was owed to the company and that therefore the plaintiffs had no *locus standi* to bring the suit because the proper plaintiff was company.

It should be noted that this rule covers only situations of internal irregularities taking place within the company. The rule therefore serves the following purposes, namely that;

1. There would be futile actions in that a court order made on an application by an aggrieved minority would be made redundant by a resolution passed later on at the company's meeting confirming or ratifying what the minority complained of in court.
2. Insistence on an action by the company as the plaintiff prevents a multiplicity of actions. This means that if every shareholder were allowed to institute a personal action, it would result to as many actions as the members.
3. The principle enunciated in ***Salomon v Salomon & Co. Ltd***[103] would be undermined. Since a company is a separate legal person from its members, it follows that it is the company that has suffered a wrong but not its members.
4. The principle of majority rule would be violated because the law views companies as democracies, which are to be managed according to the wishes of the majority shareholders.[104]

Four exceptions however do exist to this rule. These are; -

a) ***Ultra Vires* and Illegality** - where the act complained of is wholly *ultravires* the company or association, the rule has no application because there is no question of the transaction being confirmed by any majority. In such instances an aggrieved minority of the company's members may institute legal proceedings in order to remedy the wrong done.

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[103] *supra*
[104] Mac Dougall v Gardiener (1875) 1 Ch. D. 13.

b) **Special Majorities** - this rule does not prevent an individual member from suing if the matter in respect of which he is suing is to be sanctioned, not only by an ordinary resolution but also a special resolution.

c) **Personal Rights invaded** -a minority shareholder may sue to protect from invasion of his individual rights as a member for example a right to vote.

d) **Fraud on a minority** - where what has been done amounts to what is generally called in these cases a fraud on the minority and the wrong doers are themselves in control of the company. A minority shareholder's action may be brought on behalf of the shareholders and all others.

It is important to note that a strict adherence to the rule in ***Foss v Harbottle*** is likely to occasion some injustice in cases where, the directors are also the controlling shareholders; these exceptions notwithstanding. This is because the directors in the exercise of their voting powers may easily block any attempt to bring an action against them. A shareholder may therefore sue under one of the above exceptions by instituting one of the following actions.

4.2 Forms of Action:

1. Personal Action:

Where an individual member sues not in the right of the company but in his own right to protect his individual right as member, he can bring an action in his own name and may sue on behalf of himself and other members.

An example is illustrated by the case of ***Pender v Lushinton***[105] in which a shareholder was able to enforce the article giving him a right to vote at meetings and compel the directors to record his vote. Other instances an individual can sue in his name include;

i. where the company is acting illegally or *ultra vires;*

ii. where a special majority is required and has not been obtained as in ***Edwards v Halliwell***[106] and

[105] (1877) 6 Ch. D. 70

[106] [1950] W.N. 537.

iii. where the company is acting contrary to its articles as in ***Wood v Odesa Water Works Co. Ltd***.[107]

2. Representative action

Where individual shareholders have suffered personal loss in addition to the injury to the company, one shareholder may bring a representative action on behalf of himself and all other shareholders who have suffered similar injury.

If the action is successful, the plaintiff will obtain a declaration that the improper conduct has been proved. Each injured party may then claim damages without further need to prove improper conduct.

3. Derivative Action:

In ***Nurcombe v Nurcombe***,[108] Lawton L.J stated that a derivative action is a procedural device for enabling the court to do justice to a company controlled by miscreant directors or shareholders. It is called derivative because the right to sue derives from that of the company.

In such a case, the minority shareholders sue on behalf of themselves and all other shareholders except those who are defendants and may enjoin the company as a defendant. The directors are usually the defendants. Where the action is successful, the damages awarded belong to the company.

A derivative action is usually appropriate where the wrong doers have voting control and therefore prevent the company from suing as in ***Cook v Deeks***[109] or ***Alexander v Automatic Telephone Co.***[110]

Although the rule in ***Foss v Harbottle*** vindicates the right of the majority of the company's members to pass resolutions on the company's behalf, it hedges that right with rules or exceptions which are also intended to protect the interests of the minority

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[107] (1889) 42 Ch. D. 636.
[108] [1985] 1 W.L.R 370.
[109] [1916] 1 A.C 554.
[110] [1902] 2 Ch. 56.

members in appropriate situations. It should be noted also that, in the process of protecting their personal interests, the minority are also in fact protecting the interests of the company itself since the company cannot protect itself in such situations.

An additional remedy is provided for under section 324 to apply in situations where these exceptions do not apply. This section provides the power of court to assess damages against delinquent directors.

4.3 Section 324 Power of the Court to assess Damages against Delinquent Directors:

Section 324 provides that, if in the course of winding up a company, it appears that any person who has taken part in forming and promoting a company or any past or present director has misapplied, retained or become liable or accountable for any money or property of the company; the court may on the application of the official receiver, the liquidator, creditor or member, compel him to restore the money or property to the company; or to pay damages instead.

This section is designed to deal with actual breaches of trust that come to light during proceedings. However, winding up may be applied as a means of ending a course of oppression by those formally in control.

4.4 Section 219 (f) Winding up by Court to end Oppression:

The High Court is empowered under section 218 of the Act to wind up any company registered in Kenya in certain situations. Section 219 sets out the circumstances under which a company may be wound up by a court order and these include; -

a) winding up in order to bring to an end a course of conduct by the majority of the members, which constitutes oppression on the minority;

b) where the substratum of the company has disappeared.[111]

c) where there is justifiable loss of confidence in the manner in which the company's affairs have been conducted.

Under section **219 (f)**, a company may be wound up where the court is of the opinion that it is **just and equitable** to wind up the company. The court may order so where it is satisfied that it is necessary to protect members from oppression especially when the conduct of those in control suggests that they are trying to make intolerable the position of other members so as to compel such members to sell their shares on unfavourable terms.

This section has however two limitations namely that; -

1) if a company is insolvent, then a member has no necessary *locus standi* to petition and
2) even where the company is solvent, winding up contrary to majority wishes is too serious a step, which the court will take up only if a particularly strong case is made out.

From the above discussion, it may be said that winding up a company to end oppression is rather crumply and may be of no benefit to the petitioners themselves thus an undesirable step or remedy.

Owing to these shortcomings, section 211 was incorporated in the Act as an alternative remedy for the minority of the shareholders.

4.5 Section 211 Alternative Remedy to Winding Up in cases of Oppression:

Section 211 was introduced as an alternative remedy to winding up of a company to bring an end to oppression in the company. Section 211(1) provides that any member who complains that affairs of a company are being conducted in a manner oppressive to some

[111] Re German Date Coffee Co. (1882) 20 Ch. D 169.

part of members, including himself, may make an application to the court by petition for an order under the section.

The court is empowered to make such order as it thinks fit with a view to bringing to an end the matters complained of if, on such petition it is of the opinion that:

- the company's affairs are being conducted as alleged by the applicant, and that
- to wind up the company would unfairly prejudice the applicant's but the proved facts would have justified the company's winding up on the '**just and equitable**' grounds.

By section 211 (2) the court is empowered to make an order which:

a) regulates the conduct of the company's affairs in the future, as in ***Re H.R Hamer,***[112]
b) requires some members of the company to purchase the shares of other members, as in ***Scottish Wholesale Co-operative Society v Meyer,***[113] or
c) requires the company itself to purchase the shares held by oppressed members, and the consequent reduction of capital.

It is worth noting that if the court orders an alteration of the Memorandum and Articles of Association, the company cannot thereafter make an alteration inconsistent with a court order except with leave of the court. It is important to understand what constitutes oppression in order to bring an action under this section.

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4.6 Meaning of Oppression;

As discussed above a petitioner must prove oppression and the question to ask is, what is oppression? There is no statutory definition of the word oppression or oppressive

[112](1959) WLR. 62 The father was restrained from managing the company's affairs in the future.
[113] (1956) A.C 324 H.L

conduct. However the following have been given as examples of oppressive conduct[114] as envisaged by section 211.

I. Where the controlling directors unreasonably refuse to register transfers of the minority holdings so as to force a sale to themselves at a low price.
II. Where the controlling directors take excessive remuneration so as to leave virtually nothing for distribution by way of dividend.

The following were added as instances of potential oppression;

a. The issue of shares to directors and others on advantageous terms.
b. The failure of directors to declare dividends on non-cumulative preference shares held by the minority.

Case law has in addition attempted to identify conduct that amounts to oppression as discussed in the following cases:
In the case of ***Scottish Cooperative Whole sale Society Ltd. V Meyer***, [115] the Scottish Cooperative society in 1946 formed a subsidiary company to enable it to participate in the manufacture of rayon materials and to get licences to manufacture rayon cloth, the manufacture of which was controlled until 1952. The society appointed three nominee directors to the board of its subsidiary. The society thereafter adopted a policy of transferring the business of the subsidiary to a vital standstill.
On application against the society by the independent shareholders of the subsidiary on grounds of oppression, it was held that the conduct of the holding company was oppressive of the minority shareholders in the subsidiary company.

Similarly, in ***Re Hammer Ltd.***,[116] the founder and sole proprietor of a philatelic auctioneering business had formed a company to carry out business in association with his two sons, to whom he gave shares, and who were appointed directors of the company.

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[114] These were given to the British Government by the Cohen's Committee's Report in 1947.
[115] *supra*

The father was appointed Chairman and life director. He and his wife held such a majority of votes that they together could secure the passing of any ordinary or special resolution. The father disregarded resolutions of the board of directors, assumed powers he did not posses and exercised them against the wishes of his sons who were shareholders as well as directors etc. It was held that the autocratic behaviour of the father was oppressive.

4.7 Limitations of Section 211.

There are certain conditions for relief, which must be satisfied for an applicant to rely on this remedy. These were summarised by Jenkins L.J in Re Harmer Ltd. as follows;-

1. **The oppression complained of by a member of the company and must be oppression to some part of the members (including himself) in their or his capacity as a member or members of the company.**

Section 211 is limited to oppression of members only and one must therefore petition as a member. Consequently, an oppressed director or debenture-holder cannot obtain an order under this section as long as he has been oppressed in his capacity as director or creditor.

This position was illustrated in the case of ***Elder V Elder & Watson***[117] where in a petition for relief under section 211, it was alleged that two petitioners, who were shareholders in a small family company, had suffered at the hands of other shareholders who had the voting power to remove the petitioners from their offices as directors, and from their employment as secretary and factory manager respectively as a result of serious personal differences that had arisen between the parties.

It was held in this case that the matters complained of related to their status as directors and officers of the company and not as members and therefore could not be the subject of relief under section 211.

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[116] *supra*

[117] (1952) S.C 49.

A similar finding was reached by the court in the case of ***Re Lundie Bros. Ltd.***,[118] where it was held that the matters complained of by the petitioner related to his status as director and not as member and that therefore section 211 could not apply.
The conduct complained of must therefore relate to the petitioner in his capacity as a member and to the conduct of the affairs of the company.

2. **The facts of the case must not only be those that would justify the making of a winding up order under the 'just and equitable rule' but must also be of a character which has the requisite element of oppression.**

3. **The phrase "the affairs of the company are being conducted" suggests *prima-facie* a continuing process and is wide enough to cover the affairs of the company whether *de facto* or *dejure.***

The wording of the section suggests that there must be a continuous course of conduct. In other words isolated acts of impropriety will not suffice to found an order under the section.

4. **The word 'oppressive' must be given its ordinary sense and the question must be whether in that sense the conduct complained of is oppressive to a member or members as such. It must be shown that there is oppression, which at common law means;-**
    - something burdensome, harsh and wrongful.
    - a visible departure from the standards of fair dealing and a violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely.
    - something unjustly burdensome, harsh or merciless.
    - lack of probity or fair dealing.

In practice, however, the circumstances in which the section has been successfully involved are totally different from those envisaged by the architects of the section. This is

[118] (1965) 1 W. L R. 1051

due to the fact that many burbles have been put in the way of the petitioner under that section. For the petitioner to sue successfully under the section, he must satisfy one of the above conditions.

Although these conditions could be given a liberal interpretation, they are very restrictive. The rigidity with which they have been applied has virtually frustrated the salutary intentions of section 211. Nearly all the petitioners in subsequent cases have been non-suited for failure to satisfy one or the other of these conditions.

Thus in ***Re Belador Silk Ltd.***,[119] the petitioner was one of the directors and shareholders in a private company. He was interested in another company to whom the respondent company owed a substantial debt. The petitioner claimed *inter alia* that distributions of profits had not been fairly made and that the company was being conducted irregularly. The petition was dismissed on three grounds namely that;

(i) it had been brought for the collateral purpose of enforcing repayment to another company in which the petitioner was interested;

(ii) the conduct complained of related to the petitioner as a director; and

(iii) the circumstances were not such as to justify a winding up order at the instance of the petitioner because the company was insolvent and therefore the shareholders had no tangible interest.

Similarly, in ***Re Five Minute Car Wash service Ltd.***,[120] the conduct which the petitioner complained of, was alleged extreme incompetence and inefficiency, of the former chairman of the board of directors and managing director, in the management of the company.

It was held that these allegations only suggested that he was unwise, inefficient and careless in the performance of his duties as managing director, but did not establish that he had acted unscrupulously, unfairly or with lack of probity towards the petitioner or any other member of the company, or that he had disregarded the wishes of the board of

[119] (1965) Vol. 1 ALL E.R. 667
[120] (1966) 1 W.L. R. 745

directors, or that his conduct could be characterised as harsh or burdensome or wrongful towards any member of the company.

The strict application of these conditions by the English courts rendered the section largely ineffective as a minority protection section and culminated in its repeal by the English Companies Act 1985. Only the cases of ***Re Harmer Ltd.***[121] and ***Scottish Wholesale Society Ltd. V Meyer***[122] had successfully been brought under the section.

4.8 CONCLUSCION:

The directors are possessed of immense powers, which must be regulated not only for the public good but also for the protection of those whose investments are involved (the shareholders). Directors in performing their fiduciary duties, may take risks for the benefit of the company. Directorships will nevertheless always be susceptible of abuse. Some directors can be faithless to their trust. This is by capitalising their strategic positions in the company to serve their own interests. The law therefore continues to struggle against their wiles; as a result, certain duties have been imposed upon them. These if adequately enforced should materially reduce the chances of abuse of directorships and hopefully the eradication of this vice that has been so damaging to our economy.

No Kenya case appears to have been contested under the section and it is therefore not possible to evaluate the effectiveness of the section as a weapon in the minority shareholder's armory. The section would however be equally ineffective in Kenya if our courts were to adopt the same restrictive conditions adopted by the courts. Thus reform of this provision is necessary and the following recommendations can be pointed out.

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[121] *supra*

[122] *supra*

4.9 RECOMMENDATIONS:

In order to make the section more effective a few amendments should be considered:

1. The link with winding up should be severed so that the remedy may be availed whether it is just and equitable to wind up or not.
2. The section should be re-phrased in order to cover isolated acts of impropriety as well as a course of conduct.
3. The courts should be empowered to restrain the commission or continuance of any act, which would suffice to support a petition under the section.
4. The words "in a manner oppressive" should be extended by adding the expression "or unfairly prejudicial to" or "unfairly discriminative against" the members as a whole.
5. Such people as personal representatives, trustees in bankruptcy and others to whom shares are transmitted by operation of law should also be allowed to petition.

CHAPTER FIVE:

REFORM PROPOSALS AND CONCLUSCION:

5.0 INTRODUCTION:

The crises caused by companies can be avoided if directors of companies have proper regard for their responsibilities. The main regulatory framework governing the responsibilities of directors in Kenya is contained in the State Corporations Act[123] and the Companies Act 1962.[124] The Companies Act regulates public and private companies.
It is notable that as a former British colony, Kenya's regulatory framework for directors and company law as a whole was inherited. The Act is based almost entirely on the 1948 U.K's Companies Act. The U.K's Act was introduced in Kenya in 1959 and adopted in 1962 virtually verbatim.

It is noteworthy, that despite significant changes in the U.K's Companies Act since 1948 and the substantial economic development in Kenya since1962, the regulatory framework for directors has remained as it was in 1962. In contrast, several former British colonies in Africa have changed their company legislation.[125]
Given that Kenya's circumstances have greatly changed since 1962, it is doubtful whether the law created in the U.K during the 19th Century to meet the objectives of capitalists operating in a *laissez faire* environment, would adequately govern modern day commercial organiastions in Kenya.
No substantial effort has been made so far to localise the Act or inquire into the local circumstances. Kenya is therefore gearing to enter the next millennium with a law that is foreign and somewhat obsolete.

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[123] Cap. 446, Laws of Kenya
[124] Cap. 486, Laws of Kenya
[125] Ghana's Companies Code 1963 (Act 179). The Code was based on a report by Professor Gower: *Final Report of the Commission of Inquiry in to the Working and Administration of the present Company Law in Ghana,* (Accra 1961); Nigerian Law Reform Commission, Working Papers on the reform of Nigerian Company Law: Vol. 1- Review and Recommendations, 1987.

The law including its successive modifications is rather inadequate in providing the basis for effective settlement of current corporate issues as they arise in the modern corporate world.

More specifically, existing legislation does not adequately deal with the issues of transparency, effectiveness, efficiency, probity, fairness, discipline, accountability, risibility, independence and social responsibility. Thus the flaws in the law continue to impact negatively on corporate governance.

It is against this backdrop that this chapter is based and it puts forward the following reform proposals regarding company directors.

5.1 Regulatory Reform:

a) Self Regulation:

There is need to reduce government intervention particularly by African countries for instance by adopting practices that would contribute to more effective self –Regulation of corporations both before and after full privatisation.[126] This can be done by adoption of a Code of Conduct in the Corporate Governance.[127]

Although there are no self-regulatory codes[128] for directors, in Kenya, it is notable that the Private Sector Corporate Governance Trust [129](PSCGT) has drafted principles and a sample code[130] for Corporate Governance Guidelines.

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[126] Self-Regulation arises when a group of individuals or institutions regulate their activities in their common interests without government encouragement or monitoring. See R. Baggot, "Regulatory Reform in Britain: The Changing Face of Self-Regulation" (1989) 67 Public Administration 435 at 438.

[127] J.K Kihumba, "Setting Governance Policies: Codes or Regulations?" A Panel Discussion Paper presented at the Global Conference on Corporate Governance on July 10-11, 2000 in the Southern Connecticut State University New Haven, U.S.A. <http://www.gogf.org/library/speeches/kihumba.doc>

[128] The OECD defines codes as commitments voluntarily made by companies, associations or other entities, which put forth standards and principles for the conduct of business activities in the market place, See OECD Working Party of the Trade Committee, Codes of Corporate Conduct; An Inventory, 1998. P.5.

[129] The Private Sector Government Trust (PSCGT) was established in March 1999 to promote good Corporate Governance. See <www.corporategov.co.ke>

[130] Whilst codes bind members of organizations, on the basis that they have agreed to be bound by them as part of the group, regulations bind members of organizations because they have the force of law. J.K Kihumba *supra*.

Since other professional societies in Kenya have Codes of Conducts regulating various professions,[131] it has been argued that the same approach should be adopted in the corporate scene.

b) The Judiciary:

The Report of the Committee of the Administration of Justice 1998 ("The Kwach Report") confirms that the Kenyan judiciary is bedeviled by corruption, incompetence and neglect of duty.[132]

Whilst corruption impacts negatively on the performance of companies by increasing transactions costs, an inefficient judiciary acts as a disincentive to foreign investment for failing to offer expeditious fairness and certainty. Lack of judicial independence also contributes to manipulation of the judiciary by the Executive. It is thus not uncommon for courts to shield a miscreant politically correct director. Giving the judiciary more independence[133] would curtail the political dependence and in turn raise standards of corporate governance.

A legal system would be hardly considered effective if it does not set legal standards, implement and enforce those standards, resolve disputes and limit the power of the state. It is thus important to have adequate and efficient institutions, to implement and enforce the law.

c) Donations by Company Directors:

Donations from companies' resources are beneficial, however they may encourage corruption. Donations by directors of parastatals have in the past been given to the government in return for political favours among other personal benefits.

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[131] Examples include the Law Society of Kenya, Non-Governmental Organisations (NGOs), and other Medical and Accounting professions. See E.A.A. Yaansa, " An experiment in NGO Self-Regulation in Kenya" in "Self-Regulation Report Kenya" (Washington DC; International Centre for Non-Profit Law) p. 1, <http://www.icnl.org/journal/vol 1 iss. 1/kenyasr.html>

[132] Republic of Kenya. The Report of the Committee on Administration of Justice, 1998. Chapters 9,11; <http://www.lawafrica.com/rpts/go.asp?filekwach.xml>

[133] Judges are appointed by the president by virtue of Section 61 of the Constitution of Kenya.

Such donations subsequently occasion heavy losses to shareholders and creditors. Therefore abuse of donations should be safeguarded by limiting the amount that can be given and allowing them to be given only if they are expressly authorised by the constitution of a company or the shareholders.[134]

d) Directors should assume Social Responsibilities in order to facilitate effective participation of employees in economic activities:

Directors ought to consider social responsibilities so as to facilitate participation of employees in economic activities. This view confirms that a company cannot be regarded as just the association of shareholders because it also encompasses others who make commitments to it, namely employees, suppliers of goods and services and customers.

As such, a company would ultimately benefit[135] by satisfying wider social responsibilities by ensuring productive relationships with a range of interested parties.[136] Although the failure to require companies to perform social duties may increase the prevailing social injustice and exploitation because of lack of a general duty to act, it should be borne in mind that obliging directors to shoulder social responsibilities may not augur well for some companies in Kenya. This is because the developing status of the economy may discourage foreign investment and perhaps contribute to retrenchment of employees in a bid to reduce costs.[137]

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[134] The U.K's Fifth Report of the Committee on Standards in Public Life proposed that legislation should require shareholders' prior authority for political donations by companies. The American Law Institute principles provide that directors can expend a limited amount of company funds for philanthropic purposes even though no benefit to shareholders is likely to result: American Law Institute, Principles of Corporate Governance, 1994, para.2.01 (b) (3).

[135] Delmonte Kenya suffered heavy losses following the boycott of its products in Italy, a key destination for its products. The boycott was triggered by the failure on the part of the company to heed the concerns of employees and local communities. Toby Kent, " CSR Investment is not a choice" Ethical Corporate Magazine, Issue 1, Dec 2001, <htpp://www.ethicalcorp.com/magazine/issue1.pdf>

[136] A framework that is competitive and beneficial to the economy, the medium through which a company operates, should cater for both internal and external interests, The Law Review Steering Committee

[137] This view was favoured in Nigeria. Nigerian Law Reform Commission pp. 204-204.

5.2 Law Reform:

a) In Relation to Directors Duties:

Common Law Duties:

Common law principles relating to directors should be codified in the Companies Act to make the laws more accessible. Codification is absolutely necessary this is because directors' breaches of duty are attributed to non-codification of important law principles and the Act is difficult to understand.
It is true to say that the inaccessibility of the law has contributed to loss of educational benefits and in turn, negatively affected the competitiveness of Kenyan Company law. Although codification is likely to raise awareness there is a need to refrain from making the codified statute too long and complicated so as to be difficult to understand. Directors breach their duties because the Companies Act is too bulky and therefore difficult to understand. As such there is a need to avoid ambiguity arising from codification because it might impede accessibility.

Duties of care and Skill:

Directors do not take their duties in relation to skill, care and diligence seriously. This is attributed to the fact that the degree of care and skill required is that of a reasonable man depending on his skill and knowledge. This is the standard of care expected from directors in Kenya.
Although there is no statutory provision requiring directors to have expertise and experience in the management of Companies in Kenya, it is notable that the Kenyan Capital Markets Authority[138] recently issued guidelines requiring directors of public listed companies to be familiar with basic accounting principles and be "informed, vigilant, and effective overseers of the financial reporting process and the company's

[138] The Capital Markets Authority is established under the Capital Markets Act Cap. 485 A

internal controls."[139] This is a step in the right direction because it imposes on directors a positive duty and in turn raises standards.

b) Enforcement of Directors' Liability:

It is clear that there is no effective enforcement of liability for directors' actions under the Act. It is notable that the company is the only body entitled to sue a miscreant director in Kenya[140] as his duties are owed to the company alone. It is therefore possible for directors to escape liability when they form and control a majority of the shareholders because minority shareholders are precluded from pursuing enforcement suits unless the company has been a victim of a fraud or the conduct complained of is oppressive to the interests of some shareholders.

The Kenyan Capital Markets Authority has recently issued rules requiring public listed companies to have a mechanism for representation of minority shareholders without undermining the collective responsibility of the directors.

Whilst the initiative is commendable for giving minority shareholders a say on the board, the measure will not be of much use because they are still not in a position to enforce the rights of a company, where the directors form and control a majority of the shareholders. Thus it is submitted that minority shareholders can only be protected by a statutory provision allowing them to enforce the rights of the company.[141]
Reforming the judiciary to make it more efficient would enhance shareholder's faith in the system and in turn encourage shareholders to enforce directors' liability more readily. Awareness of shareholders should thus be encouraged to ascertain when they ought to enforce company liability against miscreant directors. This can be done by publishing simplified company books and pamphlets. To achieve this, directors should be required to

[139] Washington Akumu, " Stiff New Rules for Companies " Daily Nation, Jan 26, 2002
[140] Proceedings may be instituted against a *defacto* or shadow director as well as a retired director, a deceased director and a bankrupt director, Curtis Furnishings Stores Ltd. V Freedman [1966] 2 All E.R 955; Proceedings may be instituted in the name of the company on the authority of the board or the general meeting. Article 80, Table A of the Act.

undertake a certified course and to use simple language in the Articles and memorandum of Associations in order for them to be easily understood.

It is notable that the Private Sector Corporate Governance Trust has begun promoting corporate governance awareness among the Kenyan public. The trust was founded in March 1999, to promote good corporate governance.[142] This initiative is commendable because it is likely to enhance the competence of directors and the activism of shareholders.

c) <u>In Relation to Disqualification of Directors:</u>

Disqualification orders are very rare and a stricter disqualification[143] regime would ensure that unfit directors do not serve on boards. Many companies in Kenya are still run by incompetent negligent and fraudulent directors due to lack of a proper[144] disqualification regime. In order to protect creditors and enforce orders more effectively, Kenya needs to broaden the scope of provisions, offences and grounds covered by the Act in order to prevent errant directors form finding their way to or remaining in boardrooms.

The present provisions can hardly raise the standards of directors' behaviour or protect the public from errant directors.

Disqualification apart from preventing the people without necessary qualifications from managing companies, also serves as a deterrent to those who might be tempted to engage in fraudulent activities.

It is also necessary to disqualify directors who have been responsible for the insolvency of many companies regardless of whether they have been convicted of fraud. Also, extending the period of disqualification to cover periods that are longer than 5 years may serve as a deterrent.

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[141] Courts in other jurisdictions such as Australia and new Zealand have shown the tendency of not applying the rule in Foss v Harbottle when it stands in the way of justice

[142] <www.corporategovernace.co.ke>

[143] Disqualification of directors protects the public by placing a prohibition on the errant director being involved, for a specific period, in the management of companies.

[144] "The tragedy in Kenya is that those who have mismanaged the Government, the Development Finance Institutions, and even multinational corporations are those who continue to circulate in and out of

5.3 Conclusion:

Directors can only be better performers if they understand the important role they play in corporate growth. This can be achieved if they understand the relevant law regulating their status and role in the company. It is therefore vital that the company law of this country should be revised with a bid to facilitating proper management by directors.

Of great importance also is the enforcement and implementation of the foregoing reforms. The Government should steer the way forward and undertake to see the review of the relevant provisions and subsequent implementation of the same. Corporate growth is likely to encourage growth in the economy and hence the need to seriously undertake to revise the laws.

The Government's stand on zero tolerance to corruption will facilitate such desired good corporate governance if strictly adhered to. Sheer hard work and commitment by directors will also be fundamental to achieving this goal.

Government as ministers, assistant ministers, advisers and so on." See Anyang' Nyong'o, " How Bad Governance Strangles Business" Daily Nation, June 10, 2001.

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