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Shareholder Protection - Some Aspects

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by

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A dissertation submited in partial fulfilment of the requirements for the LL.B. Degree, University of NAIROBI

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INTRODUCTION

Shareholders protection is an important subject in Company Law. The importance of the subject springs mainly from the fact that a company is regarded in law as a distinct legal entity separate from its members[1]. This means that the assets of a company are regarded as distinct from those of the members[2] and hence for a member - investor to realize profits from the money he has invested in a company, he needs some measure of protection from the acts of the company's organs which determine the course of action in business or otherwise that a company may undeetake.

There are various reasons why people associate together. They may associate for a social prupose; a good example is a football club for promotion of the soccer interests of its mebbers. People may also associate for purposes of promoting business interests. The purpose of this paper is to appraise the protection that is afforded those who associate for business purposes. However this paper covers yet a smaller area of business associations. It covers only incorporated bodies whose only members' liability is limited by shares[3].

The whole dissertation covers two main areas,,in which it is considered that shareholders need most protection. To the extent that the financial position of the company depends on how its affairs are managed, it is necessary to appraise the internal administration of a company. Generally, shareholders protection entails an appraisal of not only protection of what but also protection from who. The usual action by a shareholder is directed against the company itself. Since a member on acquisition of shares in a company becomes entitled to some interests in the company. These are the interests that the law tries to protect. The complaining shareholder may also feel that the major organs of the company are acting or conducting the company's affairs in a manner which is oppresive to him.

Overall this it should be noted that the law does not endeavour to protect only existing members. It protects the members of the public by demanding that when the public is invited to purchase shares in the company they are given as adequate information as possible. This is supposed to enable them to decide intelligently on whether to invest in a certain undertaking or not and also to decide what mode of investment they will make.

For the purpose of appraising the conditions raised above, the whole dissertation has a number of chapters.

In the first chapter, the company and membership of companies will be appraised this chapter gives preliminaries on important information as to the relationship between a shareholder and the company, how one becomes a member in a company and what a company is for the purpose of shareholder protection.

In the second chapter, the internal administration of companies is analysed. This is important for the division of power between the organs of the company and the interaction of the organs will determine who holds what powers. This in turn will answer the question wields the ultimate power of control over the affairs of the company - the board of directors or the general meeting? In legal theory members in general meeting are in ultimate control of the company's affairs. This is presumed to be legally so by virtue of their powers to alter the articles, remove the directors and over this their powers to ratify the directors actions when they have acted outside the powers conferred on them but intra-vires the company. The general meeting is itself irremovable. The directors cannot just decide that there will not be general meeting of members.

The third chapter will appraise the financial protection of members and prospective members. This will mainly evaluate the rules relating to the issue of prospectuses, the disclosure principle and liability of various officers and persons for failure to comply with statutory provisions relating thereto. The rules governing the declaration of dividends and the privileged position of directors in relation to the declaration of dividends will be analysed with a view to discovering whether such rules are conducive to the interests of the members who have a right to share in the benefits of the company. As a business enterprise, it is presumed that a company makes profit; if such a profit is made its application is important. An attempt will be made to discuss directors powers to apply profits to various company's undertakings with a view to discovering whether this is for the benefit of the company. The question here is, should members be allowed to have a say in how the profits of the company should be used?

In the fourth chapter the machinery of state, especially the inspectorate which is within the office of the Registrar of Companies will be appraised with a view to determining whether the state machinery responsible for policing activities of the company has insured the protection that is legally due to members present and future. This chapter will try to indicate the extent to which the registrar of companies has been successful in exercising powers conferred upon him.

The fifty and last chapter will be a conclusion of the foregoing. This chapter will try in brief to answer the question whether or not the shareholders are protected legally and practically. If it is found that they are not protected, or that the protection is not adequate, suggestions will be made as to how such protection can be achieved.

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CHAPTER ONE

COMPANY AND MEMBERSHIP

There are various types of companies that may be registered under the Kenya Companies Act.[1] A company could either be a private of a public company; Unlimited, or limited by shares or guarantee.

A company limited by shares is that company whose members' liability is limited to the amount, if any, unpaid on the shares respectively held by them.[2] A company limited by guarantee is defined in the Companies Act as

> "a company having the liability of its members limited by the memorandum to such an amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up"[3]

In this dissertation I intend to deal with companies limited by shares[4] and not those limited by guarantee.

How Does A Person Become A Member?

A meaningful discussion on shareholder protection would entail a discussion on how a person becomes a shareholder in a company. The term shareholder and member are here interchangeably used. The reason for this being that although a shareholder need not be a member, a member will invariably be a shareholder, and to this extent, it would not be wrong to describe a member as a shareholder. The conditions under which a shareholder may not be a member ought to be mentioned here. S. 114 (1) Provide that

> "On the issue of a share warrant the company shall strike out of the registrar of members the name of the member then entered therein as holding the shares specified in the warrant as if he had ceased to be a member..."

This means that such a person is still deemed to be a shareholder even though he is not regarded as a member.

Over this a share warrant is a negotiable instrument and the holder thereof may not be the original member. A person holding a share warrant will therefore be ragarded as a shareholder of the shares specified in the warrant, whether he is the original holder or a person to whom the instrument has subsequently been negotiated.

The Act does not define who a member is but it lays down conditions as to how a person becomes a member. Thus S. 28 provides that

> "(1) The subscribers to the memorandum of a company shall be deemed to have agreed to become members of the company and on its registration shall be entered as members in the register of members."
>
> "(2) Every other person who agrees to become a member of the company and whose name is entered in its register of members shall be a member of the company."

It has been held in England that the effect of a section equivalent to section 28 (1) is that on registration of a company, the subscriber automatically become members and holders of shares for which they have signed, even if the company omits to fulfil its duty to put them on the register or allot shares to them.[5] There is one condition under which such subscribers may not be deemed to be members notwithstanding their having signed the memorandum of association of a company. This happens if the subscribers have not been alloted shares and all the shares in the company have been alloted. Under this condition, short of increasong the share capital of the company, such subscribers cannot have shares and thus cannot be members of the company.

In case of other people who are not subscribers, they become members on normal contactual principles.[6] In case of a public company, such company issues a document called a prospectus.

This is a document inviting the public to purchase shares in a company. The prospectus itself is not an offer but an invitation to treat. The prospective members offer to buy shares in a company by completing and returning the prospectus forms. If the offer is accepted either wholly or to a lesser amount depending on the number of people who have subscribed for shares, the directors allot the shares to the subscribers. Once the directors have alloted shares and dispatched allotment letters, the agreements are complete. At this point no allotee has become a member. He merely has a contractual right to become one. He may assign this right thereby relinquishing any claim to membership. The assignment is by renouncing ones right in favour of a third party. It seems that if a company does not revoke the allotment of shares to a person and that person does not renounce his rights to a third party, such a person would still be a member even if the company fails to register him in the register of members. This may be inferred from the fact that a member's rights and obligations to a company is measured by the shares he holds. In connection with this, a share has been held to be

> "the interest of a shareholder in the company measured by a sum of money for the purpose of liability in the first place, and a series of mutual covenants entered into by all shareholders inter-se in accordance with (S.22 of the Act). ... A share is not a sum of money, --- but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of more or less amount."[7]

From the above decision, it is clear that a share can only be created by a contractual obligation to pay for certain interests in the company and to be bound to the company by certain obligations. The question that arises from this is - what is the position of the statutory requirements for registration of members in a members' register? First it must be clear that registration

of a person as a member who has not agreed to be a member would create no rights accruing to that person, nor would there be any obligation owed by him to the company. These two conditions were touched upon in Mawagola Farmers Ltd v Kayanja[8] where on the question of membership, it was held that the register of members of a company is not necessarily conclusive evidence add that an allotee may prove membership in absence of registration. The contractual rights and duties come into existence with the acquisition of shares. The shares have been held to be

> "Created by the joint action of the corporation and shareholders. It imports a contribution to the capital stock made by the shareholder and accepted by the corporation. When a corporation agrees that a person shall be entitled to a certain number of shares for consideration permited by law and executed by the person, these shares come into existence and are owned by him."[9]

This decision establishes the ownership of shares in a company, which ownership determines a person's interest in the company is not created nor is registration necessary for their existence or the existence of rights acruing to shares. The members rights in a company are incidents of shares. There are various rights acruing to shares, for example, the right to attend company meetings, the right to vote in general meetings, rights to transfer shares and the right to participate in the profits of a company. These are the rights which the law endewours to protect. This protection will be analysed in this dissertation with a view to discovering to what extent the law has achieved this goal.

What Is A Company

The term company has no strict legal meaning. In legal theory it implies an association of persons for some common object or objects. There are various reasons why people associate together. People may form an association for social purposes - for example a football club may be formed to promote the spots interest in football for the members. People may also associate for the purpose of carrying on business for gain. Suffice it here to say that since the concern of this paper is protection of members who invest in companies with expectation of reaping profits from their investments, the term company in this dissertation will be limited to such business associations. In the wider legal meaning, an association of persons for reasons of carrying on business for gain includes partnerships and corporations whether private or public. Thus far it is futile to define the term company. What would be more appropriate is to show the characteristics which distinguish a company from other business associations - As Gower points out[10], -

> "A more complicated form of association with a large fluctuating membership requires a more elaborate organisation which ideally should confer corporate personality on the association that is, should recognize that it constitutes a distinct legal person subject to legal duties and entitled to legal rights separate from those of its members"

This comment goes to the root of incorporation. It must be noted however that the legal personality accorded to a company on incorporation does not flow from the fact that a company has a large and fluctuating membership. In the case that first articulated the distinct legal personality of a company, the company was virtually owned by one person - a Mr. Salomon[11]. Just as in Lee v Lee's Air farming Ltd.[12] the company in question was what is called "One Man Company."

In Salomonv Salomon & Co.[13] it was settled once and for all that a company was a legal person distinct from its members. Secondly a company may be regarded as the general body of the shareholders. Thus it has been held that "for the benefit of the company as a whole" meant the benefit of the general body of the shareholders[14]

This latter view is important especially when it is realised that the distinct legal personality is an abstraction and therefore shorn of its legal fiction, the interests of a company conote the interest of the whole body of shareholders who after all constitute the company. Thus whenever the company is protected from the acts, for example, of the officers or organs, it is the interests of the whole body of the shareholders which are being protected

The Basis of Shareholder Protection In Kenya

The Kenya Companies Act[15] is virtually a verbatin copy of the English Companies Act of 1948. The English Companies Act itself is not a codifying Act, it is merely a ~~consolidated~~ consolidating statute which lays down mainly the exceptions to the rules. Most of the English Company Law is to be found in Case - Law, Since the Kenyan Act is in pari-materia with the English Companies Act of 1948, which itself does not contain all the law on companies, it follows that in Kenya the statutory rules should be suplemented by Common Law and Equity as in England. Thus where the Act is silent the Kenyan Courts will be constrained to fall back on the English Common Law and doctrines of Equity for guidance.

The Judicature Act[16] provides that

> "The jurisdiction of the High Court and all surbodinate courts shall be exercised in conformity with --- the substance of Common Law, the doctrines of Equity --- in force in England on 12th August, 1897, and the procedure and practice observed in Courts of Justice in England at that date.
> "Provided that the said common law doctrines of equity, --- shall apply so far only as the circumstances of Kenya and its inhabitants permit and subject to such qualifications as those circumstances may render necessary"[17]

From this, it may well be noted that the English Common Law and doctrines of equity that ought to apply in Kenya are those that were in force in England on the 12th August, 1897. Even in applying those, the provision to the section that, such doctrines should apply so far only as circumstances of Kenya permit ought to be taken in consideration. However neither of these provisions have been strictly followed. The courts in Kenya have been applying and following judicial decisions of English courts of a later date than that stipulated by the judicature Act. This may be justified when one looks at the Kenya'a Companies Act which is in Pari materia with the English Companies Act. It means then that English law and Kenyan law upto 1948 were at par, and even if English decision of the period after 1897 are not of a binding authority, they are of great persuasive force. For this reason it is inevitable that English decisions will feature prominently in the whole of this discourse.

CHAPTER TWO

ADMINISTRATIVE PROTECTION WITHIN THE COMPANY

The structure of the internal management of a company determine the extent to which shareholders in a company will be in a position to control its affairs. In this respect, what is significant is the division of powers between the main organs of a company. Before determining whether the shareholders interests are protected through the internal managerial machinery such machinery ought to be looked into.

THE ORGANS OF A COMPANY

Since a company is an artificial person[1], it can only act through the agency of a natural persons. For this purpose the authority to exercise a companys powers is delegated to its main organs - the general meeting and the board of directors.

At first it was thought that the general meeting was the main organ of the company and that the board was merely an agent of the company subject to control by company in general meeting[2]. However in Automatic Self-Cleansing Filter Sydicate v Cunninghame,[3] It was made quite clear that the division of powers between the board of directors and the company in general meeting in case of a registered company depended entirely on the construction of the articles of association, and that where powers had been vested in the board, the general meeting could not interfere with the exercise of that power.

A company is free when making its constitution to allocate powers generally to any of its organs or to restrict such powers in the manner it may deem necessary. Most companies however adopt the model articles in the Table A of the First Schedule of the Companies Act. Article 80 of Table A stipulates that the management of the affairs of a company is vested in the board of directors and that no regulation made by a company in general meeting shall invalidate any prior act of directors which could have been valid if that regulation had not been made. The board however is prohibited from exercising such powers as are expressly reserved by the articles to the general meeting.

If the articles of a company are in the form of the model articles in Table A, the only way in which the members can prevent the directors from exercising powers of general management in the company is by altering the articles as provided by the Act[4].

The position of the organs of the company in relation to article 80 was well illustrated in the case of Shaw & Sons (Salford Ltd.) v Shaw.[5] In that case, certain directors had brought proceedings against fellow directors, in the name of the company. The company's articles contained an article similar to Article 80 of Table A. A general meeting of the company consequently passed a resolution instructing the directors to discontinue the proceedings. The issue was whether or not the resolution of the company bound the directors? It was held that bringing proceedings in the name of the company was a power of directors and the general meeting could not interfere with it's exercise. The only way in which the members could control the exercise of powers by directors was either by altering the articles to remove the powers vested in the directors, or by refusing to re-elect those directors when they come up for re-election or by removing them from office.

This decision establishes that where the articles of a company are in form of Table A, and such company adopts article 80, the directors are in general and direct control of the company to the exclusion of the members.

Notwithstanding the position of the directors in the internal management of a company, in legal theory the members wield ultimate control of the affairs of the company. This is because of their powers under the Act to alter the articles[6], to remove a director or directors from office[7] or by refusing to re-elect incumbent directors when they come up for re-election at the annual general meeting. They may also bring an action in the name of the company, and may also apply to court for investigation of the affairs of the company.[8] However this power exists only in legal theory. In practice, powers of ultimate control lie with the directors. This then adversely affects the protection of members in a company, since the most effective method of protection is through actual control which is lacking. Here only a few areas of the legal control which do not exist in practice or which are greatly affected by the position of the directors will be shown.

POWERS OF GENERAL MEETING TO ALTER THE ARTICLES

Under the Act, a company may by a special resolution alter its articles[9], provided that such an alteration is not contrary to any provisions in the memorandum of association of that company or any statutory limitations provided by the Act. A special resolution is one which has been passed by a majority of not less than three-fourths of such members as, being entitled so to do, vote in person, or where proxies are allowed, by proxy, at a general meeting of which notice specifying the intention to propose the resolution as a special resolution has been duly given[10]:

This power to alter the articles give members in general meetings control in two ways. In the first place, the members in general meetings may change the articles to curtail the powers of directors. The alteration may go to the extent of providing that the directors are under the general control of the general meeting. In this way the general meeting would be in a position to overule the decision of the directors by a bare majority vote.

Secondly, by realising that members hold this power in their hands and that they can infact use it, the directors would think twice before overlooking the will of the members. This would then ensure that the wishes of the members prevail when the company is acting through the directors. The power to alter the articles is a strong weapon in the hands of the shareholders. However this instrument has been blunted by the control that directors have over the proxy voting machinery.

The power to alter the articles is subject to voting. To alter the articles and infact for any action of the members in general meeting, the power to vote is important and whoever controls the voting machinery will be in effective control of the ~~voting machinery~~ company. Whenever a meeting of a company is convened, circulars calling the meeting are sent to all people who are entitled to attend and vote at such a meeting. These circulars are sent by the directors through the company secretary unless it is a requisition of meeting by some members. This means that the directors are in a position to contact the members by representations accompanying the circulars calling the meetings. Over this especially in public companies, the directors are in control of the proxy voting machinery.

The term proxy has two meanings. It may refer to a person appointed by a member to go and vote on his behalf in a meeting or meetings of a company. Secondly the term proxy may refer to the document by which such a person is appointed. Unless the articles of a company stipulate otherwise, a proxy is not supposed to vote on a show of hands.[11] However a proxy has a right to demand a poll or join in the demand of a poll.[12] All that the section saves is that if the directors at any particular meeting are the majority in number, they may decide to have a vote by a show of hands, thus defeating the members who have sent proxies to vote on their behalf since proxies are not allowed to vote on a show of hands. This is of little significance in shareholder protection. What is important is that directors are in control of proxy-voting machinery. When sending circulars convening the meetings, the directors usually send proxy forms to be filled in by members. They will solicite to be appointed as the proxies ~~of~~ for those members who feel they will not attend personally. In public

Companies, especially with a large dispersed membership attendance at meetings is very low the best that such members can do is appoint the directors as their proxies. As a result even if the directors hold only a small block of shares, they will end up having many votes on their sides. Even where the proxy forms are two, enabling the members to indicate how the proxy is to vote, they will generally vote in favour of directors' view since the directors will have given a full representation in their favour. Under such circumstances it is hard for members seeking alteration of the articles curtailing the powers of directors to succeed. What appears from this is that in voting generally and particularly in alteration of the articles the directors will not be jeorpardised since they are well guarded by the proxy voting machinery and the machinery for disseminating information to members.

Not only in alteration of the articles do members in general meeting find difficulties. The same difficulaties subsist when the members attempt to remove the directors from office. Although a director may be removed from office by an ordinary resolution before the expiration of his term of office,[13] the problem of securing majority vote by those seeking his removal is an onerous one due to the director's control over voting machinery. A director who is sought to be removed must be served with notice of the meeting and motion that he be removed. He is also entitled to make a representation which must be sent to the members of the company before the meeting.[14] In this representation he can defend himself accordingly. This reduces the chances of his removal unless other directors are against him. Even if such directors are removed from office he is entitled to compensation if the removal breaches a service contract he had with the company[15] it must be noted that although a company cannot be prevented from altering its articles thereby removing a director from office, such a company will be liable in damages if the removal is a breach of an independent service contract[16]. This does not serve to protect the members for damages will only be paid out of the funds from which they expect to receive profits by way of dividends. It must be noted that it is within the general powers of directors to enter into contracts for a company. The members might find the directors entrenched in their offices by use of independent contracts of service, which make it impossible for members in general meeting to remove them without the company incurring heavy losses. Once directors are in such a position, and they know that even if they are removed from office before the expiration of their term of office as stipulated in the contract they will be paid damages, which may amount to full remuneration for

the remaining duration which they have not served, they can easily disregard the wish of the members, even majority shareholders.

Having seen the difficulties involved in trying to alter the articles, which alteration is against the directors, and also the awkward position of members in general meeting trying to remove. director's under service contracts it may be said that the same problem subsists when members bring proceedings against the directors. As has already been seen the directors are vested with powers of general management of a company's affairs. They are therefore the ones charged with the duties of bringing proceedings in the name of the company. However if directors cannot bring proceedings in the name of the company, for example, where they are the defendants, this power reverts to the general meeting[17]. This power to institute proceedings in the name of the company will depend on effective resolution to that effect. It has already been illustrated that it is very hard for members to have a resolution passed which is against the directors. If it is the minority who are seeking to start proceedings in the name of the company, the burden of getting a resolu tion passed is a heavy one.

Thus far the directors are in a postion to hinder the members from getting resolutions passed which are against them. It cannot be said that the members interests are protected. This generally shows that where an action against the directors is subject to a resolution by the general meeting, the directors will generally emerge triumphant and members interests will hardly be maintained.

The reasons behind the conditions as subsisting is not lack of legal provisions but rather the attitude of members and the whole Act. Firstly, the Act is enacted in the spirit of laiseez faire capitalism where one is deemed to be in a position to associate with others and to arrange his own affairs in such a way as to derive maximum benefits from his association. This is the basic reason why the division of powers is in the articles and not provided for by the Act. But laissez fare capitalism presupposes equal bargaining position coupled with freedom to chose and discard. This is not possible in true life and members usually end up on the losing end, since the original drafters of the articles will be promoters who usually become the first directors and have first and foremost their own interests at hearts rather than those of other members. For this reason the initial articles will inevitably be in a form favouring the directors manifestly but seeming to allow members to exercise control. As a result members can hardly be protected.

In kenya the members in most companies are not aware of their rights. They do not know that they have power to alter the articles.

They regard the directors as people in the know-how about the business venture and belief in non-interference. This apathy leads to lack of protection. It is evident that whenever the directors are challenged, most members assume that this is just politics and is not their concern. This may greatly affect the rights of the minorities who may want to assert their rights. For the resulting apathy will mean that minority shareholders who may want to lobby against the directors will hardly find support from the fellow members to have a resolution passed against those directors.

The question that arises is the extent to which the minority shareholders are protected against the acts of the controllers. As have been reiterated, the directors are in actual control of the machinery of internal management. This in simple terms means that they can and do control the majority shares or are able to have the majority holders follow them. The system of removing them also has loopholes which prevents their removal. But as far as minority protection is concerned, it is a number of people who are outvoted who claim for some relief as a result of majority action. Usually the minority will claim opression or fraud on the minority. Protection of minority is also important because, unlike the directors who are under fiduciary duties analoguous to those of a trustee, towards the company, the controlles are under no such duties.

A vote being an incident of a share, which is a proprietary right, a member can exercise a right to vote in any way without regard to the interest of the other shareholders. But because of the realisation that the majority has such powers to controll affairs of a company through voting, which might seriously affect the rights of the minority shareholders, the Law insists on a measure of restriction in the way the majority exercise their rights to vote. Also in some resolutions the law insists on a very high majority vote requirement to pass a resolution, or alternatively requires a low fraction of shareholders to stop an action by the majority holders if such an action is not for the benefit of the company as a whole. These measures are aimed at protecting the minority.

The term minority need not refer to a numerical minority. It applies to those who have been outvoted by the controllers. The minority may bring an action when there is alleged to be fraud on the minority. In this context fraud is used in a wider sense then the common law meaning of wilful deceit. It connotes an abuse of power analoguous to its meaning in equity to describe a misuse of a fiduciary position. Fraud on the minority therefore covers certain acts of fraudulent character in this wider sence. For example, when the majority are endevouring to appropriate to themselves directly or indirectly property or

advantages which belong to the Company or in which the other members are entitled to participate.[18]

The controlling shareholders are not allowed to exercise their powers so as to deprive the other members of their shares in the company, unless such appropriation is required in the interest of the company as a whole and there is fair compensation to those whose shares or other interests are appropriated. It must be noted however that the legal position concerning this proposition has not clearly been settled by courts. Thus in Brown v. British Abrasive Wheel Company.[19] Where a public company was in urgent need of further capital, the holders of 98% of shares were willing to supply that capital provided they bought out the minority. Having failed to persuade the minority to sell they then passed a special resolution adding to the articles a clause whereby any shareholder was bound to transfer his shares upon request in writing of holders of nine tenths of issued capital. Although such a clause could have been validly inserted in the original articles, it was held that an attempt to add the clause inorder to acquire compulsarily the shares of the minority, who had bought them when there was no such a clause could not be for the benefit of the company as a whole and was solely for the interests of the majority.

But in a later case[20], it was held that such an alteration is valid since a company has statutory power to alter its articles and introduce anything that could have been validly included in the original articles provided such alteration is made bona fide for the benefit of the company as a whole. Although the law on appropriation of minorities' rights is not clear, what seems to have been settled is that the majority cannot by alteration of the articles give themselves unrestricted and unlimited powers to buy out any shareholders they might think proper. It has been held that such a power goes much further than is necessary for the protection of the company from conduct detrimental to it's interests.[21] The courts attitude is that, it is upon the members to decide what is for the benefit of the company, and courts will only intervene if the majority has not acted in good faith in what a reasonable man would consider to be for the benefit of the company as a whole[22]. From the case law as seen above, there is no consistent principle regarding expropriation of rights of minority by majority holders. The law needs clarification. Probably the best approach is that taken in Brown v British Abrassive Wheel Co. This would prevent confusion by spliting hairs to decide whether a resolution is passed by members in good faith or not. The test should be whether the appropriation is justified under the circumstances.

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Under exceptional circumstances the minorities may bring a derivative action against directors or controllers if for any reason the company cannot bring such an action. Generally when a person brings an action in the name of the company, he will be required to obtain a resolution by the company in general meeting to that effect. This view is very unrealistic of the courts. They are not always ready to appreciate the powers that the directors exercise in management of the company's affairs to the extent of de-facto control of the voting machinery.

In a derivative action the alleged wrong is against the company and not against the one suing. But because the company's organs cannot bring proceedings a minority holder is allowed to bring such an action a a matter of grace to allow the company to recover. If the company recovers against defaulters, then the whole company will benefit. This is an exception to the rule in Foss v Harbottle THAT where an alleged wrong is against the company,the only right plaintiff is the company itself. To include all parties to the suit, the degaulters and the company are joined as defendant. The applicant and all those not in default are plaintiffs, it is gromable that the company should be made a defendant when a derivative action is brought on its behalf. However this helps to remove multiplicity of suits.

Where the alleged wrong is done or threatened by the company, the company itself is the real defendant. The minority will be seeking remedy against it. The minority need not bring in the directors as co-defendants unless there is specific rememdy they are seeking against it. Here the one who sues, does so on for himself and on behalf of other shareholders except the defaulters.

What happens is that where the alleged wrong by the controllers is against the company, the minority may bring a derivative action and recover for the benefit of the company. They may also recover on personal grounds if there is an invasion of their rights. There among other exceptions to the rule in Foss v Harbottle try to ensure that unconscionable conduct by those in control of the company at the expense of minority is removed. If minorities are not allowed to sue under the circumstances, most of these grievances would never reach the courts.

The most potent remedy for the minority is operative when there is alleged oppression. Where the minority petition the court that the company be wound up on the ground that the affairs of the company are being conducted in a manner oppressive to some part of the members including the petitioner,[23] the court may order the company to be wound up iffit is just equitable.[24] Under this head the petitioner must show that they have lost confidence in the management

due to the way in which the affairs of the company are being conducted, which has resulted in abuse of powers causing an impairment of the petiitioners confidence in the probity in which the business of company is being conducted. Thus where a company had directors holding majority votes, and they had failed to convene a general meeting, to submit accounts or to recommend a divident, they had laid themselves open to suspicion that their object was to keep the minority in ignorance of the company's position and affairs so as to purchase the minority's shares at an undervalue. The minorities were entitled to a winding up order since they had properly lost confidence in the probity with which the company's affairs were being conducted.[25]

The alternative to winding up under section 211 is aimed at providing a rememdy where for some reason the court considers that although the facts entitle the petitioner to have the company wound up on 'just and equitable' principle[26], such winding up would unfairly prejudice the petitioners, rights. To be entitled to have a remedy either under this section or section 219 (f), the petitioner must not only show that he has lost confidence in the majority, but that the loss of confidence is as a result of majority's conduct in the management of the company's business departing visibly from the standards of fair dealing amounting to a violation of conditions of fair play on which every shareholder, who entrusts his money to a company is entitled.[27]

An order under S. 211 is only available where the facts would justify a winding up order. If it appears that this would unfairly prejudice the petitiner or that in winding up he would not be entitled to any tangible interest, by the fact that there would not be enough assets for distribution among the shareholders no winding up order would be given and consequently S. 211 would not be a proper remedy. To this extent, the section falls short of expectation of business practice where one would expect to get a remedy where he has been oppressed. Where no winding up order may be justified the petitioning shareholders may find themselves without a remedy. Since it might be demanded of them under other sections to go to the company for a sanction to bring an action in the name of the company.

It may also be pointed out that the minority may seek inspection of the company's affairs by an inspector.[28] The court may appoint an inspector or inspectors on application of members holding not less than one-tenth of the shares issued. But such members may be required to give security to an amount not exceeding ten thousand shillings. This requirement may prevent members from applying for the appointment of inspectors. The appointment of an inspector may be a preliminary step to shareholder actions against the company. If inspectorial rules are stringently observed then directors and controllers would act

in such a way to prevent possible inspection. This would go far in protecting the shareholders from unconscionable acts of controllers and directors.

In conclusion, it may be said that in legal theory the members are protected but in actual fact the protection they get by assuring that they are in control of the affairs of the company is minimal. The diefa in *Automatic Self Cleansing Syndicate v Cunninghame*[29] effectively vested the general powers of management in the directors, where a company adopts *article 80, Table A*. The courts have been in favour of directors as shown in various cases already mentioned.[30] Court decisions has made a move towards the strengthening of the management *vis a vis* the shareholders. By their interpretation of article 80 of Table A, members' rights to curtail the powers of the board has been properly weakened. The result has been greater liberality and protection of the board which is vested with powers of general management, and a relaxation of safe guards to shareholders. As already seen the voting powers of members are generally made ineffective where they are doing battle with the directors because of the latters' control over the proxy voting machinery. Apaty of members have helped in promoting director's powers.

The powers of directors is further enhanced as against the members by their right to use the company machinery to contact the members, whereas those who are fighting against directors have got only limited powers to use the machinery.[31]

Even where the members are allowed to use the machinery of the company to have their representations sent to members who are entitled to attend and vote, they are still at a disadvantage because the directors can read their representations and offer counter attack in the same circular, thus making the members case as useless as unstated. Thus far the protection is minimal. This shows that whether on question of voting or preliminaries to voting, the direcotrs stand in a better potition. Thus far shareholders cannot be said to be getting actual protection. The courts' interpretation of the articles and the legal provisions relating to members rights, which would afford them pretection are circumventted in practice. The high vote requirement that is supposed to afford protection against conduct of the management has turned out to be a strong weapon in the hands of the directors. A good exaple is the requirement of a special resolution for altering of the articles. Even if the directors cannot manage to control a majority, at least they are in a position to influence more then one-fourth of the votes, thus effectively preventing the passing of a resolution which is not in their favour. Furthermore where the directors give themselves special voting rights, the courts will generally not interfere

because of the freedom to attach to any share or class of shares special voting rights.[32] Thus where the articles of a company provides that in the event of a resolution being proposed to remove a director, any shares held by that director shall on a poll in respect of that resolution carry three votes to a share, was held to be proper since the right was conferred by the articles. This decision passed a death sentence to section 185 (1) that requres only a bare majority to remove directors from office. It means that by putting such clauses in the articles, the directors can disregard statutory provisions.

The minority protection in the Act is but an exception to the concept of of majority rule. The winding up remedy may not be an effective remedy. Winding up kills the problem by dismantling the company as a business enterprise. It does not mean that if a minority shareholder was oppressed that he is given satisfaction by this remedy. The alternative to winding up is only availalbe where the facts of the case would warrant a winding up order. If the facts do not warrant such an order then the alternative remedy will not be available. Since a person is complaining of opression, it does not matter that the facts may not justify a winding up order under the just and equitable rule; if c infact opression is proved such minority ought to get relieve. It means that under the Act if the opression is such that a court cannot grant a winding up order under section 219 (f), and therefore possible alternative under S. 211, and the circumstances of the case prevent a minority's action under the exceptions to the rule in Foss v Harbottle [34] the minority seems to be helpless. The law should be made more rigorous. The court should tell the members to seek sanction of the general meeting before bringing an action on behalf of the company or against the directors only where they consider that the applicant is acting unreasonably and where his allegations do not amount to a prima facie case. As already seen the director's may entrench themselves by independent service contracts thereby making any resolution of the company for their removal subject to heavy monetary losses by the company. Rightly it may be said that shareholders are not adequately protected by the Companies Act. The recomendations for reform may involve more than one alternative and these will be seen later in the paper.

CHAPTER THREE

SOME ASPECTS OF FINANCIAL PROTECTION

The protection that is afforded member's in the management of the company's affairs has been shown in the last chapter. In this chapter the paper seeks to look at financial protection that is afforded those who are already members of a company as well as those who are invited to subscribe for shares in a company. The whole range of protection cannot be covered by this paper. Therefore what will be included here is only the protection that is given when a company issues a prospectus inviting the public to purchase shares in it and the protection that is given the shareholders so that they may not be denied of profits by machinations of those in the management of a company's affairs. It should be noted that the powers given to members in the management of a company's affairs is aimed at ensuring that they have a say in how the money they have contributed should be applied so as to realize profits from which their expectation as investors can be satisfied. As shown in the last chapter, it is impossible for members in general meeting to be involved in the day to day management of the company's affairs. This is left to directors and other officer of the company. But the members are entitled to know how the affairs of the company are conducted. For this reason, the law requires disclosure of certain vital information which should be laid before the annual general meeting.

It is not only members who may be interested in a company's affairs. In case of a public company which seeks investiment from the public, there are further requirements that it should disclose certain matters to those who may be interested in purchasing the company securities. For that reason certain information is supposed to be filed with the registrar of companies. Some documents which though not required to be filed with the registra must be maintained at the company's registered office together with those other documents that are filed at the registry. Most of these documents are available for inspection by members free of charge, and by members of the public either free of charge or on payment of a small fee. This is aimed at affording members, and third parties who would like to transact with a company as adequate information as possible to allow them to appraise the postion of the company before entering into any dealings with it.

The law lays great emphasis on the disclosure principle. It is thought that the best way of protecting the interests of members and third parties is to omake public a company's affairs.

HOW IS PUBLICITY SECURED?

In Company Law, a distinction is made between private and public companies This distinction is important on a question of disclosure of a company's affairs. A private company is defined as a company which by it's articles *inter-alia* restricts the rights to transfer its shares, and prohibits any invitation to the public to subscribe for shares or debentures of the company[1]. Since a private company is not supposed to invite the members of the public to subscribe for shares or debentures of the company it need not disclose on a wide range of information as a public company. To see how disclosure is secured various documents that needs to be publicised will be shown.

The first and primary document that a company is supposed to disclose is its constitution. This must be filed with the registrar of companies.[2] If the memorandum of association is altered in accordance with section 8, or if the articles are altered,[3] the fact of the alteration must be notified to the registrar. This is supposed to provide those who may have or would like to have dealings with the company information relating to the company's objects and the powers that are wielded by various organs and officers of the company. This may help a third party to avoid an ultra vires transaction with the company. As concerns the company's directors and secretary, the company must notify the registrar of their appointment within 14 days of such an appointment If the company fails to comply with the above provision, then the company and every officer who is in default is guilty and liable to a default fine. The registrer of directors and secretary is open for inspection by members free of charge and by members of public at payment of two shillings or a lesser sum as the company may prescribe. If a company refuses inspection, the court may compel an immediate inspection.

Within fourteen days of starting business or incorporation, whichever is the earliest, the company should notify the registrar of its registered office or whenenver it changes the situation of that office. In default, the company and any of its officers in default should be liable to a default fine.[4] These are mere pleriminary requirements so that any person dealing with the company may know who to contact and where the home of the company is.

But far the most important document which the company must keep in its registered office and also file with the registrar of companies is the annual return. As well as giving the information concerning management and situation of the registered office, this document contain important information regarding the company's financial standing; Thus section 25 (1) provides that

" Every Company having a share capital, shall, at least once ever year, make a return containing with respect to the registered office of the company, registers of members and debenture holders, shares and debentures, undebtedness, past and present members and directors and secretary, the matters specified in Part I of the fifty schedule, and the said return shall be in the forn and shall be up to the date set out in Part II of the schedule or as near thereto as circumstances permit."

Part I of the fifth schedule requires the return to give details regardin g the company's capital - nominal, paid up, amount of called and uncalled capital on each share, and amount paid and unpaid on each call amount of commissions paid on shares, the number of shares forfeited and the number of shares for which share warrants are outstanding; the total amount of indebtedness of the company, number and addresses of existing members and the number of those who have ceased to be members since the last return; details of directors and the secretary.

The annual return should be made within forty-two days of the annual general meeting. This document is supposed to give a searcher valuable information concerning the company. The value of the annual return is enhanced by the fact that certified copies of the balance sheets relating to that year should be annexed to the annual return. Such copies of balance sheets must be certified by a director and the secretary. Copies of auditors' and director's report certified in like manner should be annexed thereto[5]

Over this a company is supposed to keep proper books of accounts regarding receipts and expenditure of the company, sales and purchases of goods and assets and liability. Such books should give a true and fair view of the company affairs and explain its transactions.[6] The act provides that such books are open for inspection by directors.[7] The penalty for default is a heavy one imprisonment not exceeding twelf months or a fine not exceeding ten thousand shillings or both. So also the directors are under a duty to lay before the annual general meeting a profit and loss account and also a balance sheet for the calender years of that general meeting.[8] If by wilful default a direcotr fails to comply with the requirements of both section 147 and 148, he will be liable to a fine not exceeding ten thousand shillings or to imprisonment for a term not exceeding twelf months. These section are aimed at ensuring that the company's financial affairs is discoverable if and when it is wanted. However, the requirement especially that copies of profit and loss accounts and balance sheet be laid before the members in general meeting serves little purpose. Although the Act does not provide how these documents should be made up, the usual method is such that except for those with knowledge of accounting, few members will be in a position to understand these documents.

The system of double entry in the balance sheets with the assets add liability balancing is very hard to grasp.

Over this there are some documents which are required to be maintained by the company though not filed at the registry. These include the register of debentureholders[9] copies of all instruments creating a charge requiring registration,[10] and minutes of general and directors' meetings. As to the last aspect the members can only inspect minutes of the general meetings but not of directors meetings.

Provided members are aware of their rights and that hopefully they can extract the information from documents filed at the registry and at the company's office, there is a wide enoughtrange of materials available. It cannot be hoped that further disclosure except probably an extension of directors duties to disclose more detailed information in their dealings with the company than is at present provided for can increase the protection given. The matters that are supposed to be disclosed are wide enough to help members of the company and public to take a national cause of conduct when dealing with a company.

Over this as concerns members of the public who deal with a company, either when subscribing for shares or debentures of the company the information they require will be contained in the prospectus.

SUBSCRIPTION OF SHARES BY PROSPECTUS

When a company wishes to raise money from prospective shareholders, the invitation always involve the issue of a document setting out the advantages that would acrue from such an investment. This document is called a prospectus. It is only public companies that may issue prospectuses, private companies must raise their capital privately. A prospectus is defined as

> "Any prospectus, notice, circular, advertisement or any other invitation offering to the public for subscription or purchase of any shares or debentures of a company."[12]

From this defination it appears that any instrument by which members of the public may be invited to subscribe for shares in a company will be deemed to be a prospectus and thus has to state all the matters that are supposed to be laid down in a prospectus. It is not necessary to go into the various forms that may be applied in inviting members of the public to subscribe for shares. Over this any document containing offer of shares for sale shall be deemed to be a prospectus. Thus where a company allots or agrees to allot any shares with a view to those or any of the shares being offered to the public for sale any document by which the invitation is made will be deemed to be a prospectus and any law relating to the issue of the prospectus

will apply.

PROTECTION AFFORDED TO SUBSCRIBERS

The Companies Act provides for criminal as well as civil liability of the company, its officers or any other person who is a party to the issue of a proppectus which either does not disclose all matters required by the Act, or for mis-statements thereto. The Act provides that every prospectus shall specify the matters required in part I of the third schedule and set out the reports specified in part II of that schedule.[13] The requirements of this schedule are designed mainly to provide important information regarding the directors or in the case of a new company the promoters, and the benefits and profits to be made lby them respectively; the amount of capital required to be subscribed; the amount received or to be received in cash and the precise nature of consideration to be given for the remaining capital especially if such consideration is anything other than cash; to state the company's financial record in the past five years, the company's obligation under any contract it has entered into; and voting and dividend rights of every class of shares. If the prospectus include any statement by an expert, then that expert must have given his consent to it's inclusion. Contravention of this section renders the company and everyone who was knowingly a party to the issue of the prospectus liable to a fine not exceeding ten thousand shillings.[14] Over this where a prospectus includes any untrue statement, any person who authorized the issue of the prospectus is guilty of an offence and liable to imprisonment for a term not exceeding two years or to a fine not exceeding ten thousand shillings or to both such fine and imprisonment.[15] The purpose of penal sanctions in prospectuses is aimed at making those responsible for the issue to disclose all material information and to state a true and fair view of the company's affairs. It should be noted that in case of insrepresentation, it is not necessary that the statement should be untrue per se. An omission which is material in that it gives a false impression of the whole prospectus or a statement therein will be deemded a misrepresentation. In the case of R v Kyslant[16] A prospectus for the issue of debenture stock was issued by a company. The statement in the prospectus were true, but it omitted information which gave a false impression about the company's affairs in that in saying that the company has been paying dividends regularly, the impression it created was that the company was making profits. Actually the dividends were being paid from reserves accumulated during better trading times, whereas it was currently sustaining losses. It was held that this amounted to misrepresentation

and the chairman was held liable.

However the Act envisages a situation where the misrepresentation amounts to fraud, for the one who authorized the issue will only be liable if he did not believe or had not reasonable ground to believe that the statement was true.

For any person who suffers as a result of misrepresentation in the prospectus, he has a civil remedy against any person who was a director at the time of the issue, or any person who had authorized himself to be named or a director, promoter and any person who had authorized the issue of the prospectus.[1] The section covers all persons who might be responsible for the issue. It is not quite clear whether the company itself would be liable for where the officers of a company have issued a prospectus, it may be taken that the company has authorised the issue. However, it is contended that under this section the company is not liable but only its officers.[18] There are two types of misrepresentation even under normal contract law. The first is fraudulent misrepresentation. Under a prospectus where one brings an action for deceit then such a person must prove actual fraud. This is well illustrated by Derry v Peek[19] where a company incorporated for the purpose of running from cars issued a prospectus by which they stated that they had authority to use steam-power in running trams. In fact this authority to use steam-power was subject top permission by the Board of trade. The plaintiff subscribed for shares in the company on the faith of that misrepresentation. It was held that in an action for deceit the appellant must prove actual fraud and that this is proved when it is shown that a false representation had been made knowingly or without believe in its truth or recklessly without caring whether it be true or false. Thus in an action for deceit proving merely that there was a mis-statement will not suffice. The applicant must prove that the statement was fraudulent.

Whether or not a company is liable as a principle where a director or any other officer of the company is liable under the prospectus is not very clear. It seems that on normal agency principle the company will be liable if the officers act within their authority. Also thew company is deemed to have issued the prospectus or authorized such an issue and under S. 45 (1) (d) and should therefore be liable.[20]

The Act does not provide for negligent mis-statements. In England, the Misrepresentation Act 1967 serves to fill in this gap. In Kenya such an Act does not exist, and therefore under such circumstances courts fall back on common law. At common law a person may be liable for misstatements not withstanding that such mis-statement is not fraudulent and although there

is no fiduciary relationship existing, if the one who makes such a statement know that it will be relied on and that statement is actually relied, on by a person who sustains loss.[21] In case of those who are responsible for the issue of the prospectus, they will expect those who subscribe for shares to rely on the statements made by them in the prospectus.

Once the allotment is complete, the prospectus is deemed to be exhausted. Its purpose is to invite people to apply for allotment of shares, and once this is done, subsequent parties may not come and claim against any person who was responsible for the issue of the prospectus. Thus in Peek v Gurney the plaintiff bought shares in the market three months after completion of allotment of shares. He did not know at the time of buying, the person from who he bought the shares. Thereafter he found untrue statements in the prospectus concerned with issue of those shares. It was held that the plaintiff could not base his action on a prospectus which was intended to be addressed only to original subscribers of the company's shares.

This means that generally the directors are not liable after the full initial allotment. However where the prospectus is intended to induce not only the immediate subscribers but also to influence the subsequent purchase in the market, the purpose of the prospectus will not be deemed to have been exhausted after allotment and liability will be extended to any loss occasioned by a misstatement in the prospectus though the one who suffered purchased the shares in the market. This is well illustrated by Adrews v Mockford[22] where a prospectus was issued by a company , which claimed that its purpose was to acquire lands for gold mining in Africa. A prospectus was sent to the plaintfff but he did not subscribe for any shares in the company. Later on the defendant caused a telegram to be published in a financial press claiming that the company had struck a rich vein of ore in the mines. As a result the plaintiff bought shares in the market. In fact the company was a Sham. It was held that in this case the prospectus was not exhausted and that the fraud in the prospectus and the subsequent lie in the telegram were aimed to operate on the mind of the plaintiff and induce him to purchase shares in the market.

A person relying on a misstatement in a prospectus must show not only that there was such a mis-statement but also that the prospectus was addressed to him or to a class to which he belongs. One need not point to a particular statement he relied on and which was false. In looking to see whether there was a misrepresentation which influenced a subscriber the whole of the document should be read - Thus in Arnison v Smith[23] it was said

"It is an old expedient, and seldom successful to cross-examine a person who has read a prospectus, and ask him as to each particular statement what influence it had on his mind, and how fair it determined him to enter into contract. This is quite fallacious; it assumes that a person who reads a prospectus and determines to take shares on the faith of it can appropriate among the different part of it the effect produced by the whole.

The above are liabilities of those persons who are responsible for the issue of prospectus. A person who suffers loss due to misstatements in a prospectus may also have a cause of action against the company. Where a person is induced by a misrepresentation in the prospectus to enter into a contract to take shares in a company he can rescind the contract. The essence of this rule is that where such a misrepresentation exists, the contract becomes voidable at the instance of the wronged person. It is not necessary that such a statement be fraudulent or negligent, as long as long as it amounts to a misrepresentation it will suffice for the person to whom it was made to avoid the contract. The right to rescind is however subject to certain limitations. If the allotee of shares shows any intention to affirm the contract, he will lose the right to rescind. Such an intention may be manifested by the allotee attending and voting at the company's meetings or receiving dividends when he is aware of the misrepresentation. The right to rescind should also be excercised within a reasonable time. If the allotee has not rescinded before the commencement of winding up, he loses the right to rescind. In rescinding contracts of this nature something more than express repudiation is required, the party rescinding must also take steps to have his name removed from the register of members before winding up, otherwise if at the time of commencement of winding up his name is not removed, rights of creditors may have crystalised and since these take priority over those of members, he may remain a contributory. This seems to be the basis of refusing vescission in the case of <u>Re Scottish Petroleum Co. Ltd.</u>[24] for although the applicant had expressly repudiated the contract, he had not done anything by the time of the commencement of winding up to have his name removed from the register of members.

The remedy of damages where rescission is possible is not forthcoming. A person cannot be awarded damages and at the same time remain a member.[25] Such an action for damages would be to throw the liability of that particular shareholder to the other shareholder.

From the foregoing one cannot fail to come to the conclusion that prospective shareholders are adequately protected from deception or fraud by the officers of the company. Over this an action for rescission allows a

member who relies on a misrepresentation to avoid the contract against the company.

It remains now to appraise the conditions of those who are members in relation to the declaration of dividends. The intention is to see whether the shareholders' rights are protected under rules relating to declaration of dividend

PROTECTION OF MEMBERS RIGHTS TO DIVIDENDS

The first thing to be noticed is that there is no staturoty authority as to declaration of dividends. How the dividends shall be paid and in what proportions is left to the articles of association of each company. However the articles of most companies adopt Table A . In this table, the first limitation to be noticed is that dividends can only be paid out of proffits[26] This clause is supposed to ensure that the national capital of the company is not given back to members in the guise of dividends. The clause is aimed at maintenance of capital. Thus if directors declare dividends, the result of which would be to reduce the company's capital below the subscribed amount they will be accountable to the company for the whole amount so paid[27] This however is intended to protect creditors who rely primarily on that capital when advancing credit to a company. This was well illustrated by Jessel M.R, when he said

> "The creditor has no debtor except that impalpable thing the corporation, whichehas no property except the assets of the business. The creditor therefore, I may say gives credit to that capital, gives credit to the company on the faith of the implied representation that the capital shall be applied only for the purpose of business and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders .... "[28]

It is not within the ambit of this paper to evaluate the rules relating to raising and maintenance of capital. The paper is restricted to rights of shareholders to dividends. With this, however, it should be mentioned that the term profit is an ellusive one and on the question of declaration of dividends the courts have left the financial decision to accountants. Thus in Lee v Neuchatel Asphalte Company[29] Lindley has this to say on the matter

> "There is nothing at all in the Act about how dividends are to be paid nor how profits are to be reckoned, all that is left and very judiciously and properly left, to the commercial world. It is not a subject for an Act of Parliament to say how accounts are to be kept; what is to be put into capital account, what into an income account is left to men of business."

With this warning that courts are not generally enthusiastic to lay down hard and fast rules as to the mode of company's form of capital structure, and that dividends are to be paid out of profits, the next question is, what is regarded as profits from which a dividend may be declared? Unless the articles of a company provide otherwise, a dividend can be declared even out of profits made out of sale of fixed assets, notwithstanding that such assets may have been purchased by the company's capital.[30] This is regarded as revenue profit. However generally profit will be deemed to be the difference between the net value of the assets at the beginning and end of an accounting period. Where a company suffers loss in a current trading year, those losses must be made good before a dividend is declared but losses of part years need not be made good before declaring a dividend in the current trading year. Such rules are contrally to the basic principle that a company must pay dividends out of profit only. These rules as already seen are aimed at protecting the creditor. The question is whether the shareholder is protected in this sphere.

Since a shareholder's right to dividend is an incident of the share and the rights accruing to shares are provided for in a company's articles, the extent of the rights of a shareholder will be determined by the provisions of the articles. If the articles are in the form of Table A, as they invariably are, the shareholder will have little say in how the dividends are to be declared. The articles in Table A provide that the company in general meeting may declare dividends, but such a dividend cannot exceed the amount recommended by the directors.[31] Thus it is in the directors' discretion to decide what amount should be set aside for declaration. The members have only a negative role to play in that they can only reduce the amount recommended but cannot increase it. Over this, the members have no say in the payment of an interim dividend. It is only the directors who may decide to pay it.[32] The directors need not recommend payment of dividends. The directors may decide to set aisde a certain amount of money out of profits as reserve and apply it in their discretion to any purpose to which the profits of a company can properly be applied. This means that provided the directors are acting for a proper purpose they can with impunity refuse to recommend a dividend and instead apply the money to the company's purposes. A shareholder cannot go and claim that the directors are acting improperly by failing to pay a dividend under such circumstances. It seems that the only remedy such a shareholders has is to change the directors if they are in a position to vote them out. As seen in the last chapter the directors usually retain *de facto* if not *de jure* control of the company by their control of the voting machinery. In like manner, the rights to dividends

are generally by the articles restricted to that which the directors recommend or such less sum as the members in general meeting may declare. But the basic rights of a member as contained in the share ought not to be kept out of sight; The rights that a member has under a share are regarded as the most important guilding factor. These rights will be stipulated in the articles. But whatever these rights might be it should be recognised that as incidents of the sharer they are proprietaty rights. This can be inferred by what a share has been said to be

> it is ".. the interest of a shareholder in the company measured by a sum of money for the purpose of liability in the first place, and for interest in the second, but also consisting of mutual coveneants entered into by all shareholders *inter se* in accordance with (S.22) The contract contained in the articles of association is one of the original incidents of a share. A share is not a sum of money ..., but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of more or less amount."[32(a)]

Here the concern is not liability but the interest that a shareholder has and however much the directors desire to expand the armbit of the business of the company by utilising the profits to expand the business, the members will not be satisfied if they get no returns. True the value of the share will rise with the expansion and prosperity of the business, but this will be of little consolation to a shareholder. Selling such a share, he will get a higher .price than he paid for it, but this means foregoing the future benfits that may accrue to such a share. Over this there is a presumption that in investing, the members expects to get a return on his investment at the same time leaving the initial investiment untouched for further proffits.

In order to see the rights of the shareholders as given by the articles we should look at the position where there exists more than one class of shareholders.

The initial presumption of law is that... all shares confer equal rights and impose equal liabilities. This equality is presumed in the absence of evidence to the contrary. Before the decision in <u>Andrews v. Gas Meter Company</u>,[33] it was thought that in the absence of express provision in the original constitution equality of all shares was a fundamental condition which could not be abrogated by an alteration of the articles[34] However in <u>Andrews</u> Case, it was established, overuling the previous principle, that in the absence of a prohibition in the memorandum the articles could be altered so as to authorize an issue of preference shares. Thus the <u>Prima-facie</u> equality of shares can be modified by the memorandum or in the original or amended articles,

dividing the shares into different classes with different rights as to dividends capital and voting or any of them. Normally however there are to be found only two classes of shareholders, the ordinary and preference holders. It has already been shown that the shareholders have very little if any control on declaration of dividends. Furthermore it has already been seen that except where it is aimed at maintenance of capital and protection of creditors, the courts have not developed any rules guilding the shareholders as to their rights. However as regards the preference shareholders, some rules has been evolved lby the courts regarding payment of dividends and return of capital on winding up. But first it must be mentioned that a preference share confers on the holder some preference over the other class or classes in respect either of dividend or repayment of capital or both. They may however participate with the other shareholders after their rights has been satisfied. Over this the preference shareholders rights to dividend may be cumulative or non-cumulative. If cumulative any unpaid arrears accumulate and must bep paid in later years before payment of any ordinary dividend. But the articles may specifically provide that a preference dividend is to bep paid only out of profits of the current year such a preference is non-cumulative. Over this the articles may also provide that such preference is payable only when there are profits in a certain year, by this the holders will have no right as to accumulation regarding any year when there were no profits.

RULES OF CONSTRUCTION AS TO PAYMENT OF PREFERENTIAL DIVIDENDS

The rules of construction have been developed to enable courts to decide rationally the principles to be applied where there is contention as to rights to dividends acruing to various classes. If the articles exhaustively deal with the matter, there will be no problem. But where some matters are left unclear, in view of lack of statutory provisions in the Act, then the courts must contend with the problem with the help of general law and need of justice.

For this reason the first rule is that since _prime-facie_ all shares rank equally, if some are given priority over others, this must be stated by the articles of the company.

But where shares are divideddinto different classes, it is a matter of construction in each case what the rights of each class is. Thus in _Re Isle of Tharnet Electric Co._[35] it was said that

> "in construing an article which deals with ... dividend rights, and rights to share in the company's property in liquadation the same principle is applicable and second, that principle is that where the

articles sets out the rights attached to a class of shares to participate in the profits while the company is a going concern, or to a share in the property of the company in a liquadation, prima facie, the rights so set out in each case are exhaustive."

This means that if the provision of the article confer on the preference shareholders right to a dividend, say of five per cent, then unless the articles also provide that they are participating in dividend with the ordinary shareholders, they will not be entitled to such participation.

However if nothing is said about one class in relation to either the payment of dividends or return of capital, then prima-facie that class has the same rights in that respect as the other shareholders.

Again it was laid down that unless in intention to the contrary is expressed cumulative preference shares were not entitled to payment of any arrears once a winding up had commenced.[36] HOwever if the preference shareholders are entitled to their dividends once profits are earned, irrespective of a declaration, then they will be entitled top payment if the company had accumulated profits. This can be inferred from the decision of the court of Appeal when combined with the House of Lords decision in Re Brdigewater Navigation Company.[36(a)] Where although it was apparent that the preference shareholders were entitled to a five per cent preference once, the House of Lords ruled that they were entitled to share the surplus assets equally with the ordinary shareholders. But in that these represented the undistributed profits which was available to ordinary shareholders which the ordinary holders might have divided among themselves, such surplus belonged and was payable to ordinary shareholders alone.

Where shares are entitled to participate in surplus capital on winding up prima-facie they participate in all surplus assets and not merely that part which does not represent undistributed profits that might have been distributed as dividend to another class. This removes the basic problem of trying to trace where the surplus emanated from, and to decide whether it was from profits distributed to ordinary chareholders only or not.

These are in summary the rules as laid down by courts relating to participation of members in dividends and sharing of capital on winding up. The rules have grown haphazardly to meet the needs of particular circumstances. This growth was prompted by the fact of lack of express provisions in the Act relating to payment of dividends.

What is not clear is whether a company can alter its articles in such a manner as to put within the armbit of members in general meeting the powers to recommend and declare a dividend. In that the articles of a company are

alterable in accordance with the Act.[38] Such alteration cannot be prevented by any provisisons of the articles. If it be contended that thew members in general meeting can alter the articles so as to bring the directors under their supervision thus escaping the consequences of Article 80 of Table A, there seems to be no reason why they cannot alter the articles so as to bring the payment of dividends under their control. After all from case law the recommednation of dividends seems to be an incident of management. The only limitation that may be placed on the powers of members to declare a dividend is that they should not declare such a dividend if on reasonable grounds the directors think that a certain amount of money should be retained by the company in consequence of past losses in trade which the company would like to make good to enhance the business of the company.

An appraisal of financial protection reveals one basic fact, this fact is that the courts have been unwilling to interfere in the arrangement made by businessmen as regards the capital structure of a corporation even as to disclosure of financial matters that law just insists on disclosure of such matters to give a true and fair view of the company's affairs without demanding that it be in any particular form. The result is that most documents are drawn in a form which is incomprehensible to a layman. The value of such documents as the balance sheets to the shareholders is questionable. But this may not be a serious problem in view of the requirement that auditors who appraise these documents, be indepedend. The rules of liability in respect of prospectus seems to be wide enough to cover all protection that a prospective shareholder should need. The only people who do not have protection under the prospectus are those who did not rely on the instrument in buying shares either from an individual or in the stock market. However, these have on normal contractual grounds a right to an action for damages against the parties from whom they bought shares.

There is not statutory provision in regard to declaration of dividends. This depends on the provisions of the articles and memorandum of the company in question. It seems odd that no such provision exists when it is realised that the basic idea behind investing in shares in a company is the expectation of profit that an investor will draw from the company.

It seems that the basic presumption is that in becoming a shareholder, a person will have weighed the advantages and disadvantages of investing in a particular company and hence no need for further statutory regulation as to how the profits of the company should be distributed to members. Probably

also reliance is given to the fact that the management would not like to antagonise the members by withholding a recommendation for dividends. These presumptions are not wholly justifiable when it is realised that as concerns the initial subscription for shares, a shareholder will rarely lay emphasis on the prospectus. More than not the one who sold shares to him might be the determining factor to his purchasing or subscribing for shares. If there is any fault that he discovers later it may be too late for him to rescind the contract.

In view of these propositions the law relating to declaration of dividends ought to be given particular attention by the legislature so as to give general guidlines in respect of their declaration. Financial disclosure should also be revolutionised with the aid of accountants so that a provisions as to the form the documents showing the financial position of the company can be easily understood by shareholders who are generally ignorant of accounts, and hence cannot understand the various documents showing the company's financial position.

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CHAPTER FOUR

PROTECTION OF MEMBERS BY ADMINISTRATIVE ACTION

It has been shown in the foregoing chapters that an attempt is made to see that shareholders, present and future are protected, mainly from the acts of Company's officers, and the machinery in charge of running the company. The duty to disclose the affairs of a company and participation in the management are seen as the central protective devices. However the power of the board of directors and its ability to control the affairs and members of a company makes it hard for members to participate adequately in the management. Over this members may not understand the matters that are disclosed. On top of this, some important decisions of the board may never reach the members who have no right to inspect the minutes of directors' meetings'.

For this reason the members are given rights to petition for inspection of the company's affairs, by an inspector or inspectors appointed by the court.[2] The Registrar of companies has the power to call on any company to produce any books or call on any officer of the company to give explanation to any matters, if he believes on reasonable grounds that the provisions of the Act[3] are not being complied with or on perusal of any document which a company is required to submit to him, he is of the opinion that the document does not disclose a full and fair statement of the matters to which it purports to relate[4].

The Registrar of companies may thus order production of books and any other information he may require. The section is aimed at initial investigation in a company's affairs, to enable the registrar to know whether the Com[illegible] are being conducted in the right manner. Generally the registrar of companies orders production of books after a complaint from a member or members. If he forms an opinion that all is not well with the company, he applies to the court for the appointment of an inspector to look into the company's affairs. In this connection the affairs which include its goodwill, the profit or losses its contracts and assets including its shareholding in, and its ability to control the affairs of a subsidiary.[5]

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From this point, the power to appoint an inspector is left to the court. However the grounds upon which the registrar may petition the court to appoint an inspector are inter alia that the business of the company is being conducted in a manner oppresive to any part of its members, that the persons concerned with its formation or the management of its affairs have, in connexion therewith been guilty of fraud misfeasance or other misconduct towards it or towards its members; or that its members have not been given all the information with respect to its affairs which they might reasonably expect; or that it is desirable to appoint such an inspector.[5]

It seems from the wording of S.166 (b) (iii) that the information which the members might reasonably expect is wider than that information to which they are legally entitled. Anyone may draw the attention of the registrar to an alleged scandal and seek to persuade him to apply to court for an appointment. Under such conditions, the registrar may order production of books and explanations from various officers of the company. Hen need not seek the appointment of an inspector. Instead, he may suggest ways of conduct which may end the conditions that made the complainant seek the help of the registrar. The most prevatent defaults in Kenya which make registrar investigate companies are, failure to lay the accounts of a company before the general meeting, leck of compliance with the requisite procedure in either director's or general meetings.

From my interview with the investigating officer whose functions are equivalent to those of Board of Trade in Britain, I was made to understand that sometimes complaints are based on personal rivalries among the members and the directors, and on proper checking no proper basis of an action is revealed. Be this as it may the work of the investigator is important in two ways. Firstly once the registrar orders production of books and explanation of certain matters, the result may be that if there was oppression, it would stop before the registrar decides to petition the court for the appointment of an inspector. This means that the registrar first confirms the allegation of members that the facts do not warrant such an appointment

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The appointment is not envisaged only in cases involving oppression but is a available in cases of impropriety by the controllers which would not be regarded as sufficiently improper to give rise to any of the other remedies.

Because of the fact that rivalries may exist and also the need not to kill majority rule in companies, the court would be trusted not to appoint unless the circumstances warrant it. Such circumstances demanding an appointment would be tested on the basis of commercial and public morality and not merely on the individual interests of the complaining member.

The other point of cardinal importance of the powers given to the registrar under S.164 is that there is no legal minimum of complainants. Since in practice the registrar can start investigations. on his own, it needs only a complaint by member to create suspicion and investigations will be under way. The inspection at the instance of the registrar may be cheap to the complainant, for under the circumstances he need not pay the fees necessary as cost of investigation.

Once an inspector is appointed, he has authority to inquire not only in the affairs of the company in question, but also in the affairs of subsidiary or holding companies of the first mentioned company.[7] This will facilitate a report which presents a true and fair view of the affairs of the company concerned.

On the facts of an inspector's report, if it appears that any person in relation to the company or any other body co-oporate whose affairs has been investigated is guilty of any offence for which he is criminally liable, the court forwards the report to the Attorney-General and if he considers that the case is one in which a prosecution ought to be institued, he does so accordingly. The Attorney-General may also petition for the winding up of a company whose a affairs are investigated or he may petition for an alternative remedy under section 211.[8]

The importance of these provisions is that they allow for criminal hability on the defaulters and provide for a remedy to those who has suffered oppression. It is to be noted that this remedy is just like any other where a company is wound up on just and equitable rule.[9]

The advantage of these sections is that members need not involve themselves in the petition. The Registrar is in a better position to investigate the affairs of a company and get more information. He may even order production of books, which are usually not open for inspection by members.

Even if no proceedings are brought by the Attorney-General, the certified report of an inspector would be of great help since a copy of such a report authenticated by the seal of the company whose affairs are investigated is admissible in any legal proceedings as evidence of the opinion of the inspector in matters contained therein.[10] Thus in a subsequent action by a member who was aggrieved by matters which were investigated, he is given more information upon which to lay his action. However, the provisions of these sections may seem to give members added protection especially against the controllers and management. In practice however, the members' protection is not complete. Firstly, not every complaint that comes up before the investigator can be entertained. The investigator, whose functions are equivalent to the Board of Trade in United Kingdom was appointed only in 1972. Unlike Britain's Board of Trade which is a team consisting of twenty people, in Kenya the investigating department has only one person. The volume of complaints is increasing. From the investigator, I got the information that at times there is too much work demanding attention of only one person. This may hinder effective investigation. In view of the fact that once the registrar orders production of books, the investigator is the one to go through them, and these books may be many and at times he may have to get explanations which he must satisfy himself are true, work on a single company may take a long time. At times he may write to purported directors of a company seeking explanation but the letter is returned having not reached the addressee due to the fact that the address given is wrong. In one case where the inspector was pursuing a company where a woman had bought shares in a farm in 197 but had not received the letter of allotment or certificate of shares, two letter that had been written were returned undelivered, the addressee not being a reside of that address.

The answer he got from the company's secretary that the applicant and present complainant was in the register of members was not satisfactory and the investigator had to order the production of the register of members and other company's books. The result is that a lot of delay may cause injustice with the resultant lack of remedy. The directors and management may buy time to fabricate evidence or to destroy such evidence as is necessary to make the court order an inspection.

In the course of inspection the inspectors face probless either in securing the directors to answer questions or on the fact that proper books of account are not kept. At times a member may not have a share certificate and his name may not even be in the register of members. In one such case, a person had died, he had acquired Shares in a farming company and had been allocated a plot. But the problem arose on the question of devolution of his interests pertaining to his plot. Since such a person cannot get title as the title deed to that land is vested in the company and there is no evidence to support the claim of heirs. Such practice makes continuity of interest difficult. In one company which has already been wound up - Property Growth International Ltd. the affairs of a company were investigated at the instance of a creditor. The company which was a finance company dealt with deposits and loans. On appointment of an inspector, it was difficulty to trace the responsible officers. The managing director had already flown out of Kenya. Other officers could not be found anywhere and a secretary was designated as a director in the company's books. On investigation, it was proved that she did not even know that she had been described as a directo The finance of the company had been embezzled by the officers of the company. This was due to lack of internal control in the company.

The inspection of a company's affairs is costly. The expenditure of such an investigation falls mainly on the office of the registrar of companies. It is not mandatory that any person liable as a result of the investigation must pay but will only pay to the extent that the court directs.

Where prosecution is brought by the Attorney-General as a result of appointment of an inspector under S.66(b), it seems that the whole expense falls on the registrar.[10a] Also applicants for investigation under S.165 shall only be liable to the extent if any as the court may direct.[11] Because of the heavy expenses involved, the office of the registrar is not ready to seek appointment of inspectors unless it is inevitable. For these reasons, the members may find the registrar of companies reluctant to ask for appointment of an inspector by the court. The requirement that where the minority petition for the appointment of an inspector or inspectors by the court that they may give security to an amount not exceeding ten thousand shillings may hinder a minority from petitioning for such an appointment.

It is unfortunate that in Kenya the prevention of Fraud (investment) Act[12] is not yet operative. When it comes into operation it may go a long way in issues of shares. The Act is supposed to control dealings in govenment and companies security. Licensing such dealers and prohibition of dealings in security by those who are not licensed. This would be a statutory recognition of the Nairobi Stock Exchange the only one in Kenya.

The Nairobi Stock Exchange as at present plays but a small role in controlling the securities market. It is small and in relation to the number of public companies, the number of those that seek quotations is very small. In 1968 only one per cent of the total number of companies had their securities dealt with by the stock Echange. Thus unlike the London Stock Exchange which controls a large proportion of the securities, and is thus in a position to make rules to be complied with by companies seeking quotation of their securities, the Nairobi Stock Exchange's rules would be of little importance as a result of the small number of companies it controls. Thus the role it plays in shareholder protection is very small. However, if the said Act comes into operation, the interaction of the Nairobi Stock Exchange, the Act, and the investigator in the office of the registrar of companies may help the protection of shareholders, present and future, a great deal.

In conclusion, it may be said that protection of the shareholders and in fact all security holders in a company is not adequate. The legal rules should be coached to increase investigative powers, although at present they are quite comprehensive. Over this the new investigation board which presently consists of only one man should be increased to cater for the increasing number of complaints and to facilitate quicker and more efficient inspection of the company's affairs. Instead of the usual appointment of private inspectors, there should be set up a permanent inspectorial team charged with the duty of making sure that all the companies submit the documents necessary to be filed are accurate and thus give a true and fair view of the companies affairs. One of the problem as at present is trying to make sure that all companies files regularly, the documents they are supposed to file with the registrar of companies. Such regular and constant checking would require greater man-power than at present is employed in the registrar's office. The result is that the registrar of companies has in most cases to wait until a shareholder, creditor or any interested party brings forward a complaint. By the time such a complaint is investigated and the registrar recommends for the appointment of an inspector, the wrongdoers may have destroyed any evidence to implicate them. The result is that the inspection, however expensive may reveal very little or the defaulters may have escaped. The powers given to the registrar of companies to seek the court to start inspection on a company's affairs is a very strong weapon but only if vigorously and quickly used. This does not seem to be the case as at present. The strong belief that business men should largely be left to themselves to decide who to associate with and to govern their own affairs is unfortunate in a country like Kenya where the mass of the population has not come to accept the difficulties involved and also their rights once they acquire securities. The government should set up a stronger body of investigators with a view to seeing that the affairs of the company and the dealing in a company's security is conducted for the benefit of the company as a whole.

CONCLUSION

It has been seen that the need to protect the shareholders arises from the fact of the distinct legal personality of a corporation[1] Because the members are not part owners or joint owners of the company's property, rights are determined by the shares they hold in a company. These shares and the contract as contained in the articles determine their rights as to management dividends and return of capital.

The articles of most companies are in the form of Table A[2] . Article 80 of that table vests the general management of the company's affairs in the hands of the board of directors. The members in general meeting cannot interfere with such powers. Although their powers over the board are wide enough to ensure that they are in effective control, the fact that the company's management is in the hands of directors, including the voting machinery through which the members can exercise their rights and control of the board, means that their powers are effectively controlled by the board. In many "African" companies, the members are hardly aware of their rights and the fact that they are in a position to control the directors. Where members are doing battle with directors the directors have the advantage of controlling the machinery of contacting the members, while those contending against them have only a limited power to use the company's machinery. Over this, though members may have the power to remove directors from office, they may find that the directors have already entrenched themselves by independent service contracts. This means that their removal before expiration of their term of service would make the company liable for breach of contract, and yet such contracts are made by the board.

Because of the above reasons the directors are in effective control to the exclusion of members. It is therefore suggested that as far as division of powers is concerned, the members in general meeting should have general supervisory powers over the board of directors so that whenever directors act in any way and the members are against it, they should have powers to overule the board notwithstanding that the directors action was in what they considered to be in the best interest of the company.

The rule as established in Automatic Self-cleansing Filter Syndicate V Cunninghame and Shaw & Sons (Salford) Ltd V Shaw[4] should be qualified but not abrogated.

Where a minority want to convene a meeting and intend to make representation to the members, the word limit of their representation should be removed to facilitate full representation. This is not demanding too much. It would provide a fair system. The same members should be allowed to appraise the directors representation just as directors have a chance to appraise theirs.

Though the members have power to remove any director by a simple majority vote on a special resolution, the fact that directors may outrench themselves by service contracts means that their removal will result to the company losing money in compensating those directors. It is suggested that service contracts of directors should only be effective if ratified by members in general meeting. This would prevent directors from entrenching themselves by service contracts. Over this where a director is removed from office as a result of a members' resolution he should only be compensated where the court deems such compensation equitable depending on the circumstances of the removal.

The disclosure that directors are supposed to make relating to any interest they may have with the company should be made to the members in general meeting and not merely to his fellow directors in the board.[5] This would make it possible for the company as a whole to decide whether to accept to deal with the director or not. In such contracts directors who are interested as third parties should not be allowed to vote.

To allow for as large a representation of members as possible to the board of directors, high vote requirement for appointment of directors should be implemented. At present the Kenya companies Act does not provide for any percentage for such an appointment. It can therefore be assumed that unless the articles of a company provide otherwise, a simple majority will suffice.

On the basis that shareholders are satisfied with the existing balance of power in voting, provisions should be made to ensure that such balance is retained This would be assured by laying provisions requiring that if further shares are

'this would be assured by laying down provisions requiring that if further shares [illegible]

issued with voting rights, they should be in form of rights issue in accordance with the existing shareholdings of the members. To supplement this, the minority should be given a right to veto corporate decisions affecting vital matters of business interest. At present they are only given a right to appeal to court to anull a resolution of the company.

Over this the number of persons present who are deemed to form a quorum should be increased. The number should be stipulated by a ratio or percentage of the members entitled to attend and vote at meetings. Presently the law provides that in case of a private company two members and in case of any other company three members personally present shall form a quorum.[7] It is suggested that if a company has a large membership, the number is too small. Thus the Act should provide for example that in case of any company one tenth of the members present shall form a quorum. This would mean that a high attendance would be required. If no such quorum is available, then a provision empowering the directors to apply to court for a reduction of quorum would serve the purpose Large quorums would ensure that the resolutions of a company are more representative of the will of the company. Where low quorums are prescribed, one can imagine the directors who are also members forming a quorum and voting for a resolution in their capacity as members.

The remedy afforded the minority is not adequate. The winding up order on the grounds that it is just and equitable removes the company thereby destroying the members' future interests. The alternative to winding up is only available where the facts would justify a winding up order under section 219(f). It is suggested that the remedy under section 211 should be available even if the facts proved and the circumstances would not permit a winding up order. The section should be available whenever oppression is proved even though the petitioner has no tangible interest, for example by the fact that if winding up is ordered, there would not be enough assets for distribution among members after satisfactio of the creditors. The rule lacks rationality and should therefore be amended.

On financial protection it has been shown that the basic protective devise is disclosure of the affairs of the company. Affairs of a company has been said to mean its business affairs, as Philmore J. said "... In speaking of 'its affairs', in connection with a company, the natural meaning of the words connotes its 'business affairs'."7a
It has been shown that the financial accounts are coached in technical accounting form which are not easily understood by members. The double entry in the balance sheet is confusing to the layman. It is suggested that for this information to be of any help to the shareholders, the accounts of a company should be drawn in such a manner as to be understandable by the average man. Such accounts should be in statement form explaining such factors as assets and laibilities in the balance sheet and how they balance.

There is no statutory provision relating to the declaration of dividends. However the articles of most companies provide that dividends shall be paid only out of profits.[8] The aim of this rule is to stop, theoretically reduction of capital by returning the funds to the members in form of dividends. The aim of this provision is to protect the interests of creditors who depend on a company's capital for repayment of their debts. What is to be noted however is that the members in general meeting generally has no power to declare a dividend to a sum larger than that recommended by the directors.[9] This means that if the directors recommend no dividend, the members are left helpless notwithstanding that there is a profit available for such decalration. This is compled with the directors powers to set aside profits as reserves and a discretion to invest this money in any way except the purchase of the shares of that company.[10] These provisions which largely appear unchanged in the articles of majority of companies, mean that the directors have the final say in how the profits of a company are to be employed.

It is surprising that the underlying principle in most of company law rules is the protection of the shareholders, and still there is no common law or statutory law rule giving members a right to have a say in the declaration of dividends - their ultimate aim in investing.

The companies Act should be added to provide for general guidance enabling the members either to force the directors to recommend a declaration or for the members themselves to declare one. This should be in such a form as to allow declaration only where there is a profit available over and above the current and projected expenditure of a company. This would allow members to get benefits from their investments and at the same time allow expansion of the enterprise. It would also ensure that the rights of creditors are protected if the payments due to creditors are taken as current expenditure. The rules relating to the rights of various classed depend upon the articles and the terms of contract by which they purchased their shares. The balancing of these rights has been interpreted by courts laying down general principlse to be followed. It is suggested that these should be left as they presently are for otherwise introduction of a statutory control may bring undue rigidity and investors may refuse to invest where there are more than one class of shares.

The most potent protection that would be available to the shareholders would be the powers vested in the registrar of companies.[11] His powers to investigate the affairs of the company may help not only the whole body of shareholders but also an oppressed minority. [12] This power is not however efficiently used. The reason for this is that the investigation department is one man team unlike its counterpart Board of Trade Investigation in England which has a team of 20 persons. For this reason the companies investigator can only handle complaints from members or creditors which come to him. In the companies registry, an interview with the registrar of companies revealed that there is no system by which they check that all companies that are required to file with the registry various documents in every year do so. This means that unless a member or any other person interested in a company complain, a company may go on defying statutory provisions with impunity.

It is necessary that the investigating department be enlarged to allow the scrutiny of companies to ensure that at least the legal provisions are adhered to especially the disclosure of materials that members has a right to inspect.

The increase in personnel in the investigating department would mean that, not only where a complaint is made, but also where, from any document that a company is supposed to submit to registrar for filing, it appears that the company's affairs are not conducted in accordance with law, then they would investigate.

The cost of appointing an inspector is an important eleter deterring factor in the office of registrar, preventing appointment. In one case where a company was being inspected, (The company could not be disclosed since inspection was not complete), by the time an interim report was given, the expense had run up to fifty thousand shillings. This basically arises from the need to employ proffessional accounting firms. The second difficult arises in that where a minority apply to the court for the appointment of an inspector, such applicants are supposed to give security to an amount not exceeding ten thousand shillings.[13] Especially in farming companies whose members are usually the rural populace who are generally not economically well off, they may fail to raise such a sum. Under the circumstances, their salvation is only in the registrar exercising his discretion to apply for an inspection.

It is hoped that the powers of the registrar of companies will be more vigorously exercised. The investigating department can play a vital role if personnel is increased. In that not only would it have powers to bring those who are liable for misconduct in a company's business to book, but also a more vigorous investigation would work to prevent probable defaults by fear of those in control of a company's affairs being apprehended.

Ways and means should be found to reduce the costs of inspecting. Probably an inspection committee composed of civil servants would be appropriate. These would be civil servants and at the call disposation of registrar or the court whenever an inspection is found necessary. By increasing personnel and efficiency in the office of the registrar of companies the registrar of companies would stop being a watch dog with teeth which he uses rarely and instead be a vigilant bulldog.

On the problem of sale of company shares, it has been seen that the rules relating to the issue of prospectus are comprehensive enough and afford adequate protection. The instances when prospectus offences has appeared before courts to Kenya are rare. However, in view of the importance of this initial issue of company securities, it is hoped that the Kenyan prevention of Fraud (investment) Act [14] which is not yet in force will help when it comes in operation. This Act be surportive of the Nairobi Stock Exchange, since it provides that the issue of companies securities and dellings thereat will be licenced dealers. Because of this most companies will have to have their shares dealt in by a regognised dealer and thus increase the market for the Nairobi Stock Exchange. This exchange presently deals with slightly over one per cent. of the company security For this reason its role in controling the purchase of shares to assure maximum disclosure and fair prices is very low. Its role in shareholder protection is therefore very small.

All in all it can be said that presently the rules governing the protection of shareholders fall short of expectation in practice. In theory the protection is adequate but in practice, the members of companies in Kenya are not well protected by the rules. The underlying Laissez-faire capitalism, with the concept of freedom of contract should give way to greater governmental control in company securities to afford greater protection of the shareholders. In view of our growing economy with greater emphasis in capital investments the members of the public can only be induced to invest in companies if they are assured that their rights will be adequately protected. This can well be achieved through greater state control in this sector of the country's industry.

Footnotes to Introduction

1 Salomon v Salomon & Co (1897), AC 22

2 Short v Treasury Commissioner (1948)1 K.B. 116 at 122

3 S.2 Companies Act.

Footnotes to Chapter One

1 CAP 486 Laws of Kenya

2 S4(2)(a) Ibid

3 S4(2)(b) Ibid

4 S4(2) Ibid

5 Evan's Case (1867), L.R. 2Ch. App. 427

6 Gower - "Principles of Modern Company Law" 3rd Ed. P. 374

7 Bonands Trustee v. Steel Brothers & Co, Ltd. (1901),1 Ch. 279 at P. 288

8 No(2) (1971) E.A. 272

9 United States Radiator Corporation v State Court of Appeal of New York, 1913, 208 NY 144

10 Salomon v Salomon & Co. (1897), AC 22

11 pp. 3 - 4 Supra Footnote 6

12 Footnote 10 supra

13 Footnote 1

14 Parke v Daily News (1962)3 W.L.R. 566

15 CAP 486 Laws of Kenya

16 CAP 8

17 S.3 (1) C

Footnotes Chapter Two

1. Salomon & Co. Ltd V Salomon
2. Isle of Wight v Tarhoudin
3. (1906) 2 Chapter 34
4. S. 13(1)
5. (1935) 2 K.B. 213
6. Supra - Footnote 4
7. S. 185 (1)
8. S. 165
9. Footnote 4 supra
10. S. 141
11. S. 136 (1) (iii)
12. S. 137 (2)
13. Supra - Footnote 7
14. S. 185 (3)
15. S. 185 (6)
16. Southern Foundries (1962) Ltd v Shirlow (1940) AC 701
17. Foss v Harbottle (1843), Hare, 461
18. Burland v Earle (1902) A.C. 83
19. (1919) Ch. 290
20. Sidebottom v Kershaw Lees & Co. (1920) 1 ch. 154
21. Daffen Tinplate Company v Lanerly Steel Co. (1920) 2 Ch. 126
22. Sutherland v Cox Bros. & Co. (1927) 2 K.B. 29
23. S. 210
24. S. 219 (f)
25. Loch v John Blackwood Ltd. (1924) AC 783
26. Supra footnote 24
27. Elder v Elder & Watson Ltd. 1952 S.C. 149
28. Scottish Corporative wholesale Society Ltd. veMeyer (159 AC. 324
28. S. 165
29. (1906) 2 ch. 34
30. Supra foot notes 3, 5, & 16, Article 80 Table A.
31. S. 140
32. Table A, Article 2
33. Faith v Bushell (1969) 1 All E.R. 1602
34. Foss v Harbottle (1843) 2 Hare 461

Footnotes - Chapter Three

1. S. 30 (1)
2. S. 15
3. S. 13
4. S. 201
4. SS 107 & 108
5. S. 128
6. S. 147 (1) & 2
7. S. 147 (3)
8. S. 148
9. S. 88
10. S. 104
11. S. 147
12. S. 2
13. S. 40

Footnotes - Chapter Three (cont.)

14. S. 42
15. S. 46
16. (1932) 1 K.B. 442
17. S. 45
18. Gower "Principles of modern Company Lay 3rd Edition P. 318 & 319 (last paragraph)
19. (1882), 14 App Gas. 337
20. Armstong v Strain (1952) 1 K.B. 252
21. Hedley Byrne & Co. v Helter Patners Ltd (1964) A. C 465
22. (1869) 1 Q B. 372
23. 41 ch. D. 348 at P. 369 → (1889)
24. (1883) 23 ch. D. 413
25. Houldsworth v City of Glasgow Bank (1880), 5 App. Cas. 317
26. Article 116
27. Fliteroft's Case (1882), 21 Ch. D. 519
28. P. 533 - 534 ibid
29. (1889) 41 ch. D 1
30. Lee v Neuchatel Asphalte Co. ibid
31. Article 114
32. Article 115
32(a) Borlandds Tusteen v Steel Brothers & Co. (1901) 1. ch. 279 at P. 288
33. (1897), Ch. 361 (C.A)
34. Hulton v Scarborough Cliff Hotel Co. (1865) 2 Dr & Sim 521
35. (1950) ch. 161 (C.A.)
36. Re Critchton Oil Company (1902) 2 ch. 86
36(a) (1891) 2 Ch. 317
37. (1891) 2 ch. 317
38. S. 13 (1)

CHAPTER FOUR - FOOTNOTES:

1. S.146
2. SS.165 & 166(a)
3. CAP 486. Laws of Kenya
4. S. 164 Ibid
5. S. 166(b)
6. R. V. Board of Trade exparte St. Martin's Preserving Co. (1965) 1 Q.B. 603.
7. S. 167
8. S. 170 (1) (a) & (2)
9. S. 219 (f)
10 . S. 172
10a. S. 171 (1) (c) (i)
11 . S. 171 (1)
12. Act No.1 of 1977

FOOTNOTES TO CONCLUSION

1. Salomon V Salomon & Co. (1897), A.C. 22
2. CAP 486 Laws of Kenya
3. (1906)2 Ch. 34
4. (1935)2 K. B. 213
5. S 200
6. SS. 165, 132, 134,(b)
7. S. 134(c)

7a. R.V. Board of Trade exparte St. Martin's Preserving Co. Ltd. (1965) 1 Q.B. 603, at 613

8. Article 116 of Table A
9. Article 114 Ibid
10. Article 117 Ibid
11. S. 164 Companies Act
12. S. 165 (b) (iii) Ibid
13. S. 165 (2) Ibid
14. Act No. 1 of 1977