

**THE EFFICACY OF LEGAL TRANSPLANTATION IN KENYA: AN ANALYSIS
BASED ON THE INSOLVENCY ACT, 2015 AND THE COMPANIES ACT, 2015.**

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Declaration

I, KORIR IAN KIPKOECH, do hereby declare that this research is my original work and that to the best of my knowledge and belief; it has not been previously, in its entirety or in part, been submitted to any other university for a degree or diploma. Other works cited or referred to are accordingly acknowledged.

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Date:

This dissertation has been submitted for examination with my approval as University Supervisor.

Signed:

Date:

Supervisor's Name:

ABSTRACT

Legal transplantation has become a worldwide phenomenon and with its continued use in various jurisdictions for many years, it has continued to be preferred by many legal drafters both in Kenya and beyond. The aim of this dissertation is to find out whether the process of legal transplantation is an effective process in legal drafting in Kenya based on an analysis on the Company's Act 2015 and the Insolvency Act 2015.

The research done on this paper is from online content and written work. The content is largely foreign as there is very little information on the subject here in Kenya as much as the process takes place quite evidently here.

This research found that The Company's Act and the Insolvency Act are two legislations that have been heavily borrowed from the United Kingdom and have faced numerous challenges and therefore need numerous amendments. They were borrowed without a complete understanding and have not been quite effective to address the problems they were meant to solve.

The recommendations given include the drafting of laws with an aim to only solve real problems without borrowing foreign concepts wholly. It also recommends that the process of legal transplantation ought to be used only in moderation.

LIST OF CASES

Derry v. Peek [1889] LR 14 App CAS 337, UKHL 1

Flagship Carriers Ltd v Imperial Bank, High Court of Kenya, unreported Civil Case No.1643 of 1999

Hawlett v. Dowdall (1852) 18 L.J.B. 2, 118 ER 1

Nyali Limited v. Attorney General of Kenya [1955] 1 All E.R. 646 at 653

Re Sea Fire and Life Assurance Co. Greenwood's Case (1854) 3 De GM & G, 459.

Salomon v. Salomon and Co. Ltd. (1897) AC 22, UKHL 1

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND OF THE STUDY.

Over the years, there has been an exponential increase in the volume of legal transplantation worldwide. Legal transplantation described simply is the process by which laws and legal institutions developed in one country are then adopted by another country¹. Generally, reforms in many jurisdictions over the world have borrowed ideas from others with varying levels of success and acceptance. In this respect, legal systems, policies and legal solutions are borrowed from foreign jurisdictions as a means of advancing legislation quickly and effectively.²

Legal transplantation in Kenya manifests itself from way back from a colonial-colony perspective and continues to be manifested in some of our current legislations. The Insolvency Act, 2015 and The Companies Act, 2015 for instance were both heavily borrowed and adopted from the United Kingdom.

Laws are normally drafted to find a coherent solution or to solve a particular problem that face a specific group of people at a certain period of time.³ Borrowing laws that have been drafted in a way to solve problems of the donor country, for their own specific group of people at a period of their need creates a system where there are laws but they are not tailored to solve the specific problems of the people in the recipient countries. As much as in the donor countries, the laws worked efficiently, it is a matter of dispute that these laws would also be efficient in the recipient countries.

Basing the analysis on the Insolvency Act and the Company's Act, this study assesses the process of legal transplantation and its impacts. It outlines the effect of transplanting these two laws as legislations in Kenya. Furthermore, it makes an attempt to analyze whether the process of legal transplantation is effective and eventually makes a finding of whether or not the idea of legal transplantation is an efficient way of drafting legislations.

¹ Shauer F, *The politics and incentives of legal transplantation*, 4

² Watson A 'Aspects of Reception of Law' (1996) 44 *American Journal of Comparative Law*, 335

³ Mark Segal, *Legislative Drafting: Principles and Materials*, 8

1.2 JUSTIFICATION OF THE STUDY

Kenya embarked on its long overdue transition to modern company and insolvency laws with the enactment of the Companies Act, 2015 and the Insolvency Act, 2015. The new Acts were drawn heavily from the Companies Act, 2006 of the United Kingdom and the Insolvency Act of the same country. This study is very important as one can no longer say that legal transplants are impossible. They are a reality we cannot run away from.⁴ Kenyan company law is heavily based on the principles of English company statute law and the common law, as handed down through judge made decisions of the courts. The new Act preserves this heritage of the English system. However, the sheer scale of the legislation has the effect of making statutory provisions out of former common law doctrines such as directors' common law and equitable duties, rights of shareholders to protections against unfair actions of directors and controlling shareholders, offences of fraudulent trading and many others,

Diverse critics of legal transplantation make this topic an interesting subject to discuss. For instance, Kahn-Freud compares legal borrowings to the transplant of a kidney or a heart; he states that legal transplants as well as surgical transplants have the risk of being rejected.⁵ It is dangerous to transplant a law that is culturally and vitally attached to a particular society because all jurisdictions have a unique and different social constitution⁶ Similarly T.T. Arvind uses an analogy with wine grapes to conclude that even though a variety of grape is able to travel abroad and grow outside its native ground, the wine however will always taste different. ⁷This analogy is reiterated by Mathias who notes that the same situation applies to transplanted laws.⁸

On a different note, the quest for Kenya's current constitution came to an end after it was promulgated in 2010. It was a very long that cost the country a considerable amount of money. Arguably one of the best written constitutions in the world, it was drafted specifically to solve Kenya's problems. The drafting process involved a committee of experts and accommodated the

⁴ María Paula Reyes Gaitán, *The Challenges of legal transplants in a globalized context: A case study on 'working examples'* (2013) 2

⁵ Otto Kahn-Feud, 'Use and Misuse of Comparative Law' (1974) 37 *Modern LR* 1, 2

⁶ Drummond S, *The process geography of law (As approached through Andalusian Gitano family law)* 5

⁷ Arvind TT, *The 'Transplant Effect' in harmonization in: International & Comparative Law Quarterly*, Vol 59, No. 1 (2010) 65-68

⁸ Siems Mathias, *Comparative Law*, Cambridge University Press (2014) 19

public's views. It cost Kenya's taxpayer a huge amount of money to eventually come up with a final draft. Is the amount invested in drafting Kenya's Constitution something that Kenya can afford to keep drafting legislations in a similar manner? Is it then a viable option to transplant various laws in a move to cut down expenses? It is these arguments that make the topic interesting for discussion.

1.3 STATEMENT OF OBJECTIVES

This study has a number of objectives as outlined below:

Main Objective.

To assess the efficacy of legal transplantation in Kenya based on the challenges and strengths that have been posed by The Insolvency Act, 2015 and the Companies Act, 2015 both borrowed from the United Kingdom.

Specific Objectives.

The specific objectives of this study are:

1. To explain the process of legal transplantation, its rationale and give an assessment on the process.
2. To establish how legal transplantation has manifested both globally and in Kenya.
3. To assess the impact (both strengths and challenges) the two Acts, have brought into the current field of Company Law and Insolvency Law.

1.4 RESEARCH QUESTIONS

This study seeks to answer the following questions:

1. What is the rationale behind drawing legislations from donor countries and adopting them as legislations in the recipient countries?

2. How efficient has transplanting the Companies Act, 2015 and the Insolvency Act, 2015 been to Kenya?

1.5 HYPOTHESIS

This study tests the hypotheses that:

1. Legal transplantation has created problems in the application of the laws relating to Company and Insolvency Law.
2. There are key factors and similarities in the manner that certain fields of laws are governed in both the donor and the recipient countries that allow for legal transplantation.
3. The Companies Act and the Insolvency Act have not been effective in Kenya as they do not solve existing problems.

1.6 RESEARCH DESIGN AND METHODOLOGY

The research is principally based on online and overseas content. There is little information on the subject in Kenya. Reference will mainly be done to the UK's Company Law and as a source of cases and legislation. Therefore, secondary sources of information will be the main basis for this research.

1.7 LIMITATIONS

This study has some limitations:

- The study gives a general opinion on legal transplantation based only on the Companies Act and the Insolvency Act.

1.8 CHAPTER BREAKDOWN

Chapter 1: Introduction

This chapter introduces the paper by giving the background of the topic, reasons for the research and gives the purpose for the study. It explains the research problem and also the importance of studying this topic. It includes the following subsections:

- Background of the problem
- Purpose of the study and general objective
- Research questions
- Importance of the study and its justification
- Scope and limitations of the study
- Chapter summary

Chapter 2: What is legal transplantation?

This chapter defines legal transplantation and highlights the rationale behind legal transplantation. It also gives an assessment on the process by giving a critique into legal transplantation.

Chapter 3: The manifestation of legal transplantation

This chapter shows the extent that legal transplantation has manifested both globally and more precisely in Kenya. It further puts into perspective whether the two acts have faced challenges and broadly goes through the study.

Chapter 4: Comparative analysis

This chapter will focus on comparing the United Kingdom and the Kenyan legal frameworks with regard to Company Law. It outlines the differences in the developmental aspects between the two systems. It also highlights the efficacy of the process of legal transplantation based on this comparison.

Chapter 5: Recommendations and conclusion

This chapter generally contains recommendations and gives a conclusion on the study of legal transplantation in relation to the current state of Kenya.

CHAPTER 2: WHAT IS LEGAL TRANSPLANTATION?

2.1 DEFINING LEGAL TRANSPLANTATION

‘Legal transplants’, a term devised in the 1970’s by Alan Watson, implies “the moving of a rule or a system of law from one country to another”⁹ Laws are commonly inspired by foreign policies and experiences in practice. Legal transplants are a common practice regardless of the academic discourses on whether they are sustainable as a notion in the legal theory. This will however be dealt later on in this Chapter.

New legal regimes typically, perhaps inevitably, use concepts from prior legal regimes. As Roscoe Pound put it nearly a century ago, “the history of a system of law is largely a history of borrowings of legal materials from other legal systems and of assimilation of materials from outside the law”¹⁰ Consequently, it is common practice for developing legal regimes to borrow legal ideas from other jurisdictions.

The process of legal transplantation has two aspects which are vital to note. Firstly, there is the transfer of rules, principles and legal concepts from one or more than one legal system to another. Secondly, the process involves two systems; the recipient system which is the legal system that is borrowing laws and the donor legal system which is the legal system that is lending the laws. The recipient legal system should be an existing one or a system at its initial stage of development.¹¹ These aspects bring out an interesting wide angle of viewing the process of legal transplantation. It can happen across national systems and also between national systems and international systems. Legal transplantation manifests itself either vertically or horizontally.¹² Vertical borrowing is borrowing of legal ideas between national and international law while on the other hand; horizontal borrowing is borrowing of legal ideas across national legal systems. This shows the wide extent at which legal transplantation occurs. It is not only limited to foreign concepts being borrowed to national laws but also international laws being borrowed to draft national laws and vice-versa.

⁹ Watson A, *Legal Transplants: An Approach to Comparative Law*, Edinburgh, 1974

¹⁰ Watson A, *Legal Transplants: An approach to Comparative Law* 22, 2ed 1993 (quoting Roscoe Pound)

¹¹ Abdo M and Abegaz G, *Legal transplantation*, 1, 2012

¹² Weiner J, *Something Borrowed for Something Blue: Legal transplants and the evolution of Global Environmental Law*, 1299

Having laid out what legal transplantation is and the various ways it manifests itself, there are reasons why legal borrowing has continued to be used in legal drafting for a long period of time worldwide.

2.2 LEGAL TRANSPLANTATION RATIONALE

It is important to note that legal transplantation ought to be appreciated by any legal research. Appreciating legal transplantation is important to conduct legal research, as it enables one to trace the right sources of the laws of a given country and only then is one able to also get to effectively understand some of the principles behind these laws and consequently laying a proper basis for criticism into the respective laws.¹³

There are numerous factors that allow for the occurrence of legal transplantation. A recipient country may borrow laws since they are accessible in terms of language, the laws are found out to be meritorious in terms of organizations, the laws were transplanted to other systems and found out to be fruitful and when the recipient country decided to modernize its legal system.¹⁴ The list is endless. A country may adopt foreign laws as a result of migration or commercial intercourse. A country may adopt the laws of another country because the important elites are attached to the legal system and education of the donor country. A country may be forced to accept the laws of other systems owing to war or conquest or colonization or physiological pressure.¹⁵

Legal history indicates that legal transplantation has been rampant. The Greek gave important legal theories to the Romans; the Romans borrowed from the Greek legal system some conceptions of laws. The Romans converted the idealism of the Greek into practical legal rules. The Romans gave principles of private law to European countries such as France and Germany. France added to the laws it received from the Romans some theories and techniques. France then codified its laws in early 19th century. France propagated its laws first to neighboring European countries. Later, France transplanted its codes to Asia and Africa through the instrumentality of

¹³ Abdo and Abegaz, *Legal transplantation*, 4

¹⁴ Abdo and Abegaz, *Legal transplantation*, 5

¹⁵ Abdo and Abegaz, *Legal transplantation*, 23

colonialism. Some countries, such as countries in Latin America, received laws from France voluntarily. England also transported its laws to all over the world via colonialism. Eastern European countries received laws from the civil law countries. After the end of Second World War, however, East European countries were forced to adopt socialist system of laws. Again after the 1980's, these countries went back to the civil law tradition owing to external pressures. The socialist legal system was developed as an idea in 19th century and early 20th century translated into practice in Russia. Russia, later USSR, became the mastermind behind the spread of socialist laws to Asia and Africa in some cases through force and sometimes through pressure.

The Islamic legal system originated as an idea in the Middle East in the 7th c AD, and then taken to the coastal areas of Africa, Middle East and Asia. Now a kind of Islamic belt has been created. The spread of the Islamic legal system has been attributed to a combination of the following factors: conquest, migration and commerce.

A more different approach is that where a speedy reform effort is of need as in Central and Eastern Europe in the early 1990s or most war to peace transitions today, the original law is taken as a whole and simply transferred, sometimes only edited by translation to the local vernacular.¹⁶

In sum, there are three key views that ought to be deliberated upon on whether legal transplantation is a desirable one. The first one is referred to as the custom theory. Here, a German thinker called F.Von Savigny elaborated his approach by stating that law and society have unique relationships. The connections are inherent. He proposed that laws are found in common consciousness of the people and this is manifested in the behavior of individual members of that community. Laws are related to the identity of a society for which they are created. Further, every community is legally self-sufficient; whenever a society faces a legal problem, it creates legal rules. To this theory, if one therefore makes an attempt to take the laws community X to community Y by way of legal borrowing, those transferred laws will inevitably fail. Legal transplantation will never solve the problems of a recipient legal system.

An opposing theory developed by Alan Watson however, holds the view that there is no unique connection between law and society. The theory also holds that no community has ever been

¹⁶ Bakardjieva A and Nergelius J, *New directions in Comparative Law*, 60

legally self-sufficient in the history of mankind.¹⁷ This theory views laws as intangible instruments to achieve certain goals. As laws are tools, they can be taken to any society and used with success.¹⁸ Justifications are given for this position. The first reason is that the fact that legal transplantation has been very common in the history of legal systems shows that people have found it rational and useful. In the second place, if there are laws used by X Community and if Y community needs those laws, why should the latter be asked to reinvent those legal concepts and legal rules? It is rational for Y community to receive the laws of X community, which are tested in practice.

Thirdly, the custom theory assumes implicitly, but wrongly, that countries take the laws of other nations on the basis of their own free will.¹⁹ However, history gives us several examples where countries have borrowed laws as a result of external pressures. This third theory attempts to strike a middle ground. In some areas of law, for example, in the area of commercial law, public law and technology law, there are gaps or traditional laws do not exist in developing countries. In such cases, developing countries do not have a choice; they have to borrow laws. In other areas of laws such as family law, inheritance laws and land laws, developing countries have longstanding laws. In the latter cases, it is difficult to transplant laws and even if transplantation takes place, the laws so transplanted will not be welcomed. This hybrid approach is articulated by Kahn-Feud. This moderate approach to legal transplantation states that the contexts of the recipient country should be studied well before the borrowing of laws is done.

¹⁷ Watson A, *Legal Transplants*, 24

¹⁸ Watson A, *Legal Transplants*, 27

¹⁹ Drummond S, *The process geography of law (As approached through Andalusian Gitano family law)*, 54

2.3 CRITIQUING LEGAL TRANSPLANTATION

With its wide use and its existence over a long period of time, it has attracted a rich literature on legal borrowing worldwide. The phenomenon of legal transplants has been studied and strong arguments for and against legal transplants has been presented over the years. A spirited scholarly debate has been running over the desirability of transplanting legal ideas from one national context to another as will be discussed herein.

Firstly, María Paula Reyes Gaitán in his work²⁰ studies the different theories of legal transplants in comparative law and puts into analysis specific cases that have eventually ‘worked’ efficiently in the adopted countries as they did in the country of origin. He posits that the aim of his work is not to find a definitive answer of whether the situation of transplantation was either right or wrong but rather he aims at explaining some of the situations in perspective to be able to gain comprehension of the legal transplants subject and in order to have the capacity and right tools to be able to interpret independently each and specific legal transplant case in their own context. The writer offers a contextual approach to the issue of legal transplants. He generally gives a case study on working examples, and in the process establishes challenges that come with legal transplants in a globalized context. The writer’s purpose of doing his study was to show how the results of legal transplants depend on the circumstances of each individual case,²¹ and in order to do so he mentions and makes an analysis on some ‘atypical’ cases of legal transplants that have one particular thing in common: they all unexpectedly worked without any major negative consequences. He mentions that there is no magic formula that can ensure the success of and or predict the failure of legal transplants in a particular country, economy, market or enterprise.²² For that purpose it would be necessary to refer to each and every case individually in order to say what can be a positive or a negative legal transplant. Consequently, to establish whether the process of legal transplantation has been efficient on a Kenyan context, the idea of a contextualized approach is necessary. A comprehensive study on the two legislations, The Insolvency Act 2015 and The Companies Act 2015 is therefore to be studied individually for there to be a drawn conclusion on whether the act of transplanting them was advisable and has since been successful in Kenya or not.

²⁰ Gaitán M, *The challenges of legal transplants*, 4

²¹ Gaitán M, *The challenges of legal transplants*, 7

²² Gaitán M, *The challenges of legal transplants*, 10

Secondly, Marc Galanter compares legal cultures to languages, as instruments that can engage with foreign material while maintaining its unique characteristics and idiosyncrasy.²³ He argues that the notion that legal transplants have the risk of being rejected, and the idea that it is dangerous to transplant a law is completely false. He posits that any law, just like a language can engage with foreign material anywhere and consequently, there is no problem with transplanting laws. From his argument, I can draw the idea that since the two legislations in my study are drawn from the UK, they were part of the legal system there and as a result, they can engage with foreign problems anywhere other than the UK. Regardless of the flaws in his argument, he provides a good framework upon which to approach legal transplants. In a Kenyan context, the two legislations have already faced a number of problems in their operation in Kenya. Therefore, it is not wholly true that laws can always engage foreign material efficiently and therefore a complete objection to his view.

These two arguments (Maria's and Marc's) are vital as they revolve around a comparison of the state between the origin of the legislation in the donor country and the reception of the same legislations and their operation in the recipient country which is similar to what this study of Kenya's context is based on.

On the other hand, other scholars such as Kahn-Feud and T.T Arvind have shown great consistency in opposing the process of legal transplantation. Kahn-Freud compares legal borrowings to the transplant of a kidney or a heart. He states that legal transplants as well as surgical transplants have the risk of being rejected and that it is dangerous to transplant a law that is culturally and vitally attached to a particular society because all jurisdictions have a unique and different social constitution.²⁴In this analogy, he poses that since countries have a social constitution unique and different from all others, legal transplants will always fail for that sole reason. It is this analogy that he uses to oppose the process of legal transplantation. Kahn cautions that cross-national legal borrowings can be undesirable because of national differences in culture, geography, wealth, religion, and other factors.²⁵ As much as Kahn-Feud presents an analogy based on all jurisdictions having a unique and different social constitution from the other, there are working examples presented that have shown the success of legal transplants. Is

²³ Marc G, 'Predators and parasites: Lawyer-bashing and civil justice' (28) *Georgia Law Review*, 680

²⁴ Drummond S, *The process geography of law (As approached through: Andalusian Gitano family law)*, 5

²⁵ Otto Kahn Feud, *Uses and Misuses of Comparative Law* (1974), 37

it then correct to state that legal transplants will always fail based on this and yet there are working examples of the same? In relation to Kahn's view of legal transplants, Kenya's Insolvency Act of 2015 and The Companies Act 2015 can be seen to have been heavily borrowed from the United Kingdom into Kenya's legal system. The two countries have different social constitutions, and the two legislations have been applied in both countries. The legislations have been in operation in Kenya for a while now and as much as they have faced difficulties, they have solved problems that would not have been resolved in the event that they had not been legislated. Consequently, the manner in which the two legislations operate to solve problems in Kenya, it appears that although the laws were drafted for countries totally different and each having its unique kind of problems, to an extent it is not wholly true that legal borrowing will always turn out dangerous with the risk of failure.

Similarly Arvind in his work²⁶ studies legal transplantation and provides an analogy on the operation of legal transplants. He uses an analogy of wine grapes to conclude that even though a variety of grape is able to travel abroad and grow outside its native ground, the wine however will always taste different. ²⁷ According to him, the same situation applies to transplanted legislations in the sense that legal borrowing can always happen however, the after-effect of the legislation will always be different in both countries. In as much as the laws in United Kingdom solved their problems, and therefore made Kenya to transplant the two laws into its own legal system, the after-effects are seen to be different in both countries as is evident in the Kenyan scenario.

It is the conception of these arguments that the study of the efficacy of legal transplantation in Kenya is based on. Both the Insolvency Act, 2015 and The Companies Act, 2015 are suspect of legal transplantation drawn from the United Kingdom, the donor. These two legislations in Kenya are real suspects of this process and therefore, the need to base the study upon these two legislations in the country, a contextualized approach.

²⁶ Arvind TT, *The 'transplant effect' in harmonisation.: International & Comparative Law Quarterly* (2010) Vol. 59, 65

²⁷ Mathias S, *Comparative Law* (2014) Cambridge University Press, 190.

CHAPTER 3: THE MANIFESTATION OF LEGAL TRANSPLANTATION

3.1 MANIFESTATION OF LEGAL TRANSPLANTATION GLOBALLY

Nations frequently borrow doctrines from each other, often across vast distances of space and time.²⁸ Much of American law was received from England (and in some places from France and Spain.)²⁹ Most of the other countries derived their current formal legal order from Europe during the 19th century and the early 20th century. The term 'legal transplants' is even defined by its foremost exponent as "the moving of a rule or system of law from one country to another"³⁰ This shows the frequency the process has taken place worldwide.

Earlier legal transplants are well known, including the reception of Roman law in Europe, the enactment of the Chinese codes in other parts of Asia, or the transfer of Spanish and Portuguese law to Latin America. Indeed, legal transplants are as old as the law is.³¹

Despite the lively borrowing and transplantation from the 19th and 20th century, most retained the core characteristics of the legal system they had received during this period. The wholesale transplantation of legal systems was made possible by the consolidation and formalization of legal systems in Europe that coincided with the development of the nation state. The expansion of European influence through war and conquest was primarily responsible for the transplantation of these laws to countries in Asia, Africa, North America and Latin America; although some of these non-European countries transplanted these laws voluntarily.

DIFFERENT LEGAL FAMILIES

Three legal families; the English common law, the French civil law and the German civil law, dominated the process of consolidation and formalization of formal legal orders in Europe.

The English common law has evolved over centuries and, in contrast to the French and German civil families, was never systematized and codified. Case law or precedents set out by courts defined legal principles that were applied to other cases. The roots of the common law date back

²⁸ Hagerstrand T, *The Diffusion of Innovations*

²⁹ Watson A, *The Importance of "Nutshells"* (1994) 14-15

³⁰ Watson A, *Legal Transplants*, 21

³¹ Watson A, *Legal Transplants*, 23

to the Norman conquest of England in 1066. The publication of law since the sixteenth century (Ross 1998) and the development of legal reports - which was completed in the second half of the nineteenth century (Katz 1986) - contributed to the formation of a consistent body of law that was widely accessible. Statutory law gained in importance in the nineteenth century, but case law remains the hallmark of the English legal system to this day.

Most legal families operating currently are derived either from the English common law, the French civil law or the German civil law. England, France and Germany are consequently denoted as origin countries because their formal legal orders developed largely internally and display highly distinctive features, some legal borrowing notwithstanding, and because their formal legal order served as a model for other countries.

3.2 MANIFESTATION OF LEGAL TRANSPLANTATION IN KENYA

Kenya's legal system largely developed from a colonization perspective and it is this angle that shapes the discussion of the manifestation of legal transplantation in Kenya. The development of a modern legal system in Kenya and the implementation of the common law have long been noted as a benefit of colonization by the British. The expansion of the British Empire led to the transplantation of the common law throughout the world. Kenya was colonized by the British and this colonization brought many things to Kenya introducing a whole new culture to Kenya's people. The British exercised control over Kenya economically, politically and socially for a long period of time. Eventually, Kenyans struggled for their independence and were finally free to govern themselves. However, Kenya embraced the common law system from the British. The courts at independence applied the principles already laid out in common law and this marked the beginning of legal transplantation in Kenya. The 'old regime' in Kenya is still not local law and the new regime is neo-colonialism. This probably explains the reluctant way we approach law drafting.

Kenya has continued to borrow legal ideas from other jurisdictions. The Companies Act and the Insolvency Act are two legislations in Kenya that this discussion will look at.

CHANGES BROUGHT TO KENYA AS A RESULT OF TRANSPLANTING THESE LAWS

The Companies Act and The Insolvency Act were both enacted for the purpose of modernizing the laws regulating Kenya's business environment.

A. THE COMPANIES ACT, 2015

This Act eventually replaced the previous Companies Act which had been operational for over fifty years. The Act aims to facilitate commerce, industry and other socio-economic activities by enabling one or more natural persons to incorporate as entities with perpetual succession, with or without limited liability, and to provide for the regulation of those entities in the public interest, and in particular in the interests of their members and creditors.³² The Act brought a number of significant changes to the business environment. Since the Act is by far one of the most extensive pieces of legislations in Kenya, emphasis will be put only on the various sections that have been heavily borrowed from the United Kingdom's Companies Act, 2006. Below are some of the highlights:

- a) **Company objects** - The repealed Act only allowed companies to pursue objects that were stated in its Memorandum of Association in line with the doctrine of *ultra vires*.³³ On the other hand, the new Act provides that unless the articles of a company specifically restrict the objects of the company, its objects are unrestricted.³⁴ Under the repealed Act, the effect was that the company was too restricted.
- b) **Company acquisition of its own shares** - Under the repealed Companies Act, a company was prohibited from purchasing or subscribing for its own shares or those of its holding company.³⁵ This requirement was abandoned in the 2015 Act stipulating that a limited company having a share capital is allowed to purchase its own shares in

³² Section 2, *Companies Act*, (Act No 17 of 2015)

³³ Section 7, *Repealed Companies Act*, 1962

³⁴ Section 28(1), *Companies Act* (Act No 17 of 2015)

³⁵ Section 56, *Repealed Companies Act*, 1962

accordance with the provisions of the Act.³⁶ This further allows a private limited company to purchase its own shares out of its capital.³⁷

- c) **Number of members to form a private company** – The Repealed Act required a minimum of seven persons and two persons for the formation of a public and private company respectively.³⁸ However, the 2015 Act only requires one member to form a private Company.³⁹ Most people had to put names in the list of directors merely as a formality due to the provisions of the repealed Act. The new Act makes it cheaper and faster to form a private company. This development is likely to have the effect that more private companies will be formed and further that more small businesses will be able to enter the market due to less bottlenecks.
- d) **Company secretary requirement in private companies** - every company was required to appoint a company secretary.⁴⁰ Under the new provision, a private company is only required to have a company secretary if it has a paid up capital of five million shillings or more.⁴¹ This provision is likely to stimulate an increase in small companies since it reduces the expenses for private companies.
- e) **Written Resolutions** - The repealed Act, mandated company resolutions to be passed at the general meeting of members. The new Act allows private companies to pass a resolution as a written resolution instead of passing it at a meeting of the members as is ordinarily the case.⁴²
- f) **Fiduciary duties of directors** – The common law and equity duties of company directors have been codified. The main duty being to exercise reasonable care, skill and diligence. ⁴³

³⁶ Section 424(2) *Companies Act, 2015*

³⁷ Section 449 *Companies Act, (Act No.17 Of 2015)*

³⁸ Section 4(1), *Repealed Companies Act, 1962*

³⁹ Section 11, *Companies Act, (Act No.17 of 2015)*

⁴⁰ Section 176, *Repealed Companies Act, 1962*

⁴¹ Section 243, *Companies Act, (Act No.17 Of 2015)*

⁴² Section 255(1) *Companies Act, (Act No.17 Of 2015)*

⁴³ Section 145, *Companies Act, (Act No.17 of 2015)*

B. THE INSOLVENCY ACT

The Insolvency Act amalgamates the Bankruptcy proceedings and the Companies liquidations into one insolvency law.

Similarly, there have been new changes that have been introduced to the Insolvency laws as a result of the process of legal borrowing from the UK legal system as will be highlighted below:

- a) **Petitioning for bankruptcy-** The Act introduces an instant Bankruptcy for three years once a petition for bankruptcy is filed⁴⁴ and an automatic discharge.⁴⁵ A bankruptcy order takes effect when the court makes an order in respect of a debtor who has been adjudged bankrupt. This means that there is no need of a Receiving Order and one will head straight to Bankruptcy upon the court issuing the order.
- b) **Debt restructuring mechanisms-** The Act introduces a different approach other than liquidation and focuses also on debt restructuring mechanisms. Moreover, the Act introduces several alternatives to bankruptcy which include entering into voluntary arrangement with the creditors or pay creditors in installments under summary installment order.⁴⁶
- c) **Joint Bankruptcies-** There is the introduction of a new provision on Joint Bankruptcies. This is where two or more debtors who are partners in a business partnership may make a joint application for a bankruptcy order.⁴⁷ The Act introduces an allowance which may be made out of the estate to the surviving spouse or to any of the relatives or dependents of the deceased debtor. This was not provided for previously.
- d) **Mandate of the Official Receiver-** The mandate of the Official Receiver has been expanded. The Act has placed upon the Official Receiver the duty to conduct investigations into the failure of the company and if need be the Official Receiver can apply to court to have any person examined in court.⁴⁸

⁴⁴ Section 41, *Insolvency Act*, (Act No. 18 of 2015)

⁴⁵ Section 254, *Insolvency Act*,(Act No. 18 of 2015)

⁴⁶ Section 14, *Insolvency Act*, (Act No. 18 of 2015)

⁴⁷ Section 35, *Insolvency Act*, (Act No. 18 of 2015)

⁴⁸ Section 438, *Insolvency Act*, (Act No. 18 of 2015)

- e) **Floating charge**-Section 47(4) is new to the business environment. It makes it possible for an unsecured creditor to share into the assets of a company under liquidation where there is a floating charge on the company's property. This provision will place a holder of a floating charge in the same position as an unsecured creditor in sharing the company's assets.⁴⁹

The above changes have brought about a significant impact in the business environment in relation to insolvency laws.

⁴⁹ Section 47(4), *Insolvency Act*, (Act No. 18 of 2015)

3.3 HAS TRANSPLANTING THESE LAWS BEEN EFFICIENT TO KENYA?

As much as these two laws have brought about significant developments that have already been discussed and have aspired to bring a new regime in the business environment, they have faced a number of shortcomings as discussed below:

CHALLENGES

The Challenges faced are numerous taking into account that the Act introduces a completely new regime with distinct features from the old Act.⁵⁰ The Act is very comprehensive and its voluminous nature means that it has to be constantly studied and interpretation of various sections sought. Some of the challenges as regards implementation are highlighted below:

a. Double Registration/Registration of Companies with Similar names

One of the biggest challenges facing the implementation of the Act is that of registration of companies with similar names which has led to fraudulent activities causing some companies serious financial losses. ⁵¹Double Registration is mainly a result of the three regimes of registration of companies; The C. files (manual) files, The RG-BPMS files (registered under the Business Process Management System), and the files registered under the new digital online platform. Sometimes a Clerk may innocently fail to check a name in one of the systems leading to issuance of a name already in existence. Old companies which fail to update their records also contribute to the challenge of double registration. In an effort to curb this issue it is expected that the new E-business system will integrate all the regimes of business registration into one system hence reducing the chances of making a name already registered available to another party for registration.

b. Deregistration of a Company where there is double registration

⁵⁰ Lubia M, *A presentation by the Business Registration Service on the progress and challenges on implementation and enforcement of the Companies Act and compliance and statutory returns*, 1

⁵¹ Lubia M, *A presentation by the Business Registration Service on the progress and challenges on implementation and enforcement of the Companies Act and compliance and statutory returns*, 3

Another challenge that the registrar general faces is that he lacks the powers to deregister a company where there is double registration.⁵² It gives the registrar powers to call on a business to change its name where there is double registration but is silent on the actions that the registrar can take where a party fails to comply. Hence the practice has been to call on a party to change its name and where they fail to do so all the registrar can do is to advise the offended party to seek redress in court.

c. Sensitization of the Professionals and General Public on the New Act and procedures

The general public and even the professionals are not well sensitized on the online registration system. ⁵³ Upon implementation of the new system there is the need to sensitize the general public of the procedure for online registration and lodgment of documents through the media and consultative workshops.

d. Online Registration System

Although the online registration system is a blessing, there is a challenge where some citizens cannot access the system because they are not connected to the electricity grid or they do not have access to the internet.

⁵² Section 58, *Companies Act*, (Act No.17 of 2015)

⁵³ Lubia M. *A presentation by the Business Registration Service on the progress and challenges on implementation and enforcement of the Companies Act and compliance and statutory returns*,⁷

CHAPTER 4: COMPARATIVE STUDY OF THE DEVELOPMENT OF COMPANY LAW IN THE UNITED KINGDOM AND IN KENYA

INTRODUCTION

This Chapter outlines the manner in which company law developed in both Kenya and the United Kingdom. It compares the different developments of company law in both countries and gives an opinion based on the comparison on whether borrowing the United Kingdom's legal system in relation to company law was a good idea for Kenya.

4.1 LEGISLATIONAL DEVELOPMENTS AND REGULATIONS IN UK

A. BUBBLE ACT, 1720

This Act forbade the formation of any other joint stock companies unless approved by the Crown through a Royal Charter and prohibited all entities from operating like companies unless so approved- effectively a ban on companies formed by contract. This was aimed at clamping down on bodies purporting to act as corporate bodies without legal authority. It also sought to regulate the activities of Chartered trading companies by limiting their activities to only those approved by the charter. Unfortunately, this Act suppressed "unincorporated companies" without addressing the commercial need that had led to their proliferation in the first place. This is because businesses still wanted the benefit of association and of transferable shares. This then led to a legal innovation that was a Partnership, which by various structures managed to approximate a corporation, including importantly an opportunity of having transferable shares within the association. Furthermore businesses were able to achieve a de facto limited liability through the use of trusts and contract terms limiting creditors to corporate assets.

In addition, the 1720 Bubble Act was silent on the question of liability of members of a company for debts of the latter. By this time, the Crown had begun; through the charters it issued, to address the liability of shareholders. This was however done inconsistently as while some charters expressly provided for direct shareholder liability (or the absence of such liability) most charters were silent.

However, despite the requirement that corporations be incorporated a majority of the joint stock companies were unincorporated whose existence was something of an affront to the Crown. This was because the Crown raised revenue by selling monopoly rights, and corporate charters were one of the devices used to record sales. What frequently distinguished incorporated from unincorporated joint-stock companies, therefore, was that the former were owned by politically well-connected merchants who had paid a handsome price to secure a monopoly, while the latter lacked the money or connections to gain similar privileges.⁵⁴ In a bid to address this affront Parliament in 1720 passed the Bubble Act which made it illegal, without a royal charter, to "presume to act as a corporate Body," or "to raise a transferable Stock or Stocks."⁵⁵ Thus, for the first time, English law formally embraced the proposition that a business organization with separate legal personality and transferrable shares could not be a creature of contract but must be a concession from the state.⁵⁶

Despite the heavy penalties the Bubble Act manifestly failed to eradicate unincorporated joint-stock companies with the explanation being that charters were expensive and the benefits of legal personality were considerable, and merchants were willing to run the risk of prosecution.⁵⁷ The real impact of the Bubble Act was to cut off any possibility of further development of a common law of joint-stock companies without addressing the commercial need that had led to their proliferation in the first place.⁵⁸ This is because businesses still wanted the benefit of association and of transferable shares. This then led to a legal innovation that was a Partnership, which by various structures managed to approximate a corporation, including importantly an opportunity of having transferable shares within the association.⁵⁹

B. BUBBLE'S COMPANIES ACT, 1825

In 1825 the Bubble Act 1720 was repealed. By the time of the repeal, judges having had nothing to do with unincorporated joint-stock companies for a century, were determined to fit them into an existing legal category (e.g., partnership) rather than see them as a different form of contract altogether. The notion of separate legal personality without incorporation had ceased to reside in

⁵⁴ Mahoney P, 'Contract or concession,' 887

⁵⁵ Mahoney P, 'Contract or concession,' 887

⁵⁶ Mahoney P, 'Contract or concession,' 887

⁵⁷ Mahoney P, 'Contract or concession', 888

⁵⁸ Morse G, *Charlesworth and Morse company law*, Sweet and Maxwell (1999), 5

⁵⁹ Morse G, *Charlesworth and Morse company law*, 6.

the judicial mind.⁶⁰ This way of thinking made it difficult for business creditors to sue successfully, and thus for businesses to obtain credit in reliance on legal remedies. It also made it difficult for a partner's personal creditors to cause the sale of partnership assets in order to satisfy the partner's personal debts.⁶¹

This new act empowered the Crown, in grants of future Charters, to provide that the members of the corporation should be personally liable for the debts of the corporation to such extent as the Crown should think proper. This was to ensure that limitation of shareholder liability, an increasingly relevant consideration⁶², was addressed in the charter during incorporation.

However, while the 1825 Act gave the Crown power to grant limited liability, it did not govern how this power was used. As such limited liability was simply a privilege granted by the Crown to whichever entity it deemed fit. Regardless, this Act was an important development as it was the first time that English Law had expressly addressed the concept of limited liability.

C. TRADING COMPANIES ACT, 1834

This Act empowered the crown to confer letters and privileges of incorporation without the Charter.

D. CHARTERED COMPANIES ACT, 1837

This Act empowered the Crown to grant letters patent. This meant that the Crown could grant the advantages of incorporation without granting a Charter to a body of persons associated together for trading purposes. Instead, the persons had to register a Deed of Partnership dividing the capital into shares and providing for transfers among other requirements under the Act before limited liability could be granted them. These letters patent did not however make such entities into body corporates and only granted them limited liability which they would not otherwise have entitlements.

⁶⁰ Mahoney P, 'Contract or Concession' 888

⁶¹ Mahoney P, 'Contract or Concession' 888

⁶² By the second half of the eighteenth century, limited liability, which had not been particularly important earlier, was becoming an increasingly important consideration to investors and promoters. DuBois reports that by this time, persons seeking charters were including limited liability as a motive for incorporation.

E. JOINT STOCK COMPANIES ACT, 1844

The Act was necessitated by the need to be able to incorporate a company by registration without obtaining a Royal Charter or sanction by a special Act of Parliament. This transformed registration from a privilege to a right obtainable once a company met the statutory requirements for registration. It introduced, for the first time, the notion of the formation and incorporation of a company for a commercial purpose by the act of registration by a promoter. No longer did would-be corporates have to obtain a royal charter or await the passing of an incorporating statute. Incorporation could be obtained by the administrative act of registration.⁶³ The act of registration creates the corporation.

The drafting of the sections of this Act seems to imply that the body corporate is simply the aggregate of the subscribers and members and this is why, in the 19th century, a company is referred to in judgments as 'they' or 'them'. This view is wholly superseded by the modern view that a company is separate from, and additional to, the members and is now always referred to as 'it'. The former view seems especially strange now that there is the possibility of companies being formed with a single member.⁶⁴

Among the disadvantages of the old deed of settlement companies was the difficulty in suing and enforcing judgments against them, since they essentially remained large partnerships.⁶⁵ Parliament reacted by commissioning a report on the law of partnership to propose a legislative solution. The report made two key suggestions: (1) that partnerships with more than fifteen partners are authorized to sue and be sued without suing the individual partners, and (2) that a form of entity with limited liability be authorized by statute. As a result of the report the Joint Stock Companies Act required partnerships of more than 25 persons to register, thus compelling the use of the new form of business association. Thus, there is one readily identifiable legal persona, which can sue to enforce the rights of the business and which can be sued to be held accountable for the obligations of the business. In present day the number of partners has been reduced to 20.

⁶³ Goulding S, *Company Law*, 7

⁶⁴ Goulding S, *Company Law*, 7

⁶⁵ Goulding S, *Company Law*, 7

When the English Parliament first established the registered company in 1844, it was initially envisaged that members would not escape liability for the debts of the company but there was a clear and significant difference from the position that existed with chartered corporations. Under the Act, a creditor had to proceed, first, against the company for the satisfaction of his debts and, if that did not recover the required amount, the creditor could then proceed directly against the members of the company personally. Further, a member would remain under such personal liability for three years.⁶⁶

The 1844 Act also established the Registrar of Companies. Originally, under the Act, a company only had to send a copy of its constitution, a list of members, a copy of any prospectus to the registrar and to present balance sheets to the registrar. This was because from the inception of the registered company, the idea of incorporation by registration was seen as a privilege or concession to businessmen and, in return for this, there had to be a certain amount of documentation which had to be open for public inspection and scrutiny.⁶⁷

The 1844 Act, however, denied one of the most sought after consequences of incorporation—freedom from personal liability; its object was to regulate, not to encourage, speculation. This resulted in lengthy and heated debate in Parliament, Royal Commissions, Departmental Committees, the Press, and, indeed in every forum of public and commercial opinion. Eleven years after it had been enacted.⁶⁸

Some other pertinent changes arising from the act include:

- i) Distinctions were made between public and private companies: any company with more than 25 members or with shares that were transferable without the consent of all members had to be incorporated i.e. public companies. Alternately, it prohibited other companies from the formation of partnerships or associations for profit making with more than 25 members i.e. private companies.
- ii) The creation of the office of the Registrar of Companies, where particulars of a company's constitution and its annual returns were to be lodged.

⁶⁶ Goulding S, *Company Law*, 9

⁶⁷ Goulding S, *Company Law*, 11

⁶⁸ Goulding S, *Company Law*, 7

- iii) Imposed liability on members of for the debts of the company just as if they were partners. Personal liability could cease three years after a member transferred their shares.

Although incorporation could now be done by registration, limited liability remained a privilege reserved for chartered companies. The members of registered companies had much the same liability for the debt of the company as they would have had for the debts of a partnership. As such, these members could still be held liable for unlimited losses.⁶⁹

As an adaptive response to this regime, companies began to include a limited liability clause in their internal rules. In the case of *Hallett v Dowdall*, the English Court of the Exchequer held that such clauses were binding for those who had notice of them.⁷⁰ This provided a means to exercise limited liability, despite the law's failure to provide for such an arrangement.

F. LIMITED LIABILITY ACT, 1855

The last step in the development of modern corporate law was the rediscovery of limited liability. It would have been a simple matter for Parliament to adopt limited liability in 1844, at the same time as the first general incorporation statute as the Report of the Law of Partnership had called for limited liability however it did not. In the 1850s, however, pressure for limited liability came from an unanticipated direction. Robert Slaney, a member of the House of Commons known as a champion of the poor, pushed successfully for the appointment of a parliamentary committee on investments for the middle and working classes. The committee heard testimony that the growing number of small savers found little outlet for their savings beyond government bonds; land was illiquid because of the complexity of titles and the expense of conveyance and unlimited liability made investment in joint-stock companies too risky for those who had only modest wealth. A subtler point was made, not surprisingly, by John Stuart Mill, who was called to testify before the Committee. "Mill anticipated the modern law-and-economics analysis of limited liability by pointing out that unlimited liability impaired the liquidity of shares by making the value of a share depend on the wealth of the holder. In particular, he noted that entrepreneurs of modest means could not easily incorporate a business

⁶⁹ Re Sea Fire and Life Assurance Co, Greenwood's Case (1854) 3 De GM&G, 459

⁷⁰ *Hawlett v Dowdall* (1852) 18 L.J.B. 2, 118 ER 1.

and attract capital from wealthy investors because the latter reasonably feared that they would be the only ones sued if the business became insolvent.

This Act gave legitimacy to the arrangements companies had begun to take due to the lacuna in the law discussed above. Shareholders could now limit their liability in the event of business failure to the amount unpaid on their investment in the company.⁷¹ If a company took up this option, the Act created the obligation that the word 'limited' was included in the name of the company. Companies seeking to enjoy limited liability had a minimum requirement of 25 members.⁷² This was a milestone in the development of the concept of limited liability in English Company Law as registered companies now had the option of limited liability.⁷³ In addition, it facilitated a sense of autonomy in the company structure by allowing members of a company to limit the extent of their own liability, without involving the Crown or Parliament.

Therefore, in 1855 Parliament enacted the Limited Liability Act, which allowed a company to claim limited liability in its registration documents so long as it met certain requirements, such as ending the name of the company with Limited.⁷⁴ This act was the most significant development with regards to the concept of limited liability in English Company Law as it empowered members of a company to limit the extent of their own liability without the involvement of the Crown.

The 1855 Act remained in existence only a few months when it and the 1844 Act, together with various intervening, amending and winding-up Acts, were repealed and consolidated in the Joint Stock Companies Act, 1856 which retained only the fundamental principle on which the 1844 Act had been based—the principle of publicity. If the liability of the members was to be limited the word "Limited" had to appear as the last word of the company's name, acting as a red flag warning the public of the dangers they ran if they dealt with the organization.⁷⁵ The 1856 Act had also prescribed a minimum of 7 members for a registered company, thus apparently ruling out the one-man business or the small family partnership.

⁷¹ Morse G, *Charlesworth and Morse Company Law*, 6

⁷² An exception was later made for insurance companies through the Companies Act 1862.

⁷³ Limited liability was previously only reserved for Chartered Companies.

⁷⁴ Mahoney P, 'Contract or concession', 891

⁷⁵ Gower L, *The English Private Company*, 2

G. JOINT STOCK COMPANY ACT, 1856

This Act amalgamated and substituted the Limited Liability Act and the Joint Stock Companies Act. The Act created a clear and simple registration regime, and removed the requirements on the paid up capital in the 1855 Act. Further, it introduced the Memorandum and Articles of Association of a company.

It made provision for winding up proceedings, distinguishable from bankruptcy proceedings for companies. Winding up of a company could be voluntary or involuntary under this Act. The Act provided for the liability of directors if they paid dividends while possessing the knowledge that the company was insolvent.

H. COMPANIES ACT, 1862

This Act replaced the concept of “joint stock” with the term ‘registered’ in furtherance of the understanding of the severability of the company entity from its members and administrators.⁷⁶ Additionally, companies could be limited by guarantee.

The courts of England also contributed to the development of companies: The House of Lords devised the principle of legal personality in the landmark **Salomon v Salomon and Company Limited case** where Lord MacNaghten was categorical in distinguishing the legal separation of the company as an entity from its owner as an individual and that the incorporation of a company could have a single member. Salomon was a boot manufacturer and a leather trader. He formed a company limited by shares where he, his wife, daughter and four sons all had one share. He then sold the company for a price, in return he got debentures secured by a charge on the company’s assets. After a depression the company went into liquidation. The assets were sufficient to satisfy the debentures but the unsecured creditors received nothing. The creditors challenged the payment of Salomon’s debt stating that the company and Salomon were one and the same. The court stated that Salomon was entitled to payment as the Company was a separate legal entity from Salomon. This case has remained instrumental in exemplifying the following principles:

1. Even companies with membership of only one member were distinct legal entities from the individuals who formed them;

⁷⁶ Salomon v. Salomon and Co. Ltd. (1897) AC 22

2. Apart from membership which was mainly obtained through shares, it became legally possible for a member to contribute to the company's debentures, and;
3. Following the recognition of a company's distinct legal personality, shareholders in a company could enjoy limited liability for the company's debts.

I. 1900 LEGISLATIVE AMENDMENTS

The Directors' Liability Act, 1890 introduced the liability of the directors of a company. It modified the common law of deceit espoused in **Derry v Peek**⁷⁷ and subjected directors to civil liability for untrue statements in prospectuses.

In **Derry v Peek**, the plaintiff, Sir Henry Peek (representing the shareholders of the company), sued the directors of Plymouth, Devonport and District Tramways Company, for fraudulent misrepresentation after he bought the company's shares in reliance on the prospectus which indicated that the company had the right to use steam and mechanical power. After buying the shares however, the Board of Trade refused to grant the company the right to use steam and mechanical power, resulting in the winding up of the company. At first instance, the court held that the directors were not liable for misrepresentation. On appeal, the decision was reversed as it was held that there is a need to hold the directors liable because the plaintiff has relied on the information which proved to be incorrect. The House of Lords however reversed this decision by holding that the action was one of deceit under which misrepresentation was not sufficient to prove liability. This case therefore served to set the threshold of liability high; by relying on the tort of deceit, directors could not be liable merely because of misrepresentation. The directors had to have known that they would not be able to follow through with their representation.⁷⁸ The Directors' Liability Act therefore lowered the threshold allowing for the directors to be more accountable.

J. COMPANIES ACT 1907

The Companies Act of 1900 introduced various new formalities, exempted from a number of them "a company which does not issue any invitation to the public." The Companies Act, 1900

⁷⁷ Derry v Peek [1889] LR 14 App Cas 337

⁷⁸ Derry v Peek [1889].

provided for the compulsory audit of the company's accounts. The Companies Act, 1907 provided for the rules regulating private companies mainly and it also introduced duties for auditors as well as a requirement for the holding of an AGM. It was by the 1907 Act, embodied in the new Companies (Consolidation) Act, that private companies were first given a statutory definition and clearly distinguished from others. Under the Companies Act 1907 a private company was defined as one which, by the company's constitution, restricted the right to transfer its shares, limited the number of its members to 50 and prohibited any invitation to the public to subscribe for any shares or debentures of the company. The 1907 Act was concerned with increasing the protection for investors who were considering subscribing for shares in a company by requiring it to provide relevant information when offering shares for sale to the public. This was to be done either through the established practice of issuing a prospectus or, in lieu of that, by requiring the company to furnish the Registrar of Joint Stock Companies with a statement containing the same information as would have been included in the prospectus. A private company was exempt from filing this statement. The distinction was born as a recognition of the existing state of affairs which had, by then, emerged and it was, by the beginning of the 20th century, too late to separate the provisions applying to each type of association into different statutes

K. THE COMPANIES ACT, 1948⁷⁹

The Act primarily provided for the accountability and transparency of operations of the Company.⁸⁰ It also gave shareholders the power to remove a director from office before the expiration of his period in office.

L. THE COMPANIES (AMENDMENT) ACT, 1967⁸¹

This Act amended the 1948 Act; it required all limited companies to file accounts and placed more stringent measures on director's interests in the company and disclosure thereof. The 1976

⁷⁹ The Companies Act 1948; the Act was considered the Principal Act in force in England was based on the report of a committee under Lord Cohen

⁸⁰ Sections 164-175 gave powers to the Board of Trade to order an investigation of the company's affairs.

⁸¹ The Companies (Amendment) Act, 1967; The Amending Act was based upon the report and recommendations of the Jenkins Committee presented in 1962.

Act also provided for provisions to strengthen the requirements of public accountability and those relating to the disclosure of interests in the shares of the company.⁸²

M. THE 1980s LEGISLATIVE AMENDMENTS AND AFTER

The distinction between public and private companies as was framed by the 1907 Act, namely, by defining private companies and classifying the remainder as public, lasted until the Companies Act 1980. During this period, the following proposals were given and amendments effectuated. The Companies Act 1980, when considerable amendments to the law were made, again for the protection of the public and those dealing with public companies; this time, though, the changes were made as a response to the Second Directive of the European Community. Now, it is the public company which is defined in the Companies Act and all other companies are considered to be private. A public company is one which states in its constitution that it is a public company and which complies with all the requirements laid down in the Companies Act for registration or re-registration of a company as a public company. Further, a public company cannot begin business or exercise any of its borrowing powers unless the Registrar has certified that the company has an allotted share capital of not less than £50,000. ⁸³ The 1980 Act also introduced the mandatory requirement that the name of a public company should end with the words 'public limited company' (which can be abbreviated to plc), in order to distinguish it more openly from a private company.⁸⁴

In 1981, two joint Reports of the Law Commission and the Scottish Law Commission⁸⁵ recommended many technical amendments to the existing laws in order to aid towards this end. Consequently, the Companies Act (Pre-Consolidation Amendments) Order No. 1 and 2, both of 1984 effected this various amendments which could however only come into effect when the consolidation took effect on July 1 1985.⁸⁶

The Companies Act of 1985 consolidates various Acts from 1948. The Act hived off some issues into separate Acts for example, provisions relating to the use of business names were separated into the Business Names Act, those relating to the insider dealing into the Companies Securities

⁸² Companies Act, 1976

⁸³ Goulding S. *Company Law*, 3

⁸⁴ Goulding S. *Company Law*, 4

⁸⁵ 1983 Cmmd.9114, 1984 Cmmd.9272

⁸⁶ S.I. 1984 No. 134, S.I. 1984 No. 1169

(Insider Dealing) Act while matters transitional matters, savings provisions, repeals and consequential amendments were all placed in the Companies Consolidation (Consequential Provisions) Act.

The 1985 Act remained the key company law Act in England along with some, up until 2006 when the current Companies Act of UK was enacted. One of the major contributions of this Act is the provision for the establishment of the one-person private limited company. Unlike before where there a private company needed to have at least 2 members, the company now can be formed by one person serving both as the director and the member. This has proved to be very beneficial for small business owners who work alone and no not want or need a business partner. Other notable highlights include the modernisation of company law by providing for electronic means of communication, the codification of existing common law principles on director's duties, and the overall simplification of company law, both substantive and procedural.

Hence the Companies Act of 1985 consolidated various Acts from 1948. The Act hived off some issues into separate Acts for example, provisions relating to the use of business names were separated into the Business Names Act, those relating to the insider dealing into the Companies Securities (Insider Dealing) Act while matters transitional matters, savings provisions, repeals and consequential amendments were all placed in the Companies Consolidation (Consequential Provisions) Act.

This perfect consolidation was however disrupted by the Insolvency Act of 1985 which, in a bid to implement some of the recommendations of the Cork Committee⁸⁷ repealed various sections of the 1985 Act relating to liquidation and other aspects of corporate insolvency replacing them with new concepts such as administration orders etc. The 1986 Insolvency Act consolidated all legislation on corporate liquidation and insolvency to the exception of director's disqualification which were consolidated into the 1986 Company Directors Disqualification Act.

Moreover, reforms were also conducted in the investment industry through the implementation of the Financial Services Act which had an impact of company law. First, it brought company securities, being investments, under its ambit and provided new rules for the public issue of shares whether listed on the Stock Exchange or otherwise. It also recast the position of the 1985

⁸⁷ Report of the Review Committee Insolvency Law and Practice, 1982 Cmnd 8558.

Companies Act relating to compulsory acquisition of shares on a take-over and amended the rules relating to insider trading.

For a long time the 1985 Act remained the key company law Act albeit some amendments, up until 2006 when the current Companies Act of UK was enacted. One of the major contributions of this Act is the provision for the establishment of the one person private limited company. Unlike before where there a private company needed to have at least 2 members, the company now can be formed by one person serving both as the director and the member. This has proved to be very beneficial for small business owners who work alone and no not want or need a business partner. Other notable highlights include the modernisation of company law by providing for electronic means of communication, the codification of existing common law principles on directors duties, and the overall simplification of company law, both substantive and procedural.

4.2 THE DEVELOPMENT OF COMPANY LAW IN KENYA

A. COMPANIES ACT, 1962

Kenya's first Company Act was the 1962 Companies Act, Cap 486. This Act borrowed heavily from the United Kingdom's 1948 Company Law Act, thus the history of the development of company law especially in relation to the UK is relevant to Kenya. We must also note that Kenya being a British colony and a common law country has a similar legal system to that of the United Kingdom and certain laws applicable there do form part of the Kenyan Law.⁸⁸ It is also worth noting that Kenya's company law hardly developed until the legislation of the 2015 Companies Act. This was due to several challenges in regulation. Thus a broad application of United Kingdom's law and common law led to certain challenges in the corporate sector.

Amongst these challenges are the provisions concerning the duties and responsibilities of directors, while section 45 of the repealed Act provided for director liability for issuing false prospectuses also allows the directors a defence or removal from liability where the prospectus was issued without consent and where he withdrew his consent. This provision protects the

⁸⁸ Section 3, *Judicature Act*, 1967

directors and leaves the shareholders unprotected and bearing the burden of proof to prove the wrongfulness of the director's action.⁸⁹ This provision is thus capable of abuse by directors since the directors would easily go unpunished. Sections 188 and 189 of the 1962 Act left shareholders vulnerable to unfair practices and fraud by directors. Section 188 (2) empowered the court to allow persons who have been declared bankrupt to act as the directors of the company. This provision would thus allow bankrupt individuals to raise capital using a limited liability company and in so doing remove themselves from liability. This has affected the capital market in Kenya through abuse by directors. The Anglo-leasing and Goldenberg scandals are examples of such abuses as LLCs were used fraudulently to raise capital for political purposes.⁹⁰ Section 189 further prevents persons accused of fraud from being barred from directorship for more than 5 years. This provision allowed for directors to be appointed to other companies despite having even been prosecuted.⁹¹ This unfair practice was further enabled by section 402 of the 1962 Act which provided that "If in any proceeding for negligence, default, breach of duty or breach of trust against an officer of a company ... it appears to the court hearing the case that that officer ... is or may be liable ... but that he has acted honestly and reasonably ... he ought fairly to be excused." The possibility of abuse of this provision is easily visible. Directors thus escaped liability in **Flagship Carriers Ltd v Imperial Bank** when the court using section 402 held that directors are only required to exhibit a degree of skill and care that may reasonably be expected from a person of their knowledge or experience, but they are not liable for errors of business judgment.⁹²

B. COMPANIES ACT, 2015

The 1962 Companies Act Cap 486 was repealed on 11th September 2015 following the presidential assent of the Companies Act, 2015. This Act brought about numerous changes to Kenya that has already been highlighted herein in the previous Chapter.

⁸⁹ Musikali M, 'The law affecting corporate governance in Kenya: a need for review', *International Company and Commercial Law Review*, 2008

⁹⁰ Munyi C, "Of Campaigning for Elections and Money Laundering", *Business Daily*, August 29, 2007

⁹¹ Mwaura J, 'The Kenyan Regulation of Company Directors: an analytical study', University of Wolverhampton, 2003

⁹² *Flagship Carriers Ltd v Imperial Bank*, High Court of Kenya, unreported Civil Case No.1643 of 1999.

CONCLUSION

In sum, company law developed in Kenya and in the United Kingdom quite differently. The historical stages and changes are distinct and different in both jurisdictions.

In the United Kingdom, over time, the law developed to remedy a shortcoming in a previous law. This is seen in the various extensive amendments to the laws dealing with companies outlined in this Chapter. Company Law in the United Kingdom developed over a very long period of time that started from the Bubble's Act and has become better over time in its regulation of the business environment in relation to companies. Company Law in the United Kingdom has grown over years solving emerging problems over the years.

On the other hand, Kenya borrowed its first legislation on Company law and also borrowed its latest legislation from the United Kingdom. The United Kingdom was solving the problems in its company laws with stages and the process took a long time historically to come up with an effective law that would govern the business environment in the country. Kenya, without considering the various differences in historical developments between her and the United Kingdom, heavily borrows rules and principles that solve the problems of another country without a careful consideration of the values of its people, the history, and the outcomes among others.

CHAPTER 5: RECOMMENDATIONS AND CONCLUSION

As seen in the discussion, the two Acts, The Companies Act and The Insolvency Act like any other pieces of legislations have their shortcomings. However, would this have been any different if the laws were drafted as a result of a critical study of Kenya's business environment before the enactment of the two laws? Does the act of borrowing laws from donor countries really solve the issues that they were meant to resolve in the recipient countries?

Many of our laws were heavily borrowed from a colonial-colony perspective and were applied to the population as a tool of domination. The forcible transplantation of law as a tool of domination is a less than desirable form of legal development. Transplanted legal systems are not rooted in the norms and values of the people and therefore face a greater challenge in effectively representing the interests and regulating the activities of the population as a whole. Similarly, as much as these two laws (The Companies Act and the Insolvency Act) have brought about significant developments and have aspired to bring a new regime in the business environment, they have faced a number of shortcomings. They have both faced a greater challenge in effectively governing the business environment hence the need for amendments.

Lord Denning stated that: "...in these far off lands the people must have a law which they understand and which they will respect. The common law cannot fulfil this role except with considerable qualifications..."⁹³ It is therefore important that legislations should be drafted to solve particular problems of the people. Law makers should assess the problems a society faces and make laws that solve these real problems. It is only when these laws solve the existing real problems in a society that it can be said that they are efficient in their operation.

It is my conclusion therefore that these two pieces of legislations were enacted either without their proper understanding or a lack of considerable effort to find out about problems in Kenya's business environment that needed to be solved. This attempt to take up rules wholly from other

⁹³ Nyalit Ltd v A.G. of Kenya [1955] 1 All E.R. 646 at 653

jurisdictions without their complete understanding and making them part of Kenya's jurisdiction is not an efficient method of coming up with legislations. It has very many shortcomings and is a lazy way of drawing up legislations.

Legal borrowing should only be used in moderation. The idea of legal borrowing is not an odd process as it has worked in various jurisdictions. However, its use wholly without considering other factors is what should be departed from. The Company's Act 2015 and the Insolvency Act 2015 have both fallen short of completely addressing the real problems in the business environment and it is for this reason that there are numerous sections of the said Acts that need to be amended. This would not have been the case had the legal drafters assessed the existing problems in Kenya's business environment in relation to insolvency and company laws.

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