The New Companies Act 2015 Has Come into Operation In Kenya

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Introduction

Many people will now be aware that Kenya has embarked on its long overdue transition to modern company and insolvency laws with the recent enactment of the new Companies Act, 2015 and the Insolvency Act, 2015. The purpose of this article is to highlight some of the main changes (and challenges) that will come with the new Companies Act, 2015 (**New Act**).

The New Act has drawn heavily on the Companies Act, 2006 of the United Kingdom. At 1,026 sections running to over 1,600 pages (without schedules) the New Act is by far the most extensive piece of legislation on the statute books in Kenya. By comparison, the old Companies Act (Cap 486) had 406 sections covering 270 pages (which included a regime for corporate insolvency); the 2010 Kenya Constitution has just 260 sections (without schedules). The scale of the new law is monumental. The comprehensiveness of its provisions will require a great deal of adjustment.

The UK Companies Act 2006 took more than three years to implement. Kenyans have been allowed just nine months to prepare themselves of the new regime. In many instances effective implementation will depend on the introduction of subsidiary legislation by the "Cabinet Secretary for the time being responsible for matters relating to companies" (**Cabinet Secretary**). These will have to be drafted. The institutions to support the implementation of the New Act will need to be set up, or reformed from their current operations under the old Act. Individuals will require a significant amount of training in order to be able effectively to administer the requirements of the New Act.

Transition to The Companies Act, 2015

For the time being the 'old' Companies Act, Cap 486, will continue to operate until the corresponding or new provisions of the Companies Act, 2015 come into force through legal notices prepared by the Cabinet Secretary in the Kenya Gazette. The Sixth Schedule of the New Act contains comprehensive Transitional and Savings provisions. Many parts of the New Act have been brought into force during recent weeks and the Companies Regulations 2015 are now also effective.

For the time being the Companies Registry will continue "as is" and registration of companies and all other company-related matters will continue under Cap 486. The Business Registrations Service Act is also to establish a new BRS service across the country for new business set-ups.

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 in the English system. However, the sheer scale of the legislation will have 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.

It is important to be assured that the New Act will not annul or invalidate the actions, rights and powers of existing companies incorporated in or already registered in Kenya. There will not be an overnight need to re-register or re-write the rules.

A Comprehensive Law

While the New Act does not usher in a whole new code for corporate governance and doing business in Kenya that revolutionises the law what it does do is to introduce a much heavier regime requiring substantial compliance. Companies in Kenya will need to devote greater resources to ensuring that their affairs are run in accordance with the new laws. The New Act is both a consolidation of laws on companies in Kenya and a modernisation of statute law on the subject.

The Kenyan administration and the judiciary will be under pressure in terms of resources and know-how in helping with the application and interpretation of the New Act. English law decisions, which are of persuasive value in the courts, are likely to be even more influential as we jump several generations of evolution of legal practice from early twentieth century company law to early twenty-first century law.

The Two Regimes: Private and Public Companies

One important feature of the New Act is the deliberate distinction now to be made between the regulated affairs of a private company and those of publicly-owned or stock exchange quoted companies. The emphasis has been to introduce a lighter-touch regime for small companies thus reducing the time and cost of business, while ensuring that companies with public participation are subject to greater levels of scrutiny and accountability.

Heavier Sanctions

One of the features of Cap 486 was the laxity with which many of its requirements were complied with. However, the New Act can no longer be ignored or avoided on the grounds of lax application or lenient penalties. Once the new law comes into operation, the comprehensive provisions, the extensive sanctions and potential consequences for company directors, officers and members will be serious. Companies and individual directors face civil and potentially criminal sanctions for non-compliance. The fines range from KES 100,000 to KES 15 million. Many fines are in the KES 500,000 to KES 1 million range. Imprisonment terms for indictable offences run from between one and five years, and in exceptional cases (e.g. fraud) 10 years.

One of the features of the New Act is that many provisions carry their own individual sanctions regime. Also, daily default fines are introduced.

Highlights of Main Changes

The following highlights the main changes brought about by the New Act when compared to the current system under Cap 486:

Company Formation

It will become possible for a single person to form a private and a public company. Formerly it was necessary to have at least two members for a private company and seven for a public company. A private company is still restricted to 50 members.

Other types of companies may be formed, as under the existing law: companies limited by guarantee (without or without share capital) and unlimited companies.

Constitutional Documents

A company's articles of association will become its main constitutional document and the company's memorandum will be treated as part of its articles. While it will still be important to file a memorandum of association to incorporate a new company, it will no longer form part of the company's constitution.

Historically, a company's memorandum of association contained an objects clause, which limited its capacity to act, or run the risk of an act, or power, being *ultra vires* the objects or powers contained in the constitution. Under the New Act a company's capacity will be unlimited unless its articles specifically provide otherwise, thus greatly reducing the applicability of the *ultra vires* doctrine to corporate law and removing the need for an excessively long objects clause in the memorandum. The memorandum no longer restricts the activities of a company.

New model articles for private companies to be made under the New Act are intended to reflect better the way that small companies operate, and will replace the existing Table A in Cap 486. Existing companies will be permitted to adopt the new model articles in whole or in part. The new model articles have yet to be published.

Public companies, especially those listed on the Nairobi Securities Exchange, will need to amend their existing articles, or adopt new articles, with the approval of the Capital Markets Authority.

Amendments to a company's constitution, and other resolutions passed by a company, must be filed within 14 days at the Companies Registry. The New Act imposes a penalty on the officers of the company for failure of KES 200,000, and a day fine of up to KES 20,000 for each day of delay.

Directors

A private company must have at least one director. A public company must have at least two directors. The New Act requires at least one director on the board of the company to be a natural person, although corporate directors are still permitted.

Directors will have the option of providing the Registrar with a service address, which will in future enable their home addresses to be kept on a separate register to which access will be restricted.

Company Secretaries

A private company with a share capital of less than KES 5million will not need to appoint a company secretary. This function can be carried out by an agent or by a director of the company. Private companies whose share capital is more than KES 5 million, and all public companies, must appoint a company secretary.

Consents to Appointment

At the time of registration of a company, and at any time a new director (or secretary) is appointed such person must consent to the appointment in writing. This is a new requirement. The New Act does not contain a requirement that resignations must be effected by way of letter supported by a statutory declaration by the outgoing officer, as is the current practice of the Companies Registry. It remains to be seen if the Cabinet Secretary will introduce this requirement by regulation.

Execution of Documents

Formalities for execution of company documents and contracts as a deed are introduced so that a single director can execute a document as a deed on behalf of the company by a simple signature in the presence of a witness. A document will be deemed to be validly executed as a deed if the document is duly executed by the company and delivered as a deed. It is no longer mandatory for a company to have a common seal. The modes of execution of documents will still need to be followed as required under other statutory requirements such as the Law of Contract Act and the Land Act.

Company Names

The main change on naming of companies (name approval and reservation with the Registrar will still be applicable) is on the distinction between private and public companies. Public limited companies may only be registered with a name that ends with the words "public limited company" or the abbreviation "plc" while the name of a private limited company must end with the word "limited" or the abbreviation "ltd." Changes of name must be filed within 14 days and become effective only upon issuance of a new certificate by the Registrar.

Enfranchising Indirect Investors

All companies will also be able to include provisions in their articles to identify some other party to exercise additional rights of the shareholder.

Nominee shareholders of listed companies will be able to nominate persons on behalf of whom they hold shares to receive copies of company communications and annual reports and accounts. This is to address the concern that shares in publicly listed companies are frequently held in an intermediary's name, which makes it more difficult for the beneficial owners of the shares to exercise their rights as shareholder.

The shareholders' ability to ratify any conduct of a director (including breach of duty, negligence, default or breach of trust) is regulated by the New Act, although it leaves the door open for common law principles, previously the only guide on this.

Under the New Act, directors who are also shareholders, or persons connected to them, are not entitled to vote in relation to any ratification resolution concerning their actions.

Existing restrictions on companies indemnifying directors against certain liabilities will be relaxed to permit indemnities by group companies to directors of corporate trustees and occupational pension schemes.

The New Act gives shareholders a statutory right to pursue claims against the directors for misfeasance on behalf of a company (a derivative action), although the shareholders need the consent of the court to proceed with such a claim.

Certain transactions between the company and its directors which were previously prohibited by law have become lawful subject to the approval of shareholders (for example, loans from the company to its directors).

Directors' Duties

The general duties of the directors as set out in the New Act are owed to the company and are largely based on common law and equitable principles in so far as they relate to directors.

The New Act replaces and codifies the principal common law and equitable duties of directors, but it does not purport to provide an exhaustive statement of their duties, and so it is likely that the common law duties survive in a reduced form. Traditional common law notions of corporate benefit have been swept away, and the new emphasis is on corporate social responsibility. The statutory duties should be interpreted and applied in the same way as corresponding common law rules and equitable principles (thus allowing developments in common law and equity to influence the interpretation of the statutory duties).

The seven codified duties are as follows:

- to act within their powers - to abide by the terms of the company's memorandum and articles of association and decisions made by the shareholders;
- to promote the success of the company - directors must continue to act in a way that benefits the shareholders as a whole, but there is now an additional list of non-exhaustive factors to which the directors must have regard. These factors are:
- the long term consequences of decisions
- the interests of employees
- the need to foster the company's business relationships with suppliers, customers and others
- the impact on the community and the environment
- the desire to maintain a reputation for high standards of business conduct
- the need to act fairly as between members;

- to exercise independent judgment - directors must not fetter their discretion to act, other than pursuant to an agreement entered into by the company or in a way authorised by the company's articles;
- to exercise reasonable care, skill and diligence - this must be exercised to the standard expected of
- someone with the general knowledge, skill and experience reasonably expected of a person carrying out the functions of the director (the objective test) and also
- the actual knowledge, skill and experience of that particular director (the subjective test);
- to avoid conflicts of interest - methods for authorising such conflicts by either board or shareholder approval are also to be introduced;
- not to accept benefits from third parties; and
- to declare an interest in a proposed transaction with the company - there are to be carve outs for matters that are not likely to give rise to a conflict of interest, or of which the directors are already aware. There will be an additional statutory obligation to declare interests in relation to existing transactions.

Other Provisions on Directors

A company director’s service agreement for a term of more than two years requires shareholder approval.

There are comprehensive controls of the rights of companies to make payments to directors for loss of office. The general proposition is that such payments are prohibited unless approved by the members. There are several exceptions to this contained in the relevant section (payments made in discharge of an existing obligation, etc.).

It is no longer a requirement to register details of other directorships held by a director.

Director’s Disqualification

For the first time the New Act introduces statutory provisions covering the disqualification of persons acting as directors. A director can be disqualified under the New Act or under the insolvency laws or any other enactment prescribed by regulations for the purposes of the section e.g. the Capital Markets Act.

A disqualification order made by the court will function against the following office holders:

- an officer of the company;
- a liquidator or provisional liquidator of a company; and

- administrator of a company under administration.

A disqualified person will cease to be director or a secretary of the company and will not be authorised to act as a liquidator or administrator with regard to the company or supervise any voluntary arrangement entered into by the company. A disqualification prohibits the person from being involved with the promotion, formation or management of a company, directly and indirectly.

Disqualification can be for anything between two and fifteen years, as ordered by the court. Anyone who defies a disqualification order or undertaking may be fined up to KES 1 million or imprisoned for up to 5 years, or both.

An undischarged bankrupt may not be appointed as a director and persons who are disqualified from holding office as a director in a foreign jurisdiction may likewise be barred in Kenya.

Shareholders Meetings and Resolutions

Shareholders' written resolutions in private companies - the requirement for unanimity in shareholders' written resolutions has been abolished, and the required majority is similar to that for shareholder meetings - a simple majority of the eligible shares for ordinary resolutions, or 75% for special resolutions.

Abolition of Annual General Meetings (AGMs)- private companies are no longer required to hold AGMs, although they can elect to provide for them in their articles if they wish.

Short notice of meetings - private companies can convene meetings at short notice where consent is given by holders of 90% by nominal value of shares carrying the right to vote.

The notice of a general meeting for a public company may be given in hard copy or electronic form, or by means of a website. The current practice of issuing notices of meetings by newspaper advertisement is not catered for and is therefore unlawful, unless the Regulations change this.

A public company is required to hold its AGM within six months of the end of its financial year.

Shareholder communications - The New Act makes it easier for companies to communicate electronically (e.g. by email or by website) with their shareholders by express agreement (which agreement can be obtained under the articles, or by the shareholder failing to indicate that they do not wish to communicate via the website, as well as by more conventional methods).

Share Issues

The New Act introduces a statutory framework for pre-emption rights on new issues of shares. These can be dis-applied completely by private companies but not by public companies – where general or specific waivers of such rights can be obtained for specified amounts and for fixed periods of time.

Shares in public companies must be paid up as to a minimum of one quarter of their nominal value.

A public company is prohibited from allotting shares as partly or fully paid up otherwise than in cash unless the consideration for the allotment has been independently valued in the manner set out in the New Act.

Financial Assistance

A private company will be permitted to provide financial assistance for the purchase of its own shares if the company's principal purpose in providing the financial assistance is not to give it for the purpose of any such acquisition, or the giving of the assistance for that purpose is only an incidental part of some larger purpose of the company and the assistance is given in good faith in the interests of the company.

Financial assistance for the acquisition of shares in a public company is still prohibited to be made by the company or any other company that is its subsidiary of it.

There are certain statutory carve-outs to the prohibition on financial assistance that if properly structured may open the door to what are called leveraged-financed acquisitions.

Unfortunately, there appear to be some drafting errors in the New Act on these provisions which will need to be tidied up before the relevant provisions are brought into law.

Share Buy-Backs

The New Act also permits companies to buy-back or repurchase their own shares. This is only permitted for a public company if extensive procedures for approval and terms are followed. Share buy-backs have not been specifically excluded from the financial assistance provisions in the New Act. Accordingly, there could be difficulty in implementing share buy-backs as they could arguably be subject to the financial assistance provisions..

Offers To The Public

The New Act sets out provisions on the meaning of and requirements for an offer to the public. The provisions of this part need to be reconciled with the extensive provisions of the Capital Markets Act on 'public offers' as contained in the Capital Markets Public Offers Listing and Disclosures Regulations.

Treasury Shares

Treasury shares are shares that, effectively, a company holds in itself. Shares can only be transferred into treasury where they have been purchased by a company from a shareholder out of distributable profits in accordance with the New Act and the shares are qualifying shares (i.e. are included in the list in accordance with the Capital Markets Act, or they are traded on a regulated market).

Interests In Shares

In order to create greater transparency the New Act allows a public company to investigate the ownership of its own shares through a notice procedure. This right may be circumscribed by regulations.

Take-Overs of Public Companies

The New Act will establish a statutory framework for the regulation of takeover activity. The Capital Markets Authority (the "CMA") may make rules called Takeover Rules which may regulate bids, merger transactions and transactions that have or may have a direct or indirect effect on the ownership or control of companies. The Takeover Rules must be published by the CMA. It remains to be seen how these provisions will interact with the existing CMA regulations on takeovers.

Cap 486 did not specifically regulate mergers and acquisitions, but had an impact on the financing of an acquisition since it prohibited a company from giving financial assistance to any person in acquiring its shares. The New Act, however, provides a statutory and procedural framework, together with the law of contract, which forms the legal basis for the purchase and sale of public companies in Kenya. The New Act introduces a new perspective on handling issues to deal with mergers and acquisitions of public companies in Kenya and it is not clear how this Part will interact with the rules of take-overs of public companies in the New Act and as legislated for under the Capital Markets Act.

Annual Financial Statements

Under the small companies regime, a small company is one which satisfies two or more of the following requirements:

- has a turnover of not more than fifty million shillings (KES 50,000,000);
- the value of its net assets as shown in its balance sheet as at the end of the year is not more than twenty million shillings; and
- it does not have more than fifty employees.

A small company does not need to prepare group financial statements.

Companies that are excluded from the small companies' regime include a public company, a group company whose 'group' consists of a company which is a public company, a body corporate whose shares are admitted to trading on a securities exchange or other regulated market in Kenya or a person who carries on business in the insurance market or a banking activity.

Under the New Act, <u>both</u> private and public companies are required to lodge their financial statements with the Registrar.

A new regime allowing for preparation and circulation of summary financial statements has been introduced.

Dormant companies are no longer to be required to produce accounts.

In a similar vein small companies are not required to appoint auditors so long as they continue to qualify for the exemption on preparing audited financial statements.

Annual Returns

The 42-day period allowed for filing annual returns with the Registrar has been reduced to <u>28 days</u>.

Protections Against Oppressive Conduct

Protection of members of a company has been enhanced. Members now have the *locus standi* to go to court and challenge a conduct that they think is oppressive or unfair.

Any investigations by or on behalf of the CMA (under section 13A of the CMA Act) can now be acted upon by the Attorney General where members of a listed company have been treated unfairly or oppressively in a manner prejudicial to interests of members.

Company Charges

The deadline for registration of a charge is now 30 days from the day on which the charge is created, down from the current period of 42 days. This could pose a challenge if there are delays in stamping of charges.

Dissolutions, Etc.

The New Act contains more substantial provisions on the procedures for dissolution of companies by the Registrar, striking-off and applications for restoration to the register.

Foreign Companies

The New Act contains more extensive disclosure and compliance requirement for companies that are incorporated outside Kenya that wish to register to do business in Kenya, including the unexpected requirement to have at least thirty percent of the company's shareholding held by Kenyan citizens by birth. Failure to comply carries a fine of KES 5 million.

There will be a foreign company register and the Cabinet Secretary will have to issue specific Foreign Companies Regulations.

So far as we can tell this requirement will not apply to existing foreign companies that are already registered in Kenya under Cap 486.

Fraudulent Trading

The New Act codifies the common law offence of fraudulent trading and makes persons who carry on a business of a company with the intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose liable on conviction to imprisonment of a term not exceeding ten years, or a fine of an amount not exceeding ten million shillings, or both.

Company Records

Company records may be kept in hard copy or electronic form and arranged in a manner the directors deem appropriate so long as it ensures that the information is accessible for future reference, and can be converted into hard-copy form if needed.

Service of Documents

The Cabinet Secretary is to make regulations (the Companies Communications Regulations) that are to have effect on the provisions of Kenyan statutes that require or permit documents to be sent or supplied by or to a company.

Transmission of company documents in electronic form is permitted, although a member or debenture holder can request that the document is delivered in hard copy form. Documents and information in either hard copy or electronic form are taken to be received by the intended recipient 48 hours after it was sent or supplied.

For information published on a website, it is taken to have been received by the recipient when the material was first made available on the website or if later, when the recipient received notice that the material was available on the website.

Further Regulations

The Cabinet Secretary is given various powers to make regulations for the purposes of the New Act. Without limitation the regulations may prescribe a range of matters, including:

- Accounting standards bodies;
- Maintaining and lodging documents with the Registrar;
- Allocation of unique identifying numbers for companies;
- New or amended forms (Company Forms) and how they can be signed or authenticated;
- Prescribed requirements for sending notices of meetings, lodging of resolutions, proceedings at meetings etc.;
- Methods of appointment of proxies;
- Prescribe time periods; and
- Prescribe offences.

Sixth Schedule – Transitional and Savings Provisions

The Cabinet Secretary has the powers to make savings and transitional regulations. The Sixth Schedule contains important Transitional and Saving Provisions.

Some examples of the savings provisions that will survive the New Act include:

- the validity of any companies registered under Cap 486 and company instruments (such as share certificates, register of members etc.);
- the application of Table A (template Articles of Association provided under Cap 486) in so far as it applies to an existing company prior to the commencement of the New Act;
- changes made to companies including change of names and alterations to memorandum and articles of associations that occurred under the provisions of Cap 486;
- the validity of acts of directors, as in force immediately before the repeal of Cap 486, will continue to apply; and
- the rights of debenture holders under debentures created under Cap 486.