BUSINESS LAW II

COURSE OUTLINE 1

1. Brief Introduction to Company law in Uganda.
2. Types of Companies.
3. Formation of Companies.
4. The Ultra Vires Doctrine.
5. The concept of corporate personality. (Nature and Consequences of Incorporation).
6. Companies distinguished form other types of Business Entities.
7. Promotion and Incorporation of Companies.
8. Pre - Incorporation Contracts.
9. Lifting the veil of Incorporation.

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INTRODUCTION TO COMPANY LAW IN UGANDA

Since 1844, companies have been created by registration under the Companies Act of Uganda, *Cap 85, Vol. III, Laws of Uganda*. This Act is a combination of the English Law and the principles of equity and natural justice. The concept of a registered company was introduced in Uganda by the colonialists who recognised companies as economic units used for conducting trade and business.

The main purpose of Company Law is to regulate the formation, activities, officials and the winding up (closing down) of the Company, as regulated by the Companies Act. The law also considers the mechanisms by which the company, which is a distinct legal person, raises funds through the issue of shares to the public and through borrowing. The special position of the shareholders as owners of the assets of the company is considered together with their rights and duties with regard to voting and meetings.

**TYPES OF COMPANIES**

**What is a Company?**
A company is a legal entity, a fictitious person/body, separate and set apart from its members or shareholders. This legal personality is an artificial one, with powers to sue or be sued and transact business. It is brought into being by the registration procedures laid down by the Companies Act.

**Types of Companies**

**A. PUBLIC AND PRIVATE COMPANIES**

Under Section 4(1) of the Companies Act, provision is made for the types of Companies that can be lawfully formed in Uganda. Principally these can be divided into 2 broad categories.

a. **Private Companies**

Section 30 of the Companies Act defines a private company as a Company, which limits the number of its members to 50 excluding past and present employees of the company who are shareholders, and which by its articles restricts the rights to transfer shares of the company to the public.

That is, these are companies whose required minimum number of members is 2 people. This can be seen in the case of *Lutaya V Gandesha (1987) HCB 49* where a man and his wife formed a private company with 1500 shares, of which the wife held only 2 shares.

They also prohibit any invitations to the public to purchase or subscribe for any shares or...
debentures of the company, and private companies commence business immediately, on incorporation. Where a private Company does not comply with these requirements, according to S.31, it loses exemptions and privileges conferred on a private company.

This failure can only be remedied upon showing court that it was caused by accident or inadvertence or some other sufficient cause; or that it is just and equitable.

b. **Public Companies**

The minimum required number for public companies is 7 and it goes up to infinity. Its Memorandum of Association must state that it is to be a public company and its registered name normally ends with the words public limited company (plc.).

A public company must have at least 2 directors though for a private company, the statutory minimum is one director. A public company may offer its shares / debenture to the public for subscription or purchase; but the offer is in a prospectus to which elaborate rules are applied. These companies cannot commence business immediately on incorporation. Should first have a trading certificate. S. 111(4).

A company registered as a public company on its original incorporation may not do business nor exercise any borrowing powers unless they are provided in its Memorandum of Association and articles.

To sum up, the decisive advantage of a public limited company over a private company is its right to raise capital from the public.

A private company may be converted into a public company by altering its Articles to exclude the restrictive provisions on the transfer of shares.

**B. LIMITED AND UNLIMITED LIABILITY COMPANIES.**

Under S. 4 (b) of the Companies Act, a Company whether public or private may be

- limited by shares
- limited by guarantee
- unlimited companies

a. **A Company Limited by Shares**

This is a company whose Memorandum of Association limits the liability of its members to the amount unpaid on their shares.

b. **A Company Limited by Guarantee**

Here, the liability of the members is limited to such amount as they may have undertaken to
contribute to the assets of the company in the event of its being wound up. These are commonly found in charitable organizations, religious institutions, research institutions, etc. This in essence shows that they are mostly the current bodies referred to as NGO’s.

c. Unlimited Liability Companies:
This is one where there is no limit on the liability of the members. The members are therefore liable for all the debts of the company, on winding up.

C. HOLDING AND SUBSIDIARY COMPANIES

A company may hold the majority shares in another company or several other companies where its Memorandum of Association gives it express power to do so. In such a case, the companies stand in the relationship of holding company and subsidiary company, with the holding company being the one that holds the majority share holding in the other company, (subsidiary company). Subsidiary status may be acquired by purchase or takeovers. Section 154

FORMATION OF COMPANIES

A company is formed by presenting certain documents to the Company Registry for registration. These documents include the following:

1. THE MEMORANDUM OF ASSOCIATION

The company’s most important document, as it determines the powers of the company is the Memorandum of Association. In Guiness V Land Corporation of Ireland (1882) 22 Ch. D 349, it was established that the Memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors and the outside public as well as the shareholders. These elements include:

a. Name of the Company
b. Where the registered office is situated.
c. The objects of the company. (The objects clause).
d. A statement to the nature of the company (Whether private or public).
e. A statement that the liability of the members is ltd if it is a limited liability company. It states whether it is limited by shares or by guarantee. Where it is limited by guarantee, there is an additional clause, which states the amount with which each member undertakes to contribute in case of winding up i.e. the maximum amount of the guarantee.
f. If the company is a limited by shares, the amount of its authorized share capital divided into shares of fixed amount.
g. It ends with a declaration that the subscribers wish to form the Company in pursuance of the Memorandum of Association and agree to take the number of shares.
a. Name of a company

This is required by the Companies Act to be clearly shown in the Memorandum of Association and the Business Names Registration Act, Cap 87, Laws of Uganda shows the names allowed to be used. The law excludes:

- Names which show concern with the government.
- Names which are already registered.
- Names which are identical with the one to be registered to avoid infringement of the good will of the old company by the new one.
- Names with illegal or abusive connotations

b. The objects clause

This sets out the principle activities that are to be pursued by the incorporated company. The objects must be lawful and should include all the activities which the company is likely to pursue. The objects determine what the company is going to do, and the company cannot carry out any activity that is not expressly provided for in the Objects Clause.

c. Limitation of liability

According to Sections 14 & 16, the objects clause is followed by a clause which states that the liability of members is limited. This is mandatory even for a company which is allowed to dispense with the word "ltd" in its name.

d. The capital clause

Any company limited by shares must state its nominal capital and the value of each of the shares into which the share capital is to be divided. If the company is limited by guarantee, the Memorandum should state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within 1 year after ceasing to be a member such amount as may be required, not exceeding a fixed amount, eg. 200,000/=.

e. The associative clause

The Memorandum of Association normally concludes by or with an associative clause, by which the two or more subscribers state that they are desirous of being formed into a company in pursuance of the Memorandum of Association and if the company has a share capital, that they respectively agree to take the number of shares set opposite their respective names. The attested signatures of the subscribers then follow. An associative clause is the foundation of the statutory contract between the members of the company and the company itself when incorporated.
Alteration of the Memorandum of Association

Alteration of the Memorandum of Association can take place in the following ways:

1. **Alteration of the Objects Clause under S. 8.**

There are a number of requirements which must be satisfied before a company can alter its objects clause.

- There must be a special resolution. A special resolution is a resolution which requires 3/4 of the majority of all members to vote and the notice of the meeting in which it was passed was not less than 28 days prior to the meeting. Otherwise, non-compliance renders the resolution ordinary.
- Such alteration is limited to the objects of the company, (S. 8 (1)). An omnibus alteration of the objects is not permitted and the alteration can still be challenged. It is not any shareholder that can call such a meeting to alter.

Alteration can be carried out to:

a. Carry on the companies business more economically or more efficiently.
b. Enlarge or change the local area of its operations.
c. Attain any of its earlier objects by an improved or new means which were not earlier foreseen.
d. Carry on some business under existing circumstances may conveniently or advantageously be carried on with the business of the company.
e. Restrict or abandon any of the objects specified in the Memorandum of Association or sale or dispose the whole of or any part of the undertaking of the company.
f. Amalgamate with any other company or body of persons.

According to S.8, a company cannot rely on ground (d) where the change is so fundamental that it amounts to changing the basic business of the company and as stipulated in the case of **Re Drages (1942) ALL ER 194.**

Alteration should not oppose or be incompatible with the existing object. In **Recylist Touring Club (1902) 1 Ch. 269;** the object was to promote and assist the use of the bicycles and other similar vehicles on the roads and to protect the members against motorists. The company purported to alter the object to allow motorists to join it. The court refused to allow the alteration because the change would have fundamentally altered the character of the club activities and the protection of the members against motorists was one of its original objects, hence the new activities would have been inconsistent with the original purpose of the club.

Under S.8 (2) (a) and (b) the **locus standi** of those who can challenge the company is laid down. If they are shareholders, they must constitute 15% of the numbers of the company without share contract or they must be holders of 15% of the companies share capital. Creditors owning 15% of the company's debentures can also challenge the alteration of the
objects clause. They must do so within 21 days of the resolution.

2. Alteration in respect of the company share capital.
The Memorandum can be altered where the share capital of the company is being altered. This is subject to the following:

- Applicable to companies limited by shares or by guarantee or
- According S. 63, such alterations of the share capital must have been authorised by the Articles of Association by:
  - a. Creating some shares
  - b. Cancelling some shares
  - c. Converting paid up shares into stocks and vice versa.
  - d. Issuing new shares

2. ARTICLES OF ASSOCIATION
The articles regulate the manner in which the company's affairs will be managed. They serve as regulations for its internal management of the company. That is, they determine how the company objects will be achieved and how the powers spelt out in the Memorandum of Association will be exercised (see sections 9 - 13 of the Act). They deal with such matters as the allotment and issue of shares, the rights attaching to shares, transfer, transmission of shares, conduct of general meetings and the right to receive notice and to attend and vote, the appointment and powers of directors, the accounts and payment of dividends etc.

The Companies Act contains a modelled form of articles (table A) which applies to companies limited by shares. These regulate the company unless it has its own special articles which totally or partially exclude table A. The advantage of statutory model articles are:

- That legal drafting of special articles is reduced to a minimum since even special articles usually incorporate much of the text of the model.
- There is flexibility since any company can adopt the model selectively or with modifications and include in its articles special articles adapted to its needs. Every company except that limited by shares must have its own articles of association. In practice, public companies have their own articles. Companies limited by shares may also have their own articles under Sect. 11(1) but if they don’t register them, then, according to sect 11(2), Table A automatically applies. These must also be signed and their signatures attested by the subscribers.

Interpretation of the Memorandum and Articles of Association
The Memorandum of Association is the basic law or constitution of the company and the Articles are subordinate to the Memorandum of Association. It follows therefore that if there is a conflict between the Memorandum and Articles of Association, the Memorandum prevails. The articles are void to the extent of the inconsistency or conflict.
Where there is ambiguity but no conflict, the Memorandum of Association and articles must be read together to remove any ambiguity or uncertainty. E.g. in *Re South Durham Brewery Co Ltd, (1885) 31ch. D 261*, the Memorandum of Association was silent as to whether the companies shares were to be all one class or might be of different classes. It was held that a power given by articles to issue shares of different classes resolved the uncertainty and enabled the company to do so.

If a company limited by shares has its own Articles, the regulations contained in TABLE A still govern it so far as its own Articles do not expressly exclude or modify these regulations in TABLE A. Table A Articles must thus be read with the company’s Articles except where they are inconsistent with it.

The fact that the Articles deal with the matter in question does not *per se* exclude TABLE A. In *Fisher-Vs. Black Publishing Co (1901) 1Ch. 174*, the Articles provided that a company’s profit available for dividends should be applied in a certain order amongst the different classes of its shareholders. It was held that directors could nevertheless set aside reserves out of it before paying any dividends at all, relying on the power to do so, given by table A.

Where draftsmen do not want Table A to be referred to, they expressly exclude its application from the Articles.

Any member of the company may under *Sect.26 (1)* of the Act require the company to supply him with a copy of the Memorandum and Articles of Association at a nominal fee. A penalty for failure to comply is spelt out in *Sect.26 (2)*. Under *Sect 27(1)*, the issued copies of the Memorandum of Association must contain any alterations if any and under *Sect 22(2)*, penalties for the company and the defaulting officers are set.

**Contractual effect of the Memorandum and Articles of Association**

Under section 22, the general principle is laid that when the Memorandum and Articles of Association are registered, they constitute the following contracts.

1. The Memorandum and Articles when registered bind the company and the members to the same extent as if they respectively had been signed and sealed by each member, and they contain covenants on the part of each member to observe all the provisions of the Memorandum and Articles.

Eg, in the case of *Hickman-Vs-Kent and anor, (1915) 1Ch. 881*. Hickman had been expelled from the company whose Articles contained a clause that any dispute between a member (or members) and the company should be referred to arbitration. Hickman took the company to court, instead of going for arbitration, as stipulated in the Memorandum and Articles. The company applied to stop the court proceedings on the ground that recourse to court was not open to members of the company who according to the Memorandum and Articles could only recourse to arbitration. The court accepted the company’s reasoning and stopped the court proceedings.
2. The company is bound to each individual member. Every member may enforce his rights against the company by legal action, by virtue of the existence of the Memorandum and Articles of Association.

In *Eley V Positive Government Security Life Assurance Co. Ltd (1876)*1 Ex. D 20, a clause in the Articles provided that Eley would be employed for life as the company’s lawyer. Eventually, Eley became a shareholder. At a later stage, the company ended his services. Relying on the clause in the Articles, Eley sued the company. It was held that the Articles bound the company to its members in their capacity as members and accordingly, Eley’s claim could not succeed on the basis of the Articles, (because his claim was based on his services as the company’s lawyer).

3. The members are bound to each other. Articles constitute a contract between the members *inter se*. In *Rayfield V Hands (1958)*2 All E R194, it was held that where the Articles of a private company gave a personal right to a member, such right was enforceable directly against another member.

4. A contract with non members may be implied. The Articles do not constitute a contract between the company and third parties. A clause in the Articles may however form the basis of a contract. Eg, if the Articles set out the terms as to remuneration to be paid to directors and the director takes office on that basis, the court will infer that the terms are part of his contract with the company. *Re New British Iron Company; Exparte Beckwith (1898)*1 Ch. 3.

**Alteration of Articles**

A company can alter its Articles by special resolution. A special resolution is an agreement passed by a majority of not less than ¾ of such members as are entitled to vote. The alteration will generally be valid unless if:

- It is illegal.
- It conflicts with provisions of the Companies Act.
- It extends or modifies the Memorandum.
- It deprives members of rights conferred on them by the Company Act or by court.
- It requires a shareholder to take or subscribe for more shares or increases his liability to contribute to the company.
- It amounts to fraud on the minority.

**3. OTHER DOCUMENTS REQUIRED TO COMPLETE THE FORMATION OF THE COMPANY.**

1. A statement of the address of the intended registered office of the company signed by subscribers to the Memorandum of Association delivered to the registrar to obtain incorporation. This address becomes the registered office of the company on incorporation.

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2. A statement signed by subscribers of the Memorandum of Association setting out the names of the subscribers and the secretary of the company and containing information in respect of directors and secretaries together with the consent of those people who have consented to act in those capacities.

3. A statutory declaration by an advocate engaged in forming the company or any director or secretary named in (2) above, stating that the requirements of the Act regarding registration of the company have been complied with (Sect.17). The registrar may accept such declaration as sufficient evidence of compliance.

4. A statement of nominal capital.

Stamp duty must be paid. According to Sect. 4, the higher the figure of nominal capital registered, the higher the charge for stamp duty, which stamp duty normally varies as a given percentage of the nominal capital.

The necessary registration fees must also be paid to the registrar on presenting the documents for registration.

**CERTIFICATE OF INCORPORATION**

Under Sect.17, this serves as conclusive evidence that all the requirements of the Companies Act in respect of registration have been complied with and the company is the company authorized to be registered and is duly registered under the Act. The legality and validity of the company’s incorporation cannot thereafter be challenged even if some irregularity is later discovered. *The proper procedure of disposing of a company whose objects are illegal therefore is to have it wound up rather than to revoke its incorporation.*

**COMMENCEMENT OF BUSINESS**

A private company may commence business and execute all its powers as soon as it is incorporated. However, the power to make contracts is normally vested in the directors. Thus, there must be at least one meeting of the directors or a general meeting.

**CHANGE OF NAME**

S(20) provides that the company may by special resolution change its name. If you want to change the name you must equally alter the Memorandum of Association as Article 1 of the Memorandum of Association usually specifies the name of the company.
THE ULTRA-VIRES DOCTRINE

The ultra-vires doctrine restricts an incorporated company to pursue only the objects outlined in its registered Memorandum of Association or which are reasonably related or incidental to the achievement of the said objects.

It refers to anything, which is done purportedly on behalf of the company, but without the company’s pre-requisite authority in its objects clause. The word "ultra-vires" is a Latin word meaning "beyond powers". The powers of the company are laid down in the objects clause of the Memorandum of Association, which set up the company.

Ashbury Railway Carriage Co. Ltd V Riche (1875) L.R 653

The company was incorporated under the British Company’s Act. Clause 3 of the company/s memorandum provide that the objects for which the company was established was “to make and sell or lend on hire, railway carriages and wagons and all kinds of railway plant, fittings, machinery and rolling stock...” The company agreed to provide Riche with finance for the construction of a railway in Belgium. The company later repudiated the agreement and Riche sued. The company argued that it was ultra vires for the company to enter into a contract to provide finance. It was held that even if ratification had taken place, it would have been ineffective to cure an act which was clearly beyond the powers of the company.

Lord Cairns said that a company only comes into existence for the objects stated in the memorandum and this was the condition for its incorporation and existence. The objects form the extent of the powers which by law are given to the corporation and nothing is to be done beyond that ambit.

Consequences of acting ultra-vires

As seen in the case of Ashbury Railway Carriage Co.Ltd Vs Riche 7 (House of Lords 653 (1575)) it was held that the contract was ultra vires to the company thus void so that not even the consequent assent of the whole body of shareholders could ratify it.

Effect of the Ultra Vires Doctrine

1. According to the Ashbury Railway Carriage case, generally speaking, contracts, which are patently ultra vires, are void and is unenforceable neither by the company nor by another party to it

2. Consequently not only the company itself but also third parties can rely on the fact that the contract is ultra-vires in order to escape liability under it.

3. Any contract which is ultra-vires to the company cannot be ratified.

Relevance of the Ultra Vires Doctrine

1. The aim of the doctrine is to protect investors in the company so that they know the objects for which their money is used.
2. To protect creditors of the company so that the funds of the company are not used in unauthorized activities.

3. To give protection to the subscribers who learn from the objects clause the purpose for which their money is going to be used.

**Evading the ultra-vires doctrine**

In practice today, drafters of the Memorandum have evaded the doctrine in the following ways:

- By putting as many possible or related objects as possible.

- By listing the objects of the company at great length so as to include every conceivable activity which the company may carry out.

- By including in the objects clauses related objects as much as possible so that none of the enumerated objects would be constructed or interpreted restrictively.

- By describing in the objects clause what essentially are the powers of the company.

- By firstly giving a wide liberal interpretation to the objects clause, so that whatever can be regarded incidental to the objects clause is held to be intra-vires”.

- By allowing the practice of incorporating an "independent objects clause". The last paragraph of the objects clause is made in such a way that indicates that the company may enter into any transaction as the Board of Directors may decide or deem incidental or necessary and that none of the objects is to be interpreted in light of each other.

- S. 8 allows the company to amend its objects clause.

**Who may invoke the doctrine**

The question is whether the company can invoke the doctrine, or whether a third party dealing with the company can also invoke it.

In *Bell Houses Co.Ltd Vs City Wall Properties Ltd (1960) 2 ALL ER 674*, it was held that if a third party or the defendant in that case were to be sued in a transaction he is entitled to plead that the contract on which he is being sued is ultra vires.

In *Re Jon Beauforte (London) Ltd (1953) 1 All ER 634*, where the Memorandum authorised the company to carry on the business of costumes and gown makers, but the company instead decided to do the business of candle makers, which was ultra vires, the action against the company's ultra vires acts was brought by the liquidator. In summary, the position is that:

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a. A member of the company can sue for an injunction to restrain the company or its directors from doing an *ultra vires* act.

b. A creditor has no *locus standi* to sue even though the *ultra-vires* act will diminish the company assets and make it less able to pay the debt.

c. It seems under the authority of *Lawrence Vs West Somerset Mineral Railway Co (1918) 2ch 250*. A creditor can sue if the *ultra-vires* act will affect the property on which his debt is secured.

**Remedies in the event of *ultra vires* acts.**

**a. Tracing**
One of the remedies available on a transaction which is *ultra-vires* could be the *equitable doctrine of tracing*. A third party can trace his money from either the individual director or the company on the grounds that since the transaction was void, the director or company has no legal right to such money or goods as in the case of *Reson Beaudeford London Ltd (1935) Ch.131*

**b. The remedy of subrogation**
This is a term which is derived from insurance law. It refers to stepping into someone’s shoes if a third party is able to locate a debtor of the company, he can receive the money from the debtor instead of the debtor paying the company he pays the third party and hence the third party subrogates the rights of the company.
THE CONCEPT OF CORPORATE PERSONALITY

S.16 (2) of the Companies Act stipulates that once a company has been incorporated, then the subscribers to the Memorandum of Association become a body corporate.

The concept of corporate personality is what distinguishes a company from other forms of business organisations. Simply put, it means that companies have separate legal entities distinct from their members. That is, the company is capable of enjoying rights and being subject to duties, separate from its members.

This principle was first established in the case of *Salmon V. Salmon & Co. Ltd. (1897) A.C. 22 HL*. Salmon carried on business as a leather merchant. In 1892, he converted the business into a limited liability company by forming Salmon & Co. Ltd. The company consisted of Salmon, his wife and five children as members, with Salmon as the M.D. Shortly after incorporation, the company experienced difficulties and it was wound up a year later. Because the company did not have enough assets to meet the creditors’ demands, the creditors sued Salmon personally to recover their money. On appeal, the Court held that the company at law was a different person altogether from the subscribers and that the subscribers or members were not in any way liable for the acts of the company save as is provided in the law. Court further held that:

- where the Memorandum of Association is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate, capable forth with of exercising all the functions of an incorporated company.

- a body corporate cannot lose its individuality by insuring the bulk of its capital to one person, whether he be a subscriber to the Memorandum of Association or not.

- the company is at law a different person altogether from the subscribers to the Memorandum of Association and though it may be that after the incorporation, the business is precisely the same as it was before and the same persons are managers and the same persons receive profits, the company is not in law the agent of subscribers or trustees for them nor are subscribers as members liable in any form or shape except to the extent and in the manner provided by the Act.

- there is nothing in the Act requiring that the subscribers be independent or unrelated or that they or anyone of them should take a substantial interest in the under taking or that they should have a mind or will of their own or that there should be anything like a balance in the constitution of the company. If the conditions of the Act are complied with, it does not matter whether the signatories are strangers or relations.

**Consequences of incorporation**

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1. Personal liability of the company.
The company being a distinct legal person on incorporation is liable for all its debts and obligations. The liability of the members and shareholders is limited to the amount remaining unpaid on the shares. E.g, if a share holder has been allotted 100 shares of 1000/= each and he pays 50,000/= to the company, if the company winds up, he will be required to pay the company the remaining 50,000/= for the shares he had been allotted, but which he had not yet paid for.

In the case of **Wani -Vs-Uganda Timber & Joiners Ltd, (Civil Suit No 989/1972)** Katende. Pp.143, there was an application for a warrant of arrest to be issued against the managing director of the defendant company in order that he may be called upon to show cause why he should not furnish security for his company at the hearing of this suit. It was based on the fact that the Ugandan government had decreed that all the British Asians must leave the country. It was held by Kiwanuka J.R that, "they had arrested a wrong man because the defendant was a company. The Managing Director was a mere officer and therefore should not be molested. That it is well to say that he is the managing director of the defendant company but a managing director is not the company and even if he were, the company records do not show him as a defendant."

This is the reason why people incorporate companies as opposed to doing business by themselves. Among the principal reasons which induce persons to form private companies are:-
- The desire to avoid the risk of bankruptcy.
- The used facility afforded for borrowing money.
- A trade can be carried out with limited liability and without exposing the persons interested in it in the event of failure to the harsh provisions of the bankruptcy law.
- A company too can raise money on debentures which an ordinary person cannot do.

2. Property Ownership
An incorporated company is able to own property separately from its members. This means members cannot easily interfere with the company’s property. As such, a company can own business premises as a tenant.

In the case of **Macaura Vs Northern Assurance Co. Ltd (1925) AC 619**; Macaura had 99% shareholding in a company that was involved in timber business which took out an insurance policy against fire. Fire later destroyed the company’s insured property and the assurance company refused to indemnify Macaura on the grounds that the property was for the company and not Macaura. Master J held that no shareholder has any right to any item of the property owned by the company for he has no legal or equitable interest therein. That he is only entitled to a share in the profits while the company continues to carry on business and a share in the distribution of surplus assets when the company is wound up, but not to the property. (This holding was based on the insurance principle that when you are insuring something, you must have an insurable interest in it i.e. an economic interest, which in this
3. Capacity to Contract

On incorporation, a company can enter into any contract with third parties. In the case of Lee v Lee & Air Farming Co. Ltd (1961) A.C 12, Lee formed an air farming company in New Zealand holding 90% and being the sole director of the company. The company was formed with the objective of spraying chemicals to kill pests. He was the only pilot employed by the company. He later died in a plane crash where upon his wife demanded compensation. Legally, the widow would only be entitled to compensation if only her late husband had been employed by any person. Counsel for the defendant claimed that Lee was not an employee. The New Zealand Court of Appeal was faced with the dilemma of deciding on who could have made the contract under which the husband was employed as the director.

The Privy Council held that he was an employee in one capacity and therefore should receive compensation. That once a company has been incorporated, there is no limitation for it to make any decision less it is ultra vires. That it is well established that the mere fact that someone is a director of a company is no impediment to his entering into a contract to serve the company.

3. Capacity to borrow

A company can borrow money and provide security in the form of a charge, debenture or mortgage, by virtue of its having legal personality.

In Sentamu v UCB [1983] HCB 59, it was held that individual members of the company are not liable for the company’s debts. Even a managing director cannot be held liable for the company’s debts.

4. Perpetual Succession

A limited liability company is endowed with the ability to stay in existence even after the death of any one of its members. The life of the company can only be ended by winding up the company or striking the company off the Register of companies or through amalgamation.

5. Legal proceedings

As a legal person, a company can take action to enforce its legal rights. At the same time, it can be sued for breach of its duties.

Disadvantages of Incorporation

- The exercise is very expensive
- There is publicity and therefore loss of privacy
- Incorporation involves a number of formalities which makes it complicated.
- The cost of winding up is higher than that of incorporation.
COMPANIES DISTINGUISHED FROM OTHER BUSINESS ENTITIES

There are a number of ways through which business can be carried out in Uganda other than through the creation of a limited liability company.

1. Unincorporated Associations.
   These include eg clubs, societies, trade unions, etc. These associations are governed by their constitutions, which act as contracts between the members and the clubs. The club has no legal existence of its own, separate from its members. There is however distinction between club property and the property of the members. Club property is vested in the trustees of the club who are usually the club’s governing committee. The property is held by the committee in accordance with the constitution.

2. Partnerships
   People may decide to join heads and funds and trade together under one name. The partners, except if they register as limited partnerships are personally liable for the debts of the partnership. With regard to legal proceedings, partners can be sued jointly or separately for the liabilities of the partnership and this is possible even after they have retired or withdrawn from the partnership. A partnership has no perpetual succession. The death of one partner dissolves the partnership, unless otherwise agreed in the partnership agreement.

3. Co-operative Societies
   These are governed by the Co-operative Societies Act, which establishes the criteria for registration of a co-operative society. The object of the co-operative society must be the promotion of the economic interests of its members. On registration of the Society, it becomes a body corporate with perpetual succession and power to hold property and enter into contracts.

4. Public Corporations
   These are bodies set up to operate nationalised industries for commercial purposes. They have emerged as legal instruments for public control of basic industries in the economy. They are statutory companies created by individual statutes. The main difference between a public corporation and an ordinary registered company is that a public corporation does not have share holders and share capital. It is owned by government 100% and it is established and governed by its own Act.

5. Read about
   - Sole Proprietors.
   - NGOs.
PROMOTION AND INCORPORATION OF COMPANIES

Promoters
A promoter is any person who undertakes to take part in forming a company or who with regard to a proposed newly formed company, undertakes to take part in raising capital for the company.

According to the case of Twycross Vs Grant (1877) 2C.P.D 469, Cockburn C.J defined the term promoters thus, “a promoter is one who undertakes to form a company reference to a given project and who takes the necessary steps to accomplish that purpose”. However, this term has been adopted in Uganda and given a wider interpretation in the case of Kololo Curing Co. Ltd Vs West Mengo (1981) HCB 60, that a promoter’s work does not end by incorporating the company only or even appointing directors. Under certain circumstances, the work of promoters may continue afterwards.

Essentially, a promoter is any person who is involved in a company before its formal registration and incorporation with the company registry. His position in law is different from that held by members of a company that has been incorporated.

Position of a Promoter

1. Fiduciary position
A promoter stands in a fiduciary relationship to the company and therefore owes it certain fiduciary duties.

A contract made between the promoter and the company is voidable at the option of the company, unless the promoter disclosed all material facts relating to the contract to an independent board and the company agrees to its terms.

In Erlanger V New Sombrero Phosphate Co (1878)3 App. Cas 1218, a syndicate led by Erlanger, a Paris banker obtained at 55,000 pounds a lease of an island to work its phosphate deposits. The syndicate then formed New Sombrero Phosphate Company, after obtaining the lease and appointed new directors. The lease was then sold and the company ratified the sale 8 days after the company (Sombrero) had come into existence, (after incorporation). The shareholders unhappy with the sale, removed the existing board of directors and put new directors, which new directors sued to have the sale of the lease rescinded. It was held that the transaction should be rescinded because the promoter failed to remember his fiduciary position when he appointed directors who did not sustain the interests of the company with ordinary diligence and care.

2. Not to make secret profits
A promoter is not to make secret profit, while acting as a promoter. If he does, the company may recover from him.
In *Gluckstein v Barnes (1900) A. C 240, H.L* Gluckstein and 3 others bought the Olympia Exhibition premises in liquidation proceedings for 40,000 pounds. They then promoted a company, Olympia Ltd, to which they sold the property for 180,000 pounds. In a prospectus inviting for shares, they did not disclose the profit. The company was wound up 4 years later, and the liquidator sued to claim the profit. It was held that Gluckstein was accountable to the liquidator for the secret profit made.

**Remuneration of a Promoter**

Promoters do not possess an automatic right to remuneration for their services, since a company cannot enter into a contract with them as it is not yet incorporated. The company's Articles in practice however allow the company to pay preliminary expenses from the company's fund.

**PRE-INCORPORATION CONTRACTS**

These are contracts entered into by the promoters of the company before they receive the certificate of incorporation from the registrar.

We are here concerned with the legal implications that arise from such transactions as we know that the promoters will be engaged in drafting the necessary documents, looking for the company's residence premises, etc., which generally require money for that purpose.

Thus while promoting the company, promoters enter into contracts with other people and claim that they are doing so on behalf of the unincorporated company. Such acts are not binding on the company because it is not yet in existence and therefore has no capacity to contract. In addition, the company when incorporated cannot ratify contracts entered into by the promoter.

In *Kelner v Baxter (1866) L.R 2 C.P 174*, before incorporation, A, B and C entered into a contract with Kelner to buy goods “on behalf of the proposed Gravesend Royal Alexandra Hotel Co”. The goods were supplied and consumed in the business. Shortly after incorporation, the company collapsed and Kelner sued A, B and C on the contract for the price of the goods. It was held that A, B and C were personally liable on the contract. It was further held that if Gravesend Royal Alexandra Hotel Co had been existing at the time of signing the agreement, the persons who signed the agreement would have signed as agents of the company. But as there was no company in existence at the time, the agreement was wholly inoperative unless it was held to be binding on the defendants.

On whether the company would have been liable had it ratified the contract, it was held that ratification can only be by a person ascertained at the time the act is done.

Thus for a company to be bound by pre- incorporation contracts, the company has to enter into fresh contracts when incorporated, in the same terms as the pre incorporation contracts.
Who is liable on a pre-incorporation contract?

Kelner V Baxter states that it is the relevant promoters who would be liable on the contracts. This position was however modified in 1953 by the case of *Newborne V Sensolid (G.B) Ltd (1953)1 All E R 708*, which suggests that the promoter would only be liable if he held himself out either as agent or as principle.

In this case, there was a contract for sale of 200 cases of ham to Sensolid. It was written on printed headed paper of ‘Leopold Newborne (London) Ltd’ and it ended with the words “yours faithfully Leopold Newborne (London) Ltd.” It was signed “Leopold Newborne”. The market fell and Sensolid refused to take delivery. When he was sued on the contract, it was held that on the date when the contract was made, Leopold Newborne (London) Ltd had not been incorporated and that neither the company nor Newborne personally could enforce it. The reason given was that Newborne did not claim to act personally or as an agent. He claimed to sign for the company. Since the company was not in existence when the contract was signed, there was no contract.
LIFTING THE VEIL OF INCORPORATION

Ever since the case of Salomon, Courts of law continue to uphold the doctrine of corporate personality. Nevertheless, the application of the doctrine has in certain instances led to injustice and the courts have disregarded it. In certain situations the court will disregard corporate personality and pay attention to where the real control and beneficial ownership of the company's undertaking.

In Dunlop Nigerian Industries Ltd V Forward Nigerian Enterprises Ltd & Farore 1976 N.C.L.R 243, the HC of Lagos stated that in particular circumstances, eg where the device of incorporation is used for some illegal or improper purpose, the court may disregard the principle that a company is an independent legal entity and lift the veil of corporate identity so that if it is proved that a person used a company he controls as a cloak for an improper transaction, he may be made personally liable to a third party.

The legal technique of lifting the veil is recognised under 2 heads:
1. Statutory lifting of the veil
2. Case law lifting of the veil

Statutory lifting of the veil
1. Where the number of members is below legal minimum.
If a company carries on business for more than 6 months after its membership has fallen below the statutory minimum, (2 for private companies and 7 for public companies), every member during the time the business is carried on after the 6 months and who knows that the company is carrying on business with less than the required minimum membership is individually liable for the company's debts incurred during that time. S. 33 CA.

Professor Gower an example of this situation where during the World War II, all the members of a company while in a general meeting were killed by a bomb but the company continued in existence.

2. Where the company is not mentioned in the Bill of Exchange.
An officer of a company is personally liable if he signs a bill of exchange, eg a cheque on behalf of the company without mentioning the company’s name on it in legible characters.

Under sect 109 (4), the veil of incorporation is lifted by holding any officer who has issued a company’s document which is required to bear the company’s name/seal and such a document is issued in contravention of that requirement whether he is a shareholder or not.

3. Holding and subsidiary companies
Where companies are in a relationship of holding and subsidiary companies, group accounts are usually presented by the holding company in a general meeting. In this regard, the holding and subsidiary companies are regarded as one for accounting purposes and the separate
nature of the subsidiary company is ignored. Sections 149-153

4. Reckless and Fraudulent Trading:

Under sect 327, it is provided that if in the course of winding up, it appears that any business has been conducted recklessly or fraudulently, those responsible for such business may be held liable without limitation of liability for any of the company's debts or liabilities.

5. Taxation

Under the income tax Act, the veil of incorporation may be lifted to ascertain where the control and management of the company is exercised in order to determine whether it is a Ugandan company for income tax purposes.

6. Investigation into related companies

Where an inspector has been appointed by the Registrar to investigate the affairs of a company, he may if he thinks it fit also investigate into the affairs of any other related company and also report on the affairs of that other company so long as he feels that the results of his investigation of such related company are relevant to the main investigation.

Lifting the Veil under case law

1. Where the company acts as agent of the share holders.
Where the shareholders of the company use the company as an agent, they will be liable for the debts of the company. In Re: F.G (Films) Ltd [1953]1 W.L.R 483, an American company provided all the funds for producing a film, which it sought to register as a British film because the film had been produced by arrangement with a British company in which the American company owned 90 of the 100 pound capital. It was held that the British company was no more than an agent of the American company which was the true maker of the film.

2. Where there has been fraud or improper conduct.
The veil of incorporation may also be lifted where the corporate personality is used as a mask for fraud or illegality. In Gilford Motor Co V Horne [1933] Ch. 935 Horne was the former employee of Gilford Motor Co. He agreed not to solicit its customers when he left employment. He then formed a company which solicited the customers. Both the company and Horne were held liable for breach of the covenant not to solicit. The company that Horne formed was described as a “mere cloak or sham for the purpose of enabling him to commit a breach of the covenant”.

In Jones V Lipman [1962]1 W.L.R 832 Lipman in order to avoid the completion of a sale of his house to Jones formed a company and transferred the house to the company. Court ordered him and the company to complete payment, even though the ownership of the house was no longer in his names but in that of the formed company. The company was described as a creature of Lipman, a device and a sham, a mask which he held before his face in an attempt to...
avoid recognition by the eyes of equity.

In *Re Williams Bros Ltd (1932) 2Ch.71*, a company was insolvent but the Directors continued to carry on its business and purchased its goods on credit. It was held that if a company continues to carry out business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospects of the creditors ever receiving payments of these debts, it is in general a proper inference that the company is carrying on business with intent to defraud. *R V Graham (1984) QB.675* makes it clear that a person is guilty of fraudulent trading if he has no reason to believe that the company will be able to pay its creditors in full by the dates when the respective debts become due or within a short time thereafter.

3. Public interest/policy

Sometimes, courts have disregarded the separate legal personality of the company and investigated the personal qualities of its shareholders or the persons in control because there was an overriding public interest to be served by doing so. In *Daimler Co Ltd Vs Continental Tyre And Rubber Co (1916) A.C 307*, a Company incorporated in England whose shares except one were held by German nationals resident in Germany brought an action during the First World War. All its directors were also German nationals resident in Germany, which was an enemy country at the time. The Court disregarded the fact that the company had a British nationality by incorporation in England and rather concentrated on the control of the company’s business and where its assets lay, in determining the company’s status.

4. In determining residence of a company for tax purposes.

The court may look behind the veil of the company and its place of registration so as to determine its residence. The test for determining residence is normally the place of its central management and control. Usually, this is the place where the board of directors operate. But it can also be the place of business of the M.D where he holds a controlling interest.

In *Unit Construction Co Ltd V Bullock [1960] A. C 351, H.L* 3 wholly owned subsidiaries of a company in the U.K were registered in Kenya. The board of the 3 subsidiaries were distinct from the Board of the parent company. In addition, under the Articles, Directors’ meetings could not be held in the UK. However, the management of the subsidiaries was infact in the hands of the parent company in England. It was held that for taxation purposes, the 3 Kenyan companies were resident in the UK. The issue was not where the 3 companies’ central management and control ought to have been, but where infact they were.
RAISING THE CAPITAL OF THE COMPANY
Companies are time and time again faced with the challenge of raising capital for the growth of the company. For an existing company, new capital for such a company can be raised through ploughing back profits without declaring any dividends. Alternatively, the company may decide to offer its securities to the public, by floating new shares. Also, the company may decide to borrow from the bank or the government or insurance companies or finance houses.

RAISING CAPITAL THROUGH THE PUBLIC
Companies can raise capital by inviting members of the public to subscribe for shares in the company. This is done through the issuing of a prospectus.

METHODS OF ISSUE
There are different ways of inviting the public to subscribe for shares in a company.
1. Placings (private)
2. Offer by tender.
3. Rights issue
4. Bonus Issue
5. Offers for sale
6. Direct offers e.g. by issuing prospects

Placings
These take place in the issuing house. A company issues securities, placing them in the issuing house for purposes of the issuing house selling them to its clients. The issuing house (may purchase securities and place them with clients) or may not place them with the clients. When it purchases the securities, then it ceases to be an agent of the company.

Offers by Tender
This is a new innovation in the developed world by which the company will make a tender to the public for the purchase of its shares. All the shares that have been tendered are sold to the highest bidder.

Rights issue/script issue
The company invites its own shareholders to subscribe for new shares or debentures. As an incentive, such securities are sold at a lower price than what they would normally obtain in the new market.

Bonus issue
Like the rights issue, the bonus issue method is an internal affair of the company concerned. Under this method, instead of the company paying to shareholders a dividend it may have declared, it holds on to those funds by issuing shares to the shareholders.
Offer for sale
The company concerned issues its securities in an issuing house and the issuing house sells them to the public at a higher price. This method has a number of advantages to this company:

1. The company is not responsible for unsuccessful issue to the public.
2. It is the issuing house which bears the responsibility for the prospectus.
3. Unlike the method of placings, the company does not pay anything since the issuing house pays itself a commission, the difference of the price at which the sells and the price which he bought.

Direct issue
The company itself deals with the public without an intervention of the issuing house. This method is cumbersome for a number of reasons.

1. The company has to use a prospectus i.e. legal liability are conferred upon a company.
2. The company bears a risk of unsuccessful issue.
3. Although it may protect itself against unsuccessful issue by underwriting such issue, the underwriters have to be paid a commission for that issue. S. 55 provides that the commission must not exceed 10% of the price at which the shares are issued and that there must be authority from the Articles to pay that commission. This means that a company cannot transact with underwriters who demand more than 10% of the price. Again according to S. 55, if the Articles authorise more than 10% the company cannot exceed such figure. And such payment must be disclosed in the prospectus.

THE PROSPECTUS
According to S.2, a prospectus means any document, prospectus, notice, circular, advertisement or other invitation or offering to the public for subscription of the securities of a company.

The definition in S.2 is very vague and consequently the courts have come up with some guidelines to be employed in determining whether an invitation amounts to a prospectus or not. Firstly, according to Nash Vs Lynd (1929) AC 158, for a document to amount to a prospectus, not only must it be delivered but also there must be some publicity with the aim of inducing subscription e.g. if a thief stole the document and publicized the issue of shares which the public purport to buy, the document does not amount to a prospectus.

Secondly according to S. 57, for a document to amount to a prospectus, it must be issued to the public.

Then what amounts to the Public?
The section seems to indicate that a public means a public whether selected by members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner. In Re Govt Stocks & other Securities investment Co. Ltd Vs Christopher (1956) 1 WLR 237 a company issued a circular in which it offered to acquire
shares in another company in return for its own shares. The question was did that circular amount to a prospectus. The court held that where an offer is acceptable only by the shareholders of a company, such an offer is deemed not to be to the public unless the shares are to be issued under renounceable letters or terms. (Renounceable letters are contracts of allotment of shares under which the allotees can pass those shares to third parties. Where the shares have been issued at non-renounceable terms, the allottee cannot sell them to a third party.

Secondly, the invitation must be one inviting the public to subscribe or purchase the securities. The terms subscribe or purchase means taking or agreeing to take securities for cash.

**Legal aspects of a prospectus**

According to S.39, a prospectus must be issued by or on behalf or in relation to a company or an intended company. It must be dated and must be delivered to the registrar for registration and if it contains a statement by an expert, that expert’s written consent must accompany the prospectus (S. 39-43). If these requirements are contravened, the company and any office responsible for that prospectus are liable to a fine not exceeding shs 100/= per each day the default continues.

**LIABILITY FOR A DEFECTIVE PROSPECTUS**

Both civil and criminal liability lie against the company and/or its officers for non-compliance with the statutory provisions as well as omissions or misstatements in the documents.

**Criminal liability (S.40 & 42)**

S.40 & 42 both impose a fine not exceeding shs.10,000/=. S.46 imposes a term of imprisonment not exceeding 2 years or a fine not exceeding shs. 10,000 or both. Any officer responsible for the issuing of a prospectus which includes an untrue or false statement.

**Civil liability**

Liability for the defective prospectus exists under both the Act and common law.

1. **S.45** imposes civil liability for a prospectus containing any untrue statements. This liability is upon any person who was a director at the time of the issue or a person who has authorised his name to appear in the prospectus as a director and/or promoter of the company and/or any person authorising the issue of that prospectus, but the section raises a number of defences.

If the defendant can prove that although he consented his name to be used as a promoter or director, he withdrew his consent before that issue or that the issue was without his authority or that after the issue but before allotment he withdrew his consent and gave notice of his withdrawal, then such a person cannot be held liable.
2. Damages for misrepresentation and rescission
Under common law, an aggrieved subscriber can institute an action for deceit or misrepresentation which entitles him to damages or rescission. However, there are a number of limitations to these remedies.

Limitations to damages for misrepresentation

The court may deny the action or dismiss it as disclosing no cause of action unless:-

i. The plaintiff’s complaints must be against a misrepresentation of fact and not of merely an opinion e.g. if we say, I hope to become an accountant” as opposed to "as I am going to become an accountant".

ii. That misstatement or misrepresentation must be true if a prospectus omits stating what it should have mentioned, then a company cannot be sued e.g. we are going to import maize from Uganda without mentioning the part of Uganda and bearing in mind that some parts of Uganda are insecure. However, if a statement mentions articulately the area, then it can be sued.

Limitations for rescissions

1. The plaintiff must indicate his intention of rescinding the contract i.e. immediately i.e. he must not do anything which amounts to an affirmation of the contracts. If he applies for shares on the basis of a defective prospectus, he must immediately return them on acquisition of this knowledge e.g. attending meeting, setting shares to third party, receiving dividends etc.

2. He must take steps to rescind the contract of allotment before winding up proceedings have commenced. The rationale is to safeguard the interests of creditors since such a shareholder would avoid his liability or even fall among the directors to that company. However, there are 2 exceptions:

STATEMENT IN LIEU OF A PROSPECTUS
Where a company doesn’t issue a prospectus and it is a public ltd company or if it issues one and doesn’t proceed to allotte the shares/debentures, then such a company must deliver to the registrar of companies a document known as a statement in lieu of a prospectus. Under S.50 the statement must be signed by directors or proposed by the directors and must be delivered to the registrar, 3 days before allotment.

ALLOTMENT OF SHARES
Private Companies. This is the process through which a potential shareholder or subscriber is given the number of shares which he has successfully applied for. Private companies under S. 30 restrict the issue of new shares by requiring that:-

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• a private company is not entitled to invite the public to subscribe to any of its securities.
• a private company must in its Articles of Association contain a clause restricting the right of transferability of its securities as far as its shares are concerned.

Such clauses are called pre-emptive clauses. Lack of such a pre-emptive clause automatically makes the company a public ltd company.

Public Companies. Allotment of shares in public companies is the process through which the company distributes the shares to successful applicants. Generally a company once it has gone through issuing a prospectus or filing a statement in lieu of a prospectus, then allotment of shares can proceed. If however a company is making its first allotment, its not to allot the shares unless the minimum subscription requirements have been satisfied. A minimum subscription is that minimum amount which the directors think or deem must be raised by the issue of share capital for purposes of a number of items as laid in schedule 3 par.4. These include:-

i. The purchase price of any property bought if the price of such property is to be paid out of the issue of securities.
ii. The preliminary expenses payable by the company and any commission payable by the company to persons who have agreed to subscribe or to induce subscriptions for the company's securities.
iii. The working capital - there must be enough resources from the minimum subscriptions for the day to day running of the business on the short run.
iv. S. 49(3) say that at least 5% of the total nominal amount must have been paid for in respect of each share applied for.

Where the above limitation is contravened after 60 days after the prospectus has been issued, then the company becomes liable to repay the money to the applicants without interest. If 75 days elapse before payment of such money, after issue of the prospectus, then the directors become jointly liable to pay the money with interests at the rate of 5% p.a. Any allotment which may have been made is voidable at the instance of the applicant.

SHARE CERTIFICATES
This is a document that shows one's ownership of shares in a company. S. 82 says that sixty days after the allotment or after the transfer of the shares, the company must deliver to the owners share certificates. Non-compliance with this:-

i. Makes the company and the directors liable to a default fine.
ii. The aggrieved allottee can serve the company with a note to give him his certificate. If the company still fails, then he can apply to court for such an order.

A share certificate with a company seal is prima facie evidence that the owner has title to the

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Legal effects of share certificates
1. It is **prima facie** evidence that the holder is the owner of the shares.
2. It estops the company from denying that the person to whom it is granted was at the date of the issue of the certificate the registered owner of the shares issued.
3. It estops the company from denying that the company shares are paid up as indicated in the certificate. Therefore if a third party detrimentally alters his position on the basis of that certificate, he cannot be defeated by the company's denial of the certificate unless it was forged.

SHARE WARRANTS
A company can choose to issue either share certificates or share warrants. S. 85 provides that if the Articles of Association authorise, a company may instead of issuing a share certificate, issue a share warrant in respect of any fully paid shares. There are two advantages of a warrant over a share certificate:

1. A Warrant is a share warranty that the bearer is the owner of shares indicated while the share certificate is **prima facie** evidence that the holder is the owner of shares. Prima facie evidence can be rebutted but a company cannot deny that the bearer of a warrant is the owner. This thus makes the warrant more important.
2. A purchaser of a share warrant takes the shares concerned **free of equities**, if he is a **bonafide** purchaser, while a purchaser of a certificate must first be registered as shareholder before he can become a Legal owner of those shares. When a purchaser of a warrant physically holds the same, he will defeat all warranties.

LOAN CAPITAL
Companies can decide to raise capital through obtaining loans. The loans obtained are usually secured by company property, in the form of debentures and or charges.

A debenture is a paper or a document indicating an indebtedness of some kind of permanence by the company. The debenture is an acknowledgement of a distinct debt.

A private company is not allowed to raise money by borrowing from the public. As such, instead, the company may decide to create a debenture stock. A debenture stock is a loan fund which is created by the company and which can be divisible among various creditors who each hold a debenture stock certificate. For example, a private company with debenture stock, can obtain money from several banks which could each hold a debenture stock certificate.

Differences between a debenture and debenture stock.
1. As a general rule, debentures rank according to the time of issue. The first debenture takes priority over all other debentures on repayment. On the other hand, since a debenture stock is a fund, each beneficiary ranks in **pari passu** with others (no
1. Easy transferability - The debenture covers a distinct debt which is indivisible and therefore must be transferred as a whole in case the present holder wishes to get money from it. On the other hand a debenture stockholder can always sub-divide his holdings and transfer the same to a person of his choice.

SECURED AND UNSECURED CREDITORS
Creditors may be secured or unsecured. Such collateral assets attached to secured creditors are sometimes referred to as charges.

A secured creditor may have his security or charge in form of a fixed charge or a floating charge. A fixed charge is attributed to a creditor entitled to a particular asset as security while a floating charge relates to a creditor who is entitled to any of the company's assets that have no fixed charge at all.

A floating charge is that form of charge or security which covers assets (current assets) of the same generic name but which assets are indeterminable at any given time since the borrower has to use them during his day to day business to the extent of disposing them and replacing them with others.

Under S. 96, all charges must be registered in 42 days lest they are deemed void.

MAINTENANCE OF CAPITAL
Different types of capital can be identified in a company.

1. Share Capital
Amount contributed by members entitling them to a dividend as a return to the member.

2. Loan Capital.
Loan given to a company as capital. It is that returnable portion of capital that entitles interest to the creditor.

3. Nominal capital.
The maximum amount of share capital that can be realised. S4 describes nominal capital as the authorized maximum amount of share capital that can be realized. If the authorized capital is not enough, the company may alter it by a special resolution if Articles allow.

4. Issued capital.
Nominal value of shares availed for subscription and which has been allotted.

5. Capital at call.
Issued capital that is not yet paid for.

6. Called up capital.
Portion of the issued capital that the company has requested for settlement. It is the portion of issued capital that the company has requested for settlement from the holder of shares that have not been fully paid for who is entitled to all benefits as if the shares were fully paid provided the Articles of association allow.

7. Reserve Capital (S.66)
Reserve capital is a portion of the issued capital which is at call but is not to be called up except in the event of winding up of the company. It is issued only by a company limited by shares or by guarantee.

Increase of Issued Capital
As a general rule, a company's issued capital must not be increased unless the company's ordinary business warrants such as step. One of the reasons for this rule is the need to maintain that capital fund to which creditors rely for payment when extending capital facilities to that company. Consequently in the case of Flitcofts (1882) 21 Ch.D. 519, the directors had allowed debt to be credited in the company's accounts creating imaginary profits with the knowledge that debts were bad. It was held that a company has no other debtors apart from the company. Therefore he has a right to insist that the company must keep its capital and not to return it to the shareholders.

Consequently, Article 116 of table A provides that dividends must be paid only out of profits. Because of problems of defining profits, courts have provided guidelines as to the issue of maintenance of capital;

Maintenance of Capital
1. Payment of interest out of the company's capital. According to S.67, where the Articles authorize and the registrar approves, a company may pay interest out of capital on any of its shares which were issued to raise money for defraying the expenses of the construction of any works which can't be payable profitably in the short run.

   - The section strictly does not talk about loans but capital raised by issuing shares for the purposes of the works. Before sanctioning, the registrar may appoint somebody to investigate the circumstances of the case.
   - Secondary any payment to be made as for the period specified by the registrar, but that period is not to extend beyond 1 year after the completion of the works.
   - Thirdly the interest to be paid is not to exceed 5% p.a. Fourthly, the payment of that interest doesn't operate as a reduction of the amount for the shares out of which it is paid.

2. Company's resolution to reduce its capital. According to S. 68, any company limited by shares or by guarantee can reduce its capital provided the following conditions are satisfied:
shares or guarantee and with share capital and authorized by its articles may pass a special resolution to reduce its capital. However, according to S.69 (a), the special resolution must be confirmed by court through a petition.

If the proposed reduction of capital involves a reduction in the amount of unpaid share capital or if its designed to be pay out of the paid up capital, to any shareholder every aggrieved creditor who lodges a claim is admissible. If the company were to be wound up, he is entitled to object whereupon the court may compile a list of such creditors and their claims and hear their objections.

In Re Moorgate Mercantile Holdings Ltd (1980), ALL ER.40, there was a proposal by the company to reduce its capital on the ground that the paid up capital had been lost. It was held that in exercising its jurisdiction to confirm a reduction of capital on such ground, the court should require evidence of laws and provisions for safeguarding creditors especially where the loss is less than the amount to be reduced. Moreover such a company may be required to add to its name "and reduced".

3. Order under S211 (the oppression section). This is another case in which the company may be allowed to reduce its share capital. One of the orders a court may make under the section is that the oppressed shareholder be bought out of the company.

4. Consideration for Shares. The rule in Ooregum case: In Ooregum Gold Mining Co. of India v Roper (1892) AC 125, the directors sought to issue shares at a discount. It was held that shares are not to be issued at a discount and whoever takes shares in return for cash must either pay or become to pay the full nominal value of those shares. However, there are a number of ways in which one can side step issues at a discount.

5. Company repurchasing its own shares. In the case of Trevor Vs Whiteworth (1887) 12 AC 409, during the winding up of the company, a shareholder claimed the balance of the principal for fully paid up shares which he had sold to the company before winding up. It was held that it is ultra vires for a company to purchase its own shares even if the memorandum gives express authority to do so. Apart from the foregoing holding (ultra vires aspect) the transaction is objectionable on the following grounds.

   i. If the company paid more than the actual value of the shares the value of the remaining shares is curtailed.

   ii. If the company paid the principal on the Stock exchange is affected adversely. Repurchasing is different from either forfeiture or surrender of shares. In repurchasing, a condition may be made that after a specified period of calling shares to be repurchased, and they don’t comply, then the shares may be forfeited or surrendered.
6. **Financial Assistance**

According to S.56, it is unlawful for a company to assist anybody to purchase its shares because it’s like a donation. It has the effect of reducing the share capital. However, this is not applicable where:

i. The company lends money as part of its business.

ii. The company under its scheme of helping its employees other than directors subscribes for shares in that company. It can provide money for such purpose.

NB. Any security a company may mortgage for a loan to finance certain persons to purchase the company's shares is not recoverable at all. The lenders of the money cannot sue for the loan, it is irrelevant that the lenders did not know the purposes for which the loan was held.

**DIVIDENDS**

Dividends are any return paid/given to a shareholder on his investment/shareholding in a company. Unless the Articles state otherwise, a shareholder receives dividends on his shares. In *Makidayo Oneka Vs Wines And Spirits (U) Ltd And Another (1974) HB.2*, the principle was laid that unless the articles and terms of the issue of shares confer a right upon a shareholder to compel a company to pay a dividend, it is the discretion of the directors to recommend to a general meeting that a dividend be declared.

Furthermore, where a company has an article equivalent to article 114 of table A, if the directors have recommended a certain sum for dividend, the general meeting has no discretion to increase that sum. However, a shareholder or a debenture holder can seek a court injunction to restrain a company from declaring a dividend. The Companies Act is not helpful as to when dividends should be declared. The nearest is Article 116 of table A, where dividends are to be paid out of profits. Then, the question is what are profits?

In the case of *Lee Vs Neuchattel Asphalt Co (1889) 41 CH.D.1*, a company had been formed for the purposes of acquiring and working out a concession in a mine. The company proposed to pay a dividend out of the profits shown on the reserve account. A shareholder challenged this on the ground that the company’s assets weren’t equal to its share capital and that since the mining concession was a wasting asset, dividing annual proceeds amounted to dividing the company’s capital assets. The shareholders contention was rejected. Court held that:

1. There is nothing at all in the Act about how dividends are to be paid nor how profits are to be recommended. All that is left and very judiciously and properly left to the commercial world. It is not a subject of Parliament to say how accounts are to be kept, what is to be put into capital accounts, what to be put on income accounts and what to be left to the men of business.

2. Losses of capital need not be made good before the company declares a dividend.