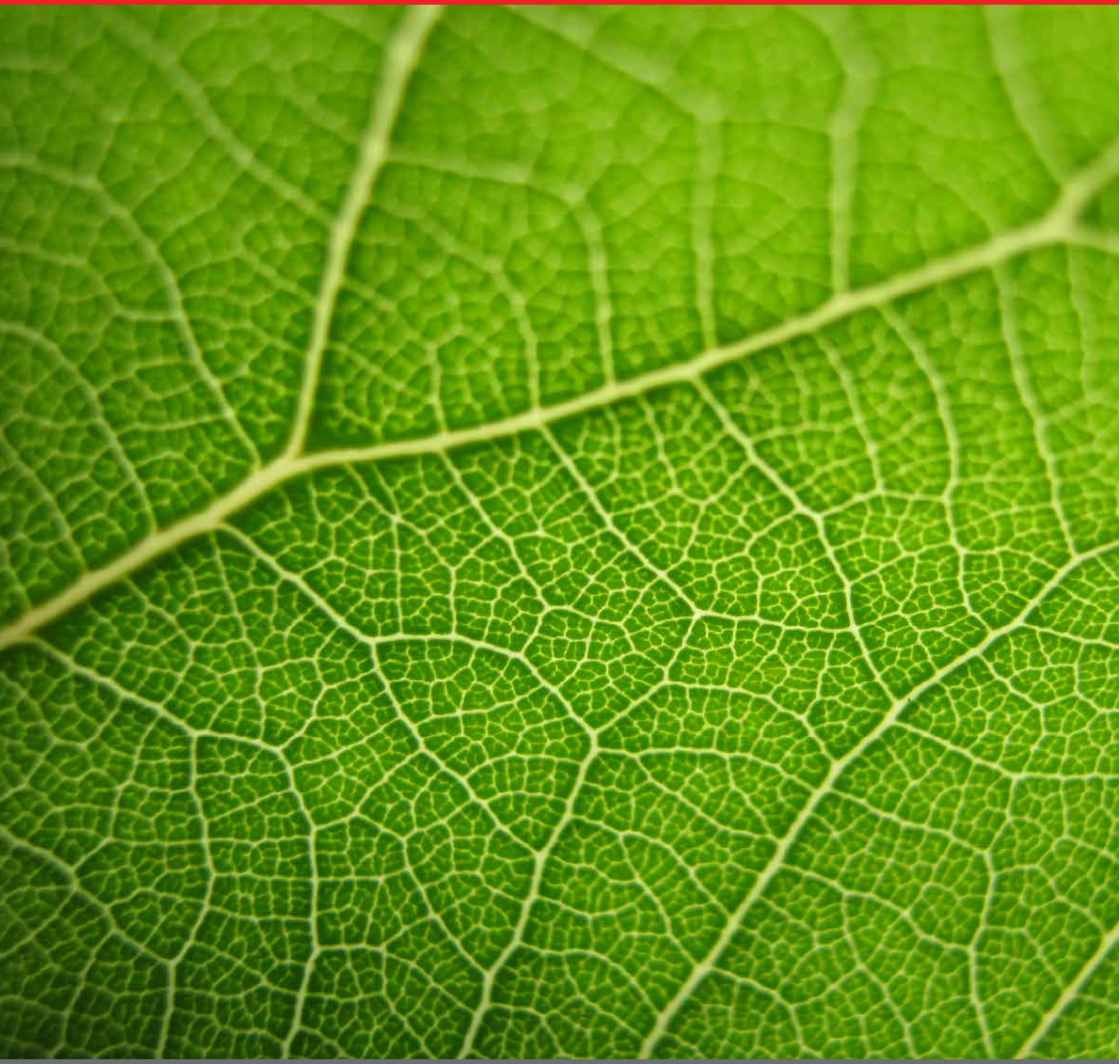
COMPANY LAW (TC12)

TECHNICIAN DIPLOMA IN ACCOUNTING



ICAM
THE INSTITUTE OF
CHARTERED ACCOUNTANTS
IN MALAWI

The Institute of Chartered Accountants in Malawi
P.O. Box 1 Blantyre
E-mail: icam@icam.mw
www.icam.mw

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ICAM

PREFACE

INTRODUCTION

The Institute noted a number of difficulties faced by students when preparing for the Institute's examinations. One of the difficulties has been the unavailability of study manuals specifically written for the Institute's examinations. In the past students have relied on text books which were not tailor-made for the Institute's examinations and the Malawian environment.

AIM OF THE MANUAL

The manual has been developed in order to provide resources that will help the institute's students attain the needed skills. The manual has been developed in such a way that even those who would like to study on their own can do that. It is therefore recommended that each student should have their own copy.

HOW TO USE THE MANUAL

Students are being advised to read chapter by chapter since subsequent work often builds on topics covered earlier.

Students should also attempt questions at the end of each chapter to test their understanding. The manual will also be supported with a number of resources which students should keep checking on the ICAM website.

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TC12: COMPANY LAW- SYLLABUS

MODULE AIM

To develop candidates' understanding of company law theory and practice in Malawi

LEARNING OBJECTIVES

On completion of this module, candidates will be able to:

- i. Explain the formation of a company, fundamental features of a company and classification.
- ii. Explain the basic or fundamental framework of the limited company.
- iii. Discuss the legal effects of incorporation of a company.
- iv. Explain the company membership and concepts of shares transferability.
- v. Discuss capital and financing of companies.
- vi. Discuss company administration in relation to some key management personnel.
- vii. Mention the various arrangements available to a company for survival in the competitive world, and the globalization.
- viii. Explain different aspects of company reorganization, receivership and liquidation and the role of the liquidator.

FORMAT AND STANDARD OF THE EXAMINATION PAPER

The examination will contain five questions each carrying 20 marks. Candidates will be required to answer all questions. Answers must be supported by case and statutory authorities. Candidates will lose marks for grammatical errors and failing to communicate accurately.

SPECIFICATION GRID

This grid shows the relative weightings of subjects within this module and should guide the relative study time spent on each. Over time the marks available in the assessment will equate to the weightings below, while slight variations may occur in individual assessments to enable suitably rigorous questions to be set.

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12) Directors and Secretaries	5
13) Duties of Directors	10
14) Accounts and Auditors	5
15) Winding up	5
Total	**100**

LEARNING OUTCOMES

1. Nature of a company

In the assessment, candidates may be required to:-

1.1 define the legal personality and the nature of a limited liability company as compared to other forms of business organizations such as partnerships; the office of Registrar of Companies and types of companies.

1.2 explain the legal personality and the nature of a limited liability company as compared to other forms of business organizations such as partnerships; the office of Registrar of Companies and types of companies.

2. Formation of a company

In the assessment, candidates may be required to:-

2.1 Explain the relevance of the office of the registrar of companies

2.2 Distinguish a company from a sole-trader, partnership and other associations

2.3 Define types of companies

2.4 Explain the significance of a promoter in the formation of a company

2.5 Explain the duties of a promoter and remedies for breach of duties

2.6 Discuss liability under pre-incorporation contracts

2.7 Explain the legal effect of the certificate of incorporation.

3. The Constitution of a Company

In the assessment, candidates may be required to:-

3.1 Define Memorandum of Association and Articles of Association and their relationship and contents

3.2 Explain the contractual effect of the Memorandum of Association and Articles of Association

3.3 Explain rules on company names and how the name may be changed.

4. The Corporate Status of a Company

In the assessment, candidates may be required to:-

4.1 Explain the rule in *Salomon v Salomon*

4.2 Explain the legal effects of incorporation

4.3 Define the term ‘lifting the corporate veil’

4.4 Explain the circumstances under which the veil of incorporation may be lifted by legislation and by the courts

5. Corporate Decision Making

In the assessment, candidates may be required to:-

5.1 Define the roles of the shareholders' meeting and the Board Meeting
5.2 Explain the types of shareholders' resolutions
5.3 Explain the *Duomatic Principle*
5.4 Explain rules governing voting in shareholders meetings
5.5 Discuss the requirements for ratify of directors' acts done in breach their duty
5.6 Explain residual powers that the general meeting has over the Board Meeting

6. Corporate mandate and authority

In the assessment, candidates may be required to:-

6.1 Define the doctrine of ultra vires in Company Law.
6.2 Explain the facts, rule and exceptions to the case of *Royal British Bank vs Turquand*
6.3 Explain the concept of *'constructive notice"*.

7. Shareholders Rights, Liabilities, Remedies

In the assessment, candidates may be required to:-

7.1 Define the rights and obligations of a shareholder
7.2 Explain the meaning of limited liability
7.3 Explain the facts, rule and exceptions to the case of *Foss v Harbottle*
7.4 Discuss how the law protects minority shareholders.

8. Share Capital

In the assessment, candidates may be required to:-

8.1 Define a share.
8.2 Describe types of shares issuable by a company
8.3 Define a prospectus
8.4 Explain key concepts such as par value/nominal value, rights issue, transfer of shares and transmission of shares

9. Maintenance of Share Capital

In the assessment, candidates may be required to:-

9.1 Discuss the importance of maintaining capital of a company
9.2 Explain mechanisms provided by the law to help a company maintain its share capital
9.3 Explain conditions that must be satisfied if a company wishes to reduce its capital.

10. Loan Capital

In the assessment, candidates may be required to:-

10.1 Define a debenture

10.2 Explain types of debentures.

10.3 Discuss the importance of the Personal Property Securities Act 2013

10.4 Discuss the remedies available to a holder of a secured and an unsecured debenture

10.5 Distinguish a fixed from a floating charge and their priorities

10.6 Explain the meaning and relevance of Company Re-organisation

10.7 Explain the significance of the Insolvency Act 2016.

11. Directors and Company Secretaries

In the assessment, candidates may be required to:-

11.1 Define a director

11.2 Explain types of directors and their qualifications

11.3 Explain the role of the company secretary

11.4 Explain the meaning of 'enlightened shareholder value' concept

12. Duties of Directors

In the assessment, candidates may be required to:-

12.1 Explain common law duties of directors

12.2 Explain statutory duties of directors

12.3 Explain the consequences for breach of directors' duties.

13. Accounts and Auditors

In the assessment, candidates may be required to:-

13.1 Define the role of the Malawi Accountants Board. And ICAM

13.2 Explain accounting and auditing requirements for companies in Malawi.

13.3 Define the qualifications of an auditor

13.4 Explain the rights and duties of an auditor.

14 Winding Up

In the assessment, candidates may be required to:-

14.1 Define winding up of a company

14.2 Discus grounds for compulsory winding up of a company

14.3 Distinguish voluntary liquidation from compulsory liquidation

14.4 Explain the circumstances under which a company may be wound up voluntarily

14.5 Explain powers of a liquidator.

REFERENCES

ICAM *Company Law Manual,* 2017

Companies Act, Number 15 of 2013

Muhome, A H (2016), *Company Law in Malawi,* Assemblies of God Press.

CHAPTER 1: NATURE OF A COMPANY

1. INTRODUCTION

A company is one form of a business organization. The basic idea of using the registered company as a tool or medium for trade and commerce is straightforward. A company is formed or 'incorporated' by a promoter. Shares are issued by the company to shareholders (who are initially 'the subscribers' to the company's constitution), who then enjoy control over the company by voting in meetings, in proportion to the number of shares they hold.

The day to day running of the company's business is then normally delegated to directors who are appointed by the shareholders and are usually, but not necessarily, from among their number. In the simplest model, the company acquires its money and assets by issuing shares. The consideration which is used to pay for the shares is then known as the 'share capital'. But, in many cases, the money provided by issuing shares is irrelevant to the amount of money which the company actually uses in its business, which will, in fact, be provided by loans (loan capital). Even the owners may, for instance, prefer just to take one share each and then lend money to the company under a formal loan. It is important to note also that any assets accumulated by the company are owned both legally and beneficially by the company alone and the shareholders have no direct interest in them at all. This is as a result of the fact that a registered company is an incorporated association and that, on its formation, a new legal personality, with its own legal rights and obligations, is created in addition to and separate from those persons who are associating together. It is this new personality or entity which owns the accumulated assets. As an illustration of this, a person who owns all the shares in a company can still be convicted of stealing from the company.

In Malawi, companies are primarily governed by the Companies Act 2013 ('the Act') as well as case law. There are also various Regulations made under the Act. In answering examination questions, your answers must be supported, where appropriate by either provisions of the Act or decided cases. These are together called authorities i.e. the source from which the law is taken.

1.2 THE OFFICE OF THE REGISTRAR OF COMPANIES

Section 3 of the Act establishes the office of the Registrar of Companies. The Registrar's functions and powers are provided for in section 4 which include the following:-

a) Administering the Act including the regulations made under it and the supervision of the incorporation and registration of companies.
b) The Registrar is mandated to establish and maintain a company's registry in the Malawi Business Registration Database.
c) The Registrar also performs such other functions as may be specified by the Act or any other written law.

d) The Registrar is mandated to keep registers as he considers necessary that record or store information electronically or by other means and that permit the information so recorded or stored to be readily inspected or reproduced in usable form.
e) The Registrar provides tools for inspection and search of documents in the registry upon payment of prescribed fees.
f) The Registrar has powers to enforce the provisions of the Act; he may conduct company inspections; issue notice requiring a company in default, to comply with the law; he may remove a company from the register of companies.
g) The Registrar may appoint independent inspectors to investigate the affairs of a company and report to him.
h) The Registrar is mandated to consult, and may enter into arrangements with other Government agencies such as the Malawi Police Service, the Immigration Department and the Anti-Corruption Bureau, among many others.
i) The Registrar is mandated to provide for two modes of filing documents; the traditional hard copy filing and the modern electronic mode of filing. The benefits of electronic filing include improved customer service, faster turnaround times, improving accuracy and audit trails, reduced processing costs and other potential savings associated with procurement, printing, postage and storage. The major disadvantage of electronic filing system is that it is prone to cyber-crime.

1.3 TYPES OF COMPANIES

The 2013 Act recognizes **four** types of companies, namely private limited liability companies, public limited liability companies, companies limited by guarantee and State Owned Companies (SOC).

1.3.1 Private Limited Liability Company

Section 23(1) of the Act defines a private limited liability company as one that firstly consists of a minimum of one person and a maximum of fifty persons and secondly its memorandum prohibits it from offering any of its securities to the public. Section 2 of the Act defines a ‘one-person company’ as a private company in which the only shareholder is also the sole director of the company; and this does not include a company in which the only shareholder is a company.

Section 62(1) of the Act allows a single member company to increase membership from a single member to two or more members if the single member has passed a resolution to that effect. The Act allows for a private company, other than a company limited by guarantee or a State Owned Company, to be re-registered as a public company by passing a special resolution and otherwise complying with other provisions of the Act.

1.3.2 Public Limited Liability Company

Section 24 of the Act defines a Public Limited Liability Company as one that firstly, consists of a minimum of three members, secondly, its memorandum permits offering of its securities to the public and lastly its memorandum permits the transferability of its securities. It is important to note that according to ***Auction Holdings Ltd v Hara and Others*** MSCA Civil Appeal Case No. 69 of 2009 all companies registered on the stock exchange are public limited companies, however not all public limited liability companies are registered on the stock exchange.

The Act allows for a public company to be re-registered as a private company by passing a special resolution and otherwise complying with other provisions of the Act.

1.3.3 Company Limited by Guarantee

Section 25 of the Act defines a Company Limited by Guarantee as one which is formed on the principle of having the liability of its members limited by its constitution to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up; and it is formed for the sole purpose of operating as a charity or as a not for profit organization. In addition, section 37 of the Act prohibits such a company from distributing profits.

The members have no liability unless and until the company goes into liquidation. When this happens those who are members at the time are required if necessary to contribute towards the payment of the company's debts and liabilities and the costs of winding-up in accordance with the guarantee. The amount guaranteed will be whatever sum is stated in the statement of guarantee on formation and it is usually a small sum although in some cases the agreed liability may be substantial depending on the type of company. The guarantee is not an asset of the company but a mere contingent liability of its members until winding-up. Consequently it cannot be charged by the company as a security nor can it be increased or reduced by an alteration of the memorandum or by agreement with the members or by any procedure equivalent to the increase or reduction of share capital.

1.3.4 State Owned Companies

Section 26(1) of the Act introduces State Owned Companies which is a company controlled within the meaning of the Act by the Government. In Malawi these companies are commonly called parastatals or statutory corporations. The provisions in the Act pertaining to public companies do apply to all State Owned Companies. However, the Minister may, where appropriate, and by notice published in the Gazette, exempt State Owned Companies from the provisions of the Act.

1.3.5 Other categorization of companies

1.3.5.1 Holding (Parent) and Subsidiary Companies

Section 2 of the Act provides that a subsidiary means in relation to another company where that other company, referred to as the parent:-

(1) Controls the composition of the Board of the company.
(2) The parent is in a position to exercise more than one-half of the maximum number of votes that can be exercised at a meeting of the company.
(3) The parent holds more than one-half of the issued shares of the company.

1.3.6 **Dormant Companies**

A dormant company is not necessarily a type of company but a state into which any company may transform into. According to section 2(1) of the Act, a 'dormant company' means that a company is 'dormant' during any period in which it has no significant accounting transaction. A dormant company ceases to be dormant when any significant accounting transaction occurs in relation to the company. A significant accounting transaction means a transaction which is required to be entered in the accounting records of the company but does not include any transaction which arises from the issue to a subscriber, of shares in the company in respect of the application for incorporation nor the payment of bank charges, licence fees or any other compliance costs.

There are at least two ways through which a company may be recorded in the register as a dormant company. Firstly, where a company has been dormant from the time of its formation; secondly, where the company has been dormant since the end of its previous accounting period, and is not required to prepare group accounts for that period. In that case, the company may pass a special resolution at a meeting of shareholders at any time after copies of the annual accounts and reports for the year have been duly sent to shareholders, declaring itself to be a dormant company. The company then gives notice to the Registrar, within 14 days of the passing of the special resolution and the Registrar records the company in the register as being a dormant company.

A company formed for the business of banking or insurance is prohibited from declaring itself a dormant company. The peculiarity of such companies is apparent as both banks and insurance companies deal with public deposits and premiums, respectively.

A dormant company is exempted from the requirement of having its accounts audited as well as payment of specified fees. Shareholders may therefore find it useful to declare their company dormant where the prospects on the ground dictate so, for example where their core product can only be sold at a loss yet better prospects are expected in subsequent years. Where a dormant company ceases to be dormant it must inform the Registrar within 14 days for him to make appropriate changes in the register.

1.3.7 Foreign Companies

A foreign company is considered as a company incorporated outside Malawi but which has a place of business or is carrying on business in Malawi. Such a company may be registered as a foreign company in Malawi and most of the provisions in the Act have equal force against a foreign company.

1.4 COMPANIES AND PARTNERSHIPS

In contrast to the company, the other main type of business association is the partnership governed by the Partnership Act 1969. This is an unincorporated association, where two or more persons associate for the purposes of business. No other separate legal personality is brought into existence on the formation of the partnership, and the business and all its assets remain the property of the partners. Section 3 of the Partnership Act defines a partnership as a relation which subsists between persons carrying on a business in common with a view of profit. It specifically excludes the relationship which exists between members of a company. However, while companies can never be considered as partnerships, companies themselves can be the partners in a partnership, for example, as part of a joint venture with other companies. The maximum number of members in a partnership is twenty (20) unless the partnership is meant for regulated professions.

Each partner is an agent for the others and, hence, can affect the legal rights and obligations of the other partners. Partners are thus jointly and severally liable. Partners owe each other fiduciary duties, which is not the case with members in a company. Partnerships can be formed by deed or quite informally and, in contrast to companies, can be formed simply in writing, orally or even by conduct. It is normal, however, to have a partnership agreement which sets out the terms on which the partners are associated. In the absence of any agreement to the contrary, when one partner wishes to leave or retire, the partnership has to be dissolved and then perhaps re-formed among remaining partners. Furthermore, when a new partner wishes to join, there has to be unanimous consent of the existing partners. Again, as we shall see, this is in contrast to the registered company. The most substantial differences between a company and a partnership can be appreciated by an examination of the main features of the modern registered company under the Act as follows:-

a) **Incorporation by Registration** – A company can only come into being through the process of incorporation. A partnership may be formed in writing, by word of mouth and even by conduct.
b) **Separate Legal Personality** - Once a company has been registered it becomes a separate legal entity. This was sanctioned by the celebrated House of Lords' decision in ***Salomon v Salomon Ltd*** [1897] AC 22, which is fully discussed in Chapter Four.
c) **Ownership of Property** - A company owns and disposes of property in its own name since it is a separate legal entity.
d) **Legal Suits** - A company can sue and be sued in its own name. A partnership even if sued in the firm's name, the suit lies against the partners personally.
e) **Transferable Shares** - Shares in a company are transferable in the manner provided for in the company's constitution. A serious disadvantage with the partnership is that, unless express provisions are made in a formal partnership deed as to what should happen in the event of there being a change in the composition of the partnership, when any partner dies or wishes to leave or when a new partner is admitted, the partnership has to be dissolved and re-formed. In respect of the registered company shareholders may change conveniently and with a minimum of disruption to the company's business.
f) **Perpetual Succession** - Furthermore, because the company is a corporate body and a recognized legal entity, it survives the death of one, or even all, of the members. The shares

of any deceased member are simply transferred to their personal representatives. The company therefore has a potentially perpetual existence.

g) **Limited Liability** - The single most attraction of a company as a means of carrying on business is that it offers members limited liability for its debts. Where the company is limited by shares, the limit will be any sum that remains unpaid on a member's share. Where the company is limited by guarantee, it will be the sum that he undertakes to pay in the event of the company winding up with unsettled debts. Unlike a partnership or a sole trader, a member's private properties cannot be seized to settle debts of the company if the member has fully paid up his shares.

h) **Disclosure and Formality** - A major feature of the law relating to registered companies is the amount of information about the company which has to be compiled and disclosed. The duty to disclose is further compounded for Public Limited Liability Companies considering that members of the public will have invested in them. Thus, the formalities and the publicity associated with the registered company can be considered disadvantageous and, to some extent, form a disincentive for a businessperson to incorporate his business. The information required of a sole trader, or of the partners, is much less and may be only the information which is required for the purposes of taxation; moreover, this is not available for public inspection. In turn, disclosure and formality offers a degree of transparency, enabling investors and creditors to have an opportunity to obtain knowledge of a company's business functions.

1.4 PRACTICE QUESTIONS

1. Explain the relevance of the office of the registrar of companies.
2. Give any **five** functions of the registrar of companies.
3. Mention **three** differences between public companies and private companies.
4. Mention **two** types of companies limited by shares.
5. State and define types of companies under the Companies Act.
6. Distinguish a company limited by guarantee from one limited by shares.
7. Distinguish a **holding** company from a **subsidiary** company.
8. Comment on the following:-
   (a) One person company
   (b) State Owned Company
   (c) Dormant company
   (d) Foreign company
9. Write an essay detailing the **advantages** and **disadvantages** of operating a business in the form of a partnership as compared to a registered company.

CHAPTER 2: FORMATION OF A COMPANY

2.1 INTRODUCTION

This Chapter is concerned with the office of the promoter who les at the heart of company formation and the key legal requirements in the formation of a company as a separate legal entity.

2.2 PROMOTERS

A promoter is someone who forms a company and performs other tasks necessary for it to begin business. According to Cockburn CJ in ***Twycross v Grant*** (1877) 46 LJ CP 636, a promoter is one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose.

Persons who are acting in a purely professional capacity who have been instructed by a promoter, for example, a lawyer or accountant, do not become promoters themselves. Although, if they go beyond this and, for example, agree to become a director or secretary of the company, they will be held to have become promoters.

There are various things that the promoter may do including the following:-

a) He may conceive the company and its business;
b) He may find directors for the company;
c) He may make statements and invitations for its shares and debenture;
d) He may pay its preliminary expenses;
e) He may hold money or property on its behalf;
f) He may acquire property for its use after incorporation and enter into transaction for its benefit
g) He may engage services of a lawyer, an accountant or other professional adviser

From the aforegoing it will be seen that there is likelihood of abuse of the promoter's powers. The Companies Act and common law in turn seek to discourage such potential and actual abuses. Below is a discussion of legal mechanisms preventing abuse of office by promoters.

A promoter owes **fiduciary duties** to the company he is forming. It was stated by Lord Cairns in ***Erlanger vs New Sombrero Phosphates Co. Ltd*** (1878)3 All Cas 1218 (facts appear below) that 'a promoter... is in a fiduciary position to the company which he promotes or causes to come into existence'.

A promoter is prohibited from making secret profits. If a promoter makes such a profit, he must disclose it to an independent board of directors or the company's existing and future shareholders. Should he fail to do that, the company may do the following;

a) It may compel him to **account**- ***Gluckstein vs Barnes*** [1900] AC 240 - A syndicate bought property for £140,000 and resold it at £180,000 to a company. In effecting that transaction, the syndicate had made a profit of £20,000 which it did not disclose. **Held;** that the syndicate was bound to pay the company the secret profit of £20,000.

b) The company may **rescind** the contract- in ***Erlanger vs New Sombrero Phosphates Co. Ltd*** (1878) 3 All Cas 1218 the appellants formed a syndicate which bought an island at £55,000. Subsequently, the syndicate created a company to which it resold the island at £110,000. No disclosure was made of the profit made by the syndicate on the deal. It was **held** that the company was entitled to rescind the contract of sale.
c) The company may **sue** the promoter for damages for breach of his fiduciary duties. Damages means compensation represented by a sum of money. An early example is ***Twycross v Grant*** (1877) 46 LJ CP 639 where the promoters had not disclosed their contracts with the company as obliged. The shares turned out to be worthless and, therefore, the damages recovered by the plaintiff were equal to the entire amount which was paid for them.

2.3 PRE-INCORPORATION CONTRACTS

Apart from breach of the fiduciary duty, a promoter may also be liable because of what are called "pre-incorporation contracts". These are contracts entered into on behalf of a company not yet formed to procure goods or property which it will need to operate after incorporation.

Quite commonly, a promoter will have to enter into contracts with third parties on behalf of the proposed company, at a time when the company has not yet been formed. Third parties would face a problem in such a situation if, for instance, the company is subsequently never formed or is formed but goes into liquidation before the bill is paid. They would have no one to enforce the contract against. This is because the promoter would claim only to be standing in the position of an agent for the company and, therefore, not to be personally liable on the contract. The company would argue that it was not in existence at the time the promoter went into a contract on its behalf.

The law must then come out clear on who is liable in such circumstances so that the innocent party is protected. To begin with promoters are not agents of the yet to be formed company. It is a basic principle of the law of agency that one (an agent) cannot act on behalf of another person (principal) who does not exist.

The position under section 45 of the Act is to the effect that a pre-incorporation contract can be ratified by the company after its incorporation. and if not ratified it cannot bind the company according to section 44(4) of the Act. In that event the promoter will be personally liable.

Thus in ***Nali Farms Limited & Khoromana v National Seed Co. of Malawi***, High Court Civil Case No. 469 of 1989, the second plaintiff who was the sole owner of Nali Farms bought chillie seeds from the defendant. Subsequently, he formed a company, the first plaintiff of which he was the majority shareholder and director, which took over all the assets of the farm. When the seed turned out to be defective and caused losses, the second plaintiff sued the defendant. The issue for the determination of the court was whether the company could sue on the contract and it was **held** by Mbalame J that the company could not sue as it had not adopted the contract, in other words the promoter was the one who could sue and be sued on the contract.

In ***Zikomo Flowers Ltd and another v Finance Bank Malawi Ltd (In Voluntary Liquidation)*** [2008] MLR (Com) 272 the court mentioned that since the loan created by the promoter on behalf of a company, yet to be formed, was adopted by the company, the promoter was not liable but the company itself.

2.4 COMPANY FORMATION

2.4.1 Formation

The formation of a company is an administrative process, involving the delivery to the Registrar of the company's memorandum and articles and accompanying statements. The memorandum and articles of association are fully discussed in Chapter 3.

Section 27 of the Act allows any person, subject to the provisions of the Act, to apply to incorporate a company in any one of the categories that were discussed in Chapter 1, namely private limited liability company, public limited liability company, companies limited by guarantee and State Owned Companies.

Under section 28 of the Act, an application for incorporation of a company must be sent or delivered to the Registrar in the prescribed form, signed by each applicant and accompanied by written consent to act as a director or secretary and a declaration that the person is not disqualified from being appointed or holding office as a director or secretary of a company. Where a company has share capital, every shareholder must submit written consent to being a shareholder and to taking the class and number of shares specified in the document and stating the consideration to be provided by that shareholder for the issue of those shares.

Where the proposed company is limited by guarantee, a document must further state a specified amount up to which the member undertakes to contribute to the assets of the company, in the event of its being wound up while that person is a member.

According to section 28(2) of the Act, in general, the application must state the following:-

a) the full name and address of each applicant;
b) the present full name; any former name and the usual residential address of every director and of any secretary of the proposed company;
c) particulars of any business occupation and directorships of any public company or subsidiary of a public company held by each director;
d) the full name and residential address of every shareholder of the proposed company, and the number of shares to be issued to every shareholder and the amount to be paid or other consideration to be provided by that shareholder for the issue of those same shares;
e) the type of company that is being formed;
f) the registered office of the proposed company;
g) such other information as may be prescribed;
h) in the case of a one person company, the full name and residential address and occupation of the person nominated by the proposed director to be the secretary of the company in the event of death or some incapacity.

i) a declaration made by the applicant that the information provided in the application is true and correct.

2.4.2 Statement of Capital

Under the Companies Act of 1984, in the case of a limited company with a share capital the memorandum was required to state the amount of the share capital with which the company proposed to be registered and the nominal amount of each of its shares. This was known as the **'authorised share capital'** and acted as a ceiling on the amount of capital which could be issued, although the limit could be increased by an ordinary resolution. The 2013 Act abolished the concept of 'authorised share capital'. Thus the information about the shares subscribed for by the subscribers to the memorandum, which was earlier set out in the memorandum itself, is now provided to the registrar in the statement of capital.

In that regard, section 30 of the Act sets out the mandatory contents of the statement of capital as follows:-

a) the total number of shares of the company;
b) for each class of shares (i) prescribed particulars of the rights attached to the shares; (ii) the total number of shares of that class; (iii) the aggregate par value of those shares where applicable; and
c) the amount paid up and the amount, if any, unpaid on each share, whether on account of the par value of the shares, as applicable or by way of premium.

2.4.3 Certificate of Incorporation

Section 29 of the Act provides for incorporation. Thus, where the Registrar is satisfied that the application for incorporation of a company complies with the Act, the Registrar is obliged, upon payment of the prescribed fee to:-

1. Enter the particulars of the company on the register;
2. Assign a unique number to the company as its company number; and
3. Issue a certificate of incorporation in the prescribed form.

2.4.4 Conclusiveness of the Certificate of Incorporation

A certificate of incorporation of a company issued under section 29 of the Act is conclusive evidence that all the requirements of the Act as to incorporation have been complied with; and on and from the date of incorporation stated in the certificate, the company is incorporated under the Act. This means that even if it is subsequently discovered that the formalities of registration were not in fact complied with, the registration will not be held invalid. The reason for this is that once a company has commenced business and entered into contracts, it would be unreasonable to void the contract because of a procedural defect in the registration of the company. The affected party can at any time request the Registrar to remedy the defect in the registration. In other words, the certificate of incorporation is enough proof of the existence of the company.

2.4.5 Legal Effect of the Certificate of Incorporation

Section 32 of the Act provides that a company incorporated under the Act is a body corporate with the name by which it is registered and continues in existence until it is removed from the register of companies. This means that from the date of incorporation mentioned in the certificate, the subscribers to the memorandum together with such other persons as may from time to time become members of the company, become a body corporate by the name contained in the memorandum capable forthwith to exercise all the functions of an incorporated company having perpetual succession and power to hold land per ***Salomon v Salomon*** in Topic Four.

2.5 PRACTICE QUESTIONS

1. Who is a promoter of a company?
2. Explain the significance of a promoter in the formation of a company.
3. Mention **four** activities that a promoter has to undertake in the course of establishing a company.
4. What duties does a promoter owe to the company?
5. Explain the duty of a promoter regarding any profits he may make in relation to the company.
6. The case of ***Erlanger v New Sombrero Phosphates Co. (1878)*** holds that promoters of a company stand undoubtedly in a fiduciary position. Mention any **two** consequences of this fiduciary relationship in dealings between the company and the promoters.
7. What remedies do members have against promoters who breach their duties during the incorporation of a company?
8. Who is liable to pay for the price of goods bought by the promoters on behalf of the company, once the company is incorporated?
9. Discuss the legal position regarding the effect of pre-incorporation contracts to a company after its incorporation.
10. Explain relevance of ***Nali Farms Limited & Khoromana v National Seed Co. of Malawi***, 1989.
11. What is meant in company law by the term 'incorporation'?
12. List any **five** contents required in the application for incorporation form.
13. What is meant by statement of capital?
14. What is the historical relationship between the statement of capital and authorized share capital?
15. Explain the legal effect of the certificate of incorporation.
16. Discuss the legal position where a company enters into a contract and it is subsequently discovered that it did not follow certain registration requirements. Is the contract valid? Give reasons for your answer.
17. Discuss how conclusive the certificate of incorporation is.
18. Union Bus Company (UBC), once a successful passenger transport company, is now on the verge of liquidation mainly due to stiff competition from minibus operators. Of immediate concern to UBC is its failure to pay its suppliers most notably General Tyre Merchants Ltd

(GTM) whom UBC had contracted to supply it with K10 million worth of tyres. In its present financial position, the only option available to UBC is to have the sale agreement rescinded without attracting a legal suit for loss of business. In their desperate bid to justify the intended rescission of the contract, UBC conducted a search at the Registrar of Companies. To UBC's delight the search has revealed that while GTM is a duly registered company number M0922490, some formalities required for registration of a company had not been fulfilled. Mr Chifisi, the Managing Director of UBC, has approached you for advice eager to confirm his conviction that although registered, GTM Ltd is an illegal company and therefore cannot enforce or in any way sue on the contract.

Required: Advise Mr Chifisi whether or not the information discovered justifies the rescission of the contract.

19. Wanangwa Jere, acting as a promoter for a prospective fruit juice company to be known as Golden Canners Co. Ltd, borrowed K10 million from Horizon Investment Bank Ltd in March 2014. The loan agreement expressly stipulated that Wanangwa was contracting the loan as an agent of a group of investors of the proposed company. The conviction of the bank was that the incorporation of the company was underway. In fact, on a number of occasions, Wanangwa had shown Mr Brown, the Bank Manager, a number of legal documents to that effect. The loan was repayable by April, 2016 the bank having been convinced that by then the company would have been incorporated and be in a position to effect the repayment. Contrary to expectations, Golden Canners Co. Ltd is yet to be incorporated and consequently no single instalment has been paid on the loan to date. Mr Brown is now under intense pressure from the Head Office, Durban, South Africa, to have the loan recovered immediately.

    Required: Advise Mr Brown on the recoverability of the loan in the circumstances.

CHAPTER 3: THE CONSTITUTION OF A COMPANY

3.1 INTRODUCTION

Every club, society or association needs a constitution or set of rules to regulate the way the business of the association is conducted. The registered company is no different and its constitution is contained in two documents, the memorandum of association and the articles of association. The memorandum of association consists of rules that govern the relationship between the company and outsiders whereas the articles of association are rules for internal management of a company. Both documents are filed with the registrar when the company is formed and they remain open for public inspection. Together, they form the complete constitution which must be consistent with the provisions of the Act and other written law.

3.2 **THE MEMORANDUM OF ASSOCIATION**

The memorandum is the more fundamental of the two documents and is the one to which the original parties forming the company will subscribe their names. Section 34 of the Act allows a company to adopt as its constitution the model memorandum and articles of association applicable to it as prescribed in the regulations to the Act and where none are filed it is deemed that the company has adopted the appropriate model.

The general contents of the memorandum include the name of the company; restrictions, if any, imposed on the company's business; company's authorised capital; whether the company is private or public limited and that liability of members is limited.

3.2.1 Company Names

Reservation of Name
Just like a natural person, a company is identifiable by name. Section 45 of the Act allows for reservation of a name. The reservation may be revoked sooner by the Registrar, if not used for incorporation or change of name within two months. The law permits the reservation of name without guaranteeing that the Registrar will as a matter of fact permit the use of the name once the proposer finally wants to use it.

Prohibited Names
Section 47 of the Act prohibits the registration of a name which is identical with that of an existing company or so nearly resembles that name as to be likely to mislead the public.

The Act also lists names that may only be registered with the Minister's written consent such as 'Authority', 'Corporation', 'Government', 'Malawi' and 'National'. According to section 48 of the Act all public limited liability companies must now end their names with the words "public limited company" or "plc". Private limited companies and companies limited by guarantee must end their names with "Limited" or "Ltd".

Every company is required to clearly state its name in every written communication sent by, or on its behalf which evidences or creates a legal obligation of the company. Every person who issues or signs a document where the name of a company is incorrectly stated is liable to the same extent as the company.

Change of Name

There are at least three ways through which the name of the company may be changed.

a) the **Registrar may direct** that the company change its name where, after registration, it appears to the Registrar that misleading information has been given for the purpose of a company's registration by a particular name.
b) the company may pass **a special resolution** followed by an application to the Registrar to change its name under section 52 of the Act.
c) Through a **court order**- courts have always enjoyed wide powers to regulate companies generally and specifically their names. If an application is brought by an injured party that the defendant is using a similar name as that of the applicant's (commission of the tort of passing off), the court may issue an injunction against such wrongful use and order the defendant to change its name. In ***Celtel Malawi Limited v Globally Advanced Integrated Networks Limited*** Com. Cause No. 177 of 2008 the plaintiffs who had long carried on business under the name ZAIN sought an injunction restraining the defendants' use of the name GAIN. Both parties were operating in the telecommunication industry. An injunction was granted. In ***Panjira Chicken v Panjira Poultry 2007*** Com. Case No. 74 of 2007 the defendant was restrained from using the name 'Panjira' as the same constituted the tort of passing off.

3.2.2 Registered Office

Particulars of the registered office are supposed to be provided in the registration documents of the company and a change in the particulars of the registered office is effected by filing a notice with the Registrar. The registered office is important for general communication and in particular service of summons and other legal documents. In ***Cheseborough Ponds (Mal) Ltd v Gala Estates Ltd*** [1990] 13 MLR 83, the High Court held that service of summons under the Companies Act 1984 could only be effected at the company's registered office or through its registered postal address and on the facts of that case no effective service was done as the summons were served elsewhere other than the companies registered office.

3.3 ARTICLES OF ASSOCIATION

Every registered company has to have, in addition to a memorandum, articles of association. This document will contain the basic regulations for the management of the company, covering such matters as the issue and allotment of shares, the calls on shares, the rules relating to the transfer of shares, the procedures to be followed at general meetings and the regulations relating to members voting, the appointment, removal and powers of directors, the payment of dividends and the capitalisation of profits.

3.3.1 The Relationship between Articles and the Memorandum

The memorandum is the more fundamental both because of its content and because, if conflict arises between the terms of the memorandum and the articles, the memorandum takes precedence. In ***Re Duncan Gilmour and Co. Ltd*** [1952] 2 All ER 871, the memorandum provided that preference shareholders had priority in the distribution of the company's assets on winding up. The articles, on the other hand, provided that preference shareholders had no priority but that distribution of surplus would depend on whether a member's shares were fully paid up or not, regardless of whether one was a preference or an ordinary shareholder. It was **held** that the memorandum would take precedence therefore preference shareholders were entitled to preference in the distribution of the company's assets.

3.3.2 The Contractual Effect of the Constitution

Section 33(3) of the Act provides that subject to the Act, the constitution of a company has the legal effect of a contract firstly as between the company and each member; secondly as between the members themselves and not outsiders. This means that both the company and members have individual rights and obligations such that failure to comply with the memorandum and articles amounts to breach of contract entitling the innocent party to sue.

In ***Hickman v Kent*** [1915] 1 Ch 881, the articles of the company required that any dispute between the company and a member be referred to arbitration. There was a dispute between the plaintiff member and the company. The plaintiff member ignored the articles and decided to sue the company. It was **held** that the company would be allowed to compel the plaintiff to refer the dispute to arbitration before suing. In ***Rayfield v Hands*** [1960] Ch 1, the articles required the company to buy a member's shares at a fair price if he intended to transfer them. The company refused to buy the shares and it was **held** that the company had to buy the shares.

Lastly, it must be made clear that the constitution binds members of the company and not outsiders. Thus in ***Ely v Positive Government Security Life Association Company Limited*** (1876) 1 Ex D 88, the articles provided that the plaintiff should be the lawyer for the company. The Plaintiff lawyer was not a member of the company. The defendant company terminated his contract and he sought to rely on the articles. It was **held** by the court that he could not rely on the articles because he was not a member of the company.

3.3.3 Shareholders' Agreement

A shareholders' Agreement operates as a binding contract and deals with the rights and duties of members of a particular company to which it applies. It may be made by all members of the company, or be limited to a portion of them.

There are a number of reasons why the shareholders may wish to supplement the constitution in this way. For example, the constitution is normally available for public inspection, whereas the terms of a shareholders' agreement, as a private contract, are normally confidential between the parties. It is also believed that a shareholders' agreement is generally cheaper and less formal to form, administer, revise or terminate thereby providing greater flexibility to shareholders.

3.4 PRACTICE QUESTIONS

1. Mention the basic constitutional document of a company limited by shares and state its usual contents.
2. What is the relationship between a Memorandum of Association and Articles of Association?
3. What is the contractual effect of the Memorandum of Association and Articles of Association
4. State the effect of the Articles of Association upon the company, its members and outsiders
5. Outline the information required to be contained in the Memorandum of Association.
6. State any **five** clauses that should be contained in the articles of association.
7. In relation to company names, comment on the following terms:-
    (a) Reservation of name
    (b) Prohibited names
8. How would a company, registered under the Companies Act, change its name?
9. Explain with reasons why each company must have a registered office.
10. State the importance of Shareholders agreement.

CHAPTER 4: CORPORATE STATUS OF A COMPANY

4.1 INTRODUCTION

The most important consequence of incorporation under the Act is that the company gets transformed into a body corporate with power to exercise all the functions of an incorporated company.

According to ***Salomon v Salomon*** [1897] AC 22, the company is at law a different person altogether from the subscribers to the Memorandum; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits the company is not in law the agent of the subscribers or a trustee for them. The facts in ***Salomon v Salomon*** itself were that Salomon incorporated his business as a limited company, which consisted of seven members of his family and himself. He held all the shares except seven, and also debentures to the value of £10,000, representing a loan which the company borrowed from him. The debentures entitled him to a first charge on the assets of the company. Thus, when the company went into liquidation, Salomon claimed that, as a debenture-holder, he was a 'secured' creditor. The other creditors claimed that Salomon and the company were the same person, and that a man cannot owe himself money. The House of Lords, however, **held** that a company, once incorporated has a legal existence of its own, which was quite independent of the existence of any individual member.

4.1.1 Some Effects of Incorporation

(a) Members of the company are not personally liable for the company's debts as long as it is a going concern. In ***Naidoo vs. Madzi Import and Export and Chongwe [1985]***, the plaintiff and the 2nd defendant formed the 1st defendant company. The plaintiff and the 2nd defendant being directors and shareholders. The 2nd defendant incurred some expenses in the name of the company. The issue was whether or not the plaintiff could recover those expenses from the 1st and the 2nd defendant. It was **held** that since the company is a distinct legal personality the expenses could be recovered from it and not from the 2nd defendant. This conforms to the accounting principle of separate legal entity.

(b) Directors of the company are not ordinarily liable for the acts of the company. In ***SC Yiannakis Ltd v Tione Enterprises and Another*** [1993] 16 (2) MLR 782 it was held that the managing director could not be sued together with the company where the company had entered into a lease agreement through the managing director as its agent.

(c) The company's property (assets) belongs to it and not its members or creditors. Thus in ***Macaura vs Northern Assurance Company Limited*** [1925] AC 619 the appellant owned a timber estate. He assigned it to a company in return for the allotment by the company of fully paid up shares to him. Later, he insured the timber in his own name against fire. The timber was later destroyed by fire. He sought compensation from the company. It was **held** that the company was not obliged to compensate him since he had no **insurable interest** in the timber which belonged to the company. In other words the appellant had insured property which did not belong to him. The law of insurance demands that one can only insure property in which he has some interest called 'insurable interest'.

(d) Shareholders cannot validly pay money belonging to the company into their personal accounts or draw money from its accounts for their personal use. This also corresponds with the accounting principle of separate legal entity.

(e) A company is immortal; it does not come to an end because of death of one or all of its shareholders. It enjoys perpetual succession.

(f) Under the Taxation Act a company is charged tax on its own income and not as an agent for its shareholders.

(g) A person may perform multiple functions as a director, shareholder and employee of the same company. In ***Lee vs Lees Air Farming Limited***, [1961] AC 12 Lee formed a private company to carry on a crop spraying business. He held all the shares except one; he was the managing director and also employed as a chief pilot. He was killed while piloting the company's aircraft. The court held that his widow could claim compensation under the Worker's Compensation Act applicable in the UK then.

4.2 LIFTING THE CORPORATE VEIL

The fundamental principle of English Company Law which is the foundation of Malawi Company Law was laid down in the case of ***Salomon vs Salomon*** namely that a company duly incorporated is a separate legal entity with its own rights and obligations distinct from those of its shareholders.

However, there are instances where the law will depart from this rule. The law goes behind the corporate veil (facade) to expose the real actors. Such exceptions are referred to as 'lifting the veil of incorporation' or 'piercing the veil of incorporation'.

There are **two** instances through which the veil of incorporation may be lifted. First under an Act of Parliament and second under common law (case law/by the courts). Let us now turn to details of lifting the corporate veil under both instances.

4.2.1 Lifting the Corporate Veil through Acts of Parliament

Examples under the Companies Act 2013

a) The advantages of the corporate form can be removed where the director or other officer does not maintain the company's name outside its place of business or where the company's name does not appear on the company's letters, notices and bills, etc. (section 54 of the Act)

b) A person will not be able to hide behind the corporate veil and avoid liability for the company's debts if he has used the company to perpetrate fraud. ***In the Matter of NBM, Continental Traders Ltd and another*** [2001-2007] MLR (Com) 78, Nyandovi-Ker was a shareholder and director of Continental Traders Limited. The company obtained through her an overdraft facility with an undertaking to constitute her house in Zomba as security. After obtaining the overdraft, but before executing a charge over the house, she sold the house to a third party. The court lifted the veil of incorporation and held her personally liable for having conducted the company business with intent to defraud National Bank of Malawi. (section 346 of the Act)

c) Any director or employee who knowingly furnishes false or misleading statements is liable on conviction to five years imprisonment and a fine determinable by the court. (section 345(2) of the Act

d) In a public company certain payments must be made with the approval of shareholders and where a payment is made without such approval, any director who authorised the payment is jointly and severally liable to indemnify the company. (section 215 of the Act)

Examples from other Acts of Parliament

There are numerous other instances, outside the Companies Act, wherein the veil of incorporation may be pierced. For example section 119 of the Taxation Act provides that where a company is liable to a penalty, every person who at the time of the offence was an officer of the company shall also be liable to the same penalty. Similarly, section 24 of the Penal Code provides, in part, that where a criminal offence is committed by a company, every person charged with or concerned or acting in, the control or management of the affairs or activities of such company is guilty of that offence and is liable to be punished accordingly.

4.2.2 Lifting the Corporate Veil by the Courts

a) Where a company is using the veil of incorporation to evade legally binding obligations:-

In ***Gilford Motor Company Limited vs Horne*** [1933] Ch 935:- An employee undertook not to solicit his employer's customers after the termination of his employment. Soon after termination, he formed a company of which his wife and another person were directors and shareholders. In violation of the undertaking he sent out circulars to customers of his former employer. It was **held** that the company was formed as a sham to get around his obligation under the contract. An injunction was granted against the circulars.

In ***Jones v Lipman*** [1962] 1 WLR 832 here, L entered into a contract to convey a parcel of land to J. Subsequently, he changed his mind and, in an attempt to avoid being compelled to convey the land, he formed a company, A Co, of which he and a clerk were the only shareholders and directors. L then conveyed the land to A Co. The court granted an order for specific performance against both L and A Co to convey the land to J because the company was a creation of L as a device and a sham or a mask which he held before his face in an attempt to avoid recognition by the eye of the law.

b) Where an individual controls a number of companies as if they were his property, the court may ignore the distinction between him and the companies, and hold him responsible for their acts. In ***Wellersteiner vs Moir (No. 2)*** [1975] QB 373 the plaintiff was a financier who controlled a number of business concerns. He would keep the money at a bank, in which he was a chairman and made most of the decisions himself. It was **held** that although the concerns were distinct legal entities, the court would lift the veil of incorporation and treat them "as being creatures for whose doings he should be responsible."

c) The court may lift the veil of incorporation if it feels that the company's corporate personality is being used for illegal purposes such as tax evasion and money laundering. In ***Unit Construction Company vs Bullock*** [1959] 1 All ER 591 a holding company in the United Kingdom created many subsidiaries in Kenya in order to evade tax. The court **held** that since the subsidiaries were managed in the UK and were resident in that country, the parent company would be liable to taxation in the United Kingdom.

d) In a group company situation, the court may lift the veil by refusing to recognise that a holding company and its subsidiaries are separate legal entities and holding them to be a single economic unit.

i)In ***Smith, Stone and Knight vs Birmingham Corporation*** [1939] 4 All ER 116 it was **held** that the parent company which owned property which was compulsorily acquired by Birmingham Corporation could claim compensation for removal and disturbance, even though it was a subsidiary company which occupied the property and carried on business there. This was because the subsidiary was operating on the property, not on its own behalf, but on behalf of the parent company.

ii) In ***Energy Powers and Telekom Solutions Ltd v Airtel Malawi Ltd*** Com Case No. 25 of 2013, the court dismissed the plaintiff's claim for sums due to it from the defendant but already paid to an associate company. The court cracked the corporate skull and treated the plaintiff and its associate as one and the same person.

e) For security reasons such as during a period of war, the veil of incorporation may be pierced to identify the true nationality of a company; in ***Daimler Company Limited vs Continental Tyre and Rubber (GB) Limited*** [1916] 2 AC 307 the court lifted the veil to determine whether the defendant company was an "enemy" during the first world war as the shareholders were German, the court determined that the company was indeed "an enemy". Thus, the court maintains a watchful eye on any misuse of the corporate form.

4.3 PRACTICE QUESTIONS

1. What is meant by 'lifting the corporate veil'?
2. Though it is generally accepted that a limited company is a separate legal entity distinct from its shareholders, there are instances when the courts look behind the company as a legal person to discover who is behind it. Outline **four** circumstances in which the **courts** may act in the manner mentioned above.
3. Mention **three** circumstances under which the veil of incorporation may be lifted under the provisions of the Companies Act, 2013.
4. Discuss the legal principle expounded in the classic case of ***Salomon v Salomon.***
5. Outline the facts and holding in ***Salomon v Salomon.***
6. To what extent have the courts relaxed the concept of separate legal personality?
7. Identify and comment on any **five** legal effects of incorporation.
8. Mr Phiri is a sole shareholder and director of Tikwere Investments Limited. The company obtains through him a loan from Makwacha Bank with an undertaking to constitute his matrimonial home in Zolozolo as security. After obtaining the loan, but before executing a charge over the house, Mr Phiri sells the house to Mr Phoso. The bank has now learnt with shock about this development considering that the company is no longer servicing the debt and the loan account is in heavy arrears.
   Required: advise the Bank.

CHAPTER 5 : CORPORATE DECISION MAKING

5.1 INTRODUCTION

At the heart of company law lies the issue of who controls the company. The answer to this question will ultimately determine how the company's property is used, what transactions are entered into or approved and whether persons who have caused harm or loss to the company will be pursued. There are two primary decision making bodies within a company, the **general meeting of shareholders** and the **board of directors**

5.2 SHAREHOLDERS' MEETINGS

5.2.1 Quorum

Quorum is the number of persons who must, by the rules, be present at a meeting before its proceedings can have authority. The requisite quorum for a meeting will be specified in the company's constitution. A problem which sometimes arises is where the meeting is quorate at the outset but, subsequently, a member or members leave, reducing the number present to below the minimum required for a quorum. In ***Re Hartley Baird Ltd*** [1955] Ch 143, the quorum set by the company's articles was 10 and the meeting began with that number of members present. One member then left but, despite this, Wynn Parry J **held** that the departure of the member did not invalidate the proceedings carried on after his departure.

It is also possible to have a valid meeting even if all the members attending the meeting are not physically in the same room, if they are connected by audiovisual equipment, as long as this equipment is sufficient to allow members to debate and vote on matters affecting the company.

5.2.2 Notices

The power vested in the directors to call shareholders meetings and send out notices is a power which is potentially open to great abuse. First, the notice given for a meeting may be extremely short, giving shareholders little opportunity to make arrangements to attend or mount an effective opposition to the directors' proposal. Secondly, the circular accompanying the notice, being drafted by the directors, will not only, of course, put the directors' views forward but may also not present a true picture. As a result, the company's constitution may prescribe minimum notice periods to promote order and fairness.

5.2.3 Ordinary Resolution

The ordinary resolution means a resolution passed by a simple majority of votes cast by such shareholders of the company as are entitled to vote, voting in person or by proxy at a general meeting. Decisions that may be effected by an ordinary resolution include alteration of the number of shares in a company and appointment of directors.

5.2.4 Special Resolution

A special resolution means a resolution approved by a majority of not less than seventy-five per cent of the votes cast of those shareholders as are entitled to vote. Decisions that may be effected by a special resolution include alteration of the company's constitution; change of company name; alteration of company status by re-registration; reduction of capital and removal of directors, subject to the company's constitution.

5.2.5 Unanimous Resolution

Where all the shareholders of a company assent to a matter that could be brought into effect by a resolution in general meeting the unanimous consent of the shareholders without a formal meeting is enough. This is called the **'Duomatic Principle'** from the case in which it was established i.e. ***Re Duomatic*** [1969] 1 All ER 161. The **Duomatic Principle** is embraced of the Act through what has been termed a **'unanimous resolution.'** This is a resolution which has the assent of every shareholder entitled to vote on the matter.

5.2.6 Voting

The articles will normally make provision as to the voting rights of members and the procedure to be followed on a resolution put to the general meeting. In the absence of any provision to the contrary in the articles, every member of a company with a share capital has one vote in respect of each share held by him and, in the case of other companies, every member has one vote.

The common law position adopted by companies is that, when a resolution is put to the vote, it shall be decided on a show of hands, unless before, or on the declaration of the result of the show of hands, a poll is duly demanded. On a show of hands, every member present in person shall have one vote, but, on a poll, he or she shall have one vote for every share of which he or she is the holder. This ensures that decisions in a company are made by the majority. The case of ***Re Horbury Bridge Coal, Iron and Wagon Co.*** (1879) 11 Ch.D. 109 illustrates the application of the voting rules in a general meeting. Here, at a meeting where 5 members of the company were present a resolution was passed to wind up the company. The company then proceeded to elect its liquidator by show of hands. There were two candidates, A and B. A, got 3 votes while B got 2 votes which were cast by the majority. No poll was demanded by the majority. The chairman decided that B, who got 2 votes, was duly elected. The minority challenged this decision. It was **held** that the chairman erred because no poll was demanded and in a vote by show of hands the candidate who gets more votes carries the day regardless of the fact that he has been voted in by the minority. Therefore, A, who got 3 votes should have been declared the liquidator.

5.2.7 Proxy Voting

There may, of course, be shareholders' meetings which not all members are able to attend. The larger the company and the more distinct the shareholding, the more likely it is that only a relatively small proportion of the shareholders can attend the meetings in person or even fit into the room where the meeting is being held. If attendance were necessary in order to vote, substantial prejudice may be caused to investors, especially since the directors in normal circumstances have control over the exact date of the meetings. The legislature has provided, therefore, that any member of a company entitled to attend and vote at a meeting of shareholders is entitled to appoint another person (whether a member or not) as his proxy to attend and vote instead of him.

5.2.8 Class Meetings

Section 84 of the Act allows a registered company to create different classes of shares by attaching certain rights or restrictions to some of its shares. Members of a class may therefore hold meetings called class meetings.

5.2.9 Minutes

Good corporate governance demands that minutes be kept of proceedings of all shareholders' meetings.

5.2.10 Ratification of Director's Acts done in Breach of their Duty

The general meeting may ratify acts of directors done in breach of their duty. What is required is that the members must have all material facts before them. Further than that, a director who is also a member but is in breach of his duty as a director may also be allowed to vote. In ***North West Transportation v Beatty (1877)***, a director sold a ship to the company at a fair price. A general meeting was called to approve the sale. He was permitted to cast his votes (in his capacity as a member) for the resolution to approve the sale. However ratification is, by law, not allowed in the following circumstances;

(a) If the director's act is illegal or *utlra vires* (See ***Ashbury Railway Carriage v Riche (1875)*** discussed in Chapter 6)

(b) If the directors defraud the company, the majority cannot sanction the fraud [In ***Cook v Deeks*** [1916] 1 AC 554 directors who were also a majority shareholder took in their own names a contract meant for the company and it was held that that act could not be sanctioned by the general meeting as it constituted fraud on the company.]
(c) The company cannot, in a general meeting, waive or relax the principle that a director must exercise his powers bona fide in the interest of the company.
(d) If the directors allot shares to alter the balance of votes in a general meeting, the votes attached to those shares may not be cast to support a resolution approving the issue (In ***Bamford v Bamford*** (1970) Ch 212 the directors had used their share issuing powers for improper purpose and the said issue of shares was void)

5.3 BOARD MEETINGS

The constitution of a company will usually allow directors to regulate their proceedings as they think fit. Any director can call a meeting of the directors and the quorum for conducting any business is two. Questions are decided by a majority vote and, in the case of equality of votes, the chairman of the board has a casting vote. At common law, every director is entitled to notice of directors' meetings and to be able to attend and speak.

Meetings called at very short notice, and held at a time when it is known that certain directors will not be able to attend, will not be held to be valid board meetings and, therefore, decision taken even when a quorum is present will not bind the company.

A valid board meeting can be held informally, as long as all directors who should be informed are informed, and agree to the informality. An informal board meeting cannot be held against the wishes of one or more of the directors, as was shown in ***Barron v Potter*** [1914] 1 Ch 895, where one of the two directors of the company attempted to convene an informal board meeting on the platform of Paddington Station as the other alighted from a train and against his wishes. It was **held** that the additional directors who had been purportedly elected at this 'meeting' by the use of a casting vote had not been properly appointed.

5.4 THE RESIDUAL POWERS AND ROLE OF THE GENERAL MEETING

5.4.1 Shareholders' Powers to Remove Directors

Under section 166 of the Act, if the shareholders fundamentally disagree with the policies pursued by the directors or are unhappy with their performance then, ultimately, a majority of the shareholders can remove the directors from office.

5.4.2 Miscellaneous Residual Statutory Powers

Apart from the power to dismiss a director under section 169 of the 2013 Act gives the general meeting a number of statutory powers to control and scrutinise the activities of directors. So, for example, in a public company, a director's contract which is to last for more than two years has to be approved by the general meeting. So too does any payment to a director by way of compensation for loss of office. Directors may not enter into a substantial transaction unless approved by the general meeting. There are also requirements that the general meeting passes a special resolution, in order to effect major structural changes to the company, including alteration of the memorandum or articles, re-registration, reduction of capital and change of name.

5.5 PRACTICE QUESTIONS

1. Identify the **two** primary decision making bodies within a company and discuss any **five** rules, for each body, that govern their activities.
2. Which persons are entitled to receive notices of Shareholders Meetings of a company?
3. Comment any **three** types of resolutions that a shareholders meeting may pass.
4. Explain the **meaning of Duomatic Principle**.
5. What are the rights of a member's proxy at a Shareholders' Meeting?
6. Mention **four** acts which a company can only do by special resolution
7. What is the difference between an ordinary and a special resolution of a meeting?
8. At a company's meeting a resolution may be decided by voting either by show of hands or by ballot. Discuss.
9. Can a Shareholders' Meeting ratify a director's act which is in breach of his duty and if so what rules should a company follow?
10. State **four** circumstances under which ratification is, by law, not feasible.
11. What is a class meeting?
12. How may a Board Meeting be convened?
13. Explain residual or supervisory powers that the general meeting has over the Board Meeting?

CHAPTER 6 : CORPORATE MANDATES AND AUTHORITY

6.1 INTRODUCTION

Since a company is an artificial legal person, special considerations have to be made in relation to how it is to enter into contracts. Section 38 of the Act states that subject to the Act and to any other enactment, a company has full capacity to carry on or undertake any business or activity, do any act, or enter into any transaction both within and outside Malawi. In addition, the constitution of a company may contain a provision relating to the capacity, rights, powers, or privileges of the company only where such provision restricts the capacity of the company or those rights, powers, and privileges.

6.2 THE HISTORY OF THE DOCTRINE OF *ULTRA VIRES*

When a company is registered, the founders are required to send a memorandum of association to the registrar and one of the clauses of the memorandum is the 'objects clause'. The original intention of the legislature was that the founders would identify the purposes for which the company was formed and that these would be publicly known. In ***Ashbury Carriage Co. Ltd vs Riche*** (1875) LR 7 HL 653, a company was formed with the objects of making, selling and mending railway carriages (trams/rail cars). The company purported to build a railway line. It was **held** that the company's decision to build a railway line was *ultra vires* (outside its powers) and void. This was so regardless of the directors' and general meeting's ratification.

The rule was problematic as it could prove to have disastrous consequences for a person dealing with a company in good faith and was totally innocent apart from failing to obtain and interpret the company's objects clause.

Following that philosophy, the Act, simply provides in section 39 that a company is bound to act *intra vires* (within its powers) thus where the constitution of a company sets out the objects of the company, there is deemed to be a restriction in the constitution on carrying on any business or activity that is not within those objects, unless the constitution expressly provides otherwise. So much freedom is now left to the company to regulate its own affairs through its constitution.

6.3 DEALINGS BETWEEN THE COMPANY AND THIRD PARTIES

6.3.1 The Rule in Royal British Bank vs Turquand [1856] - Indoor Management Rule.

The rule in ***Turquand's Case*** states that a company will only be bound by the acts of a person who purports to act on its behalf as a director if he was appointed as such, and was acting within his authority. Thus if he was not appointed as director and was not held out as having authority to bind the company, the company cannot be held liable for his acts. However if he is appointed but lacks authority his acts may still more bind the company.

This absence of appointment and authority will not affect a third party (an outsider) unless the outsider actually knew or ought to have known that the purported director had no authority. An outsider is further protected because he is not bound to inquire whether or not the company has followed its internal rules.

Thus persons contracting with a company and dealing in good faith may assume that acts within its constitution and powers have been properly and duly performed and are not bound to inquire whether acts of internal management have been regular.

The facts in ***Turquand's Case*** were that according to the memorandum and articles of a company, directors could borrow money after authorisation by the general meeting. The directors borrowed money from the plaintiff bank without authority. It was **held** that what they did was clearly inconsistent with the constitution of the company. However, since externally the directors appeared to comply with the company's constitution, the company was bound by the loan. The bank (third party) was not bound to check whether or not the resolution had been passed; a third party is entitled to infer/assume the fact that a company complies with its constitution in its dealings.

The ***Tarquand's case*** was applied in ***National Bank of Malawi v Dairiboard Malawi Limited*** [2008] MLR (Com) 45 where a managing director for the defendant took a loan from the plaintiff bank guaranteed by the defendant company. The guarantee was signed on behalf of the defendant by the managing director and the company secretary. The defendant company denied liability as guarantor claiming that those who signed did not have authority and such guarantees were supposed to be ratified by the defendant's board under its articles of association. It was **held** that the defendant was liable since where an outsider entered into a contract with a company through its directors in good faith without knowledge that the directors had no authority from the company to enter into the transaction in question, the contract was still binding on the company.   Similarly in ***Mulli Brothers Limited v National Bank of Malawi*** Com Case No 92 of 2016, the argument that the loan was not binding on the company because a board resolution was not passed, was rejected by the Court.

There are some exceptions to the rule in ***Turquand's Case*** and they include:-

a) **Insider exception** – where the third party knew or ought to have known of the non-compliance with the company's rules of internal management, he is an insider through knowledge and so not protected by the rule in Turquand's case. In ***Howard vs Patent Ivory Manufacturing Co.*** [1888] 38 Ch D 156 directors had power to borrow up to £1,000 and needed the general meeting's consent to borrow above that figure. The directors themselves lent more than £1,000 to the company without the general meeting's consent. It was **held** that the company liable up to £1,000 only.

b) **Suspicious circumstances-** The law requires a reasonable person to make proper inquiries where circumstances are suspicious. In ***Underwood Ltd vs Bank of Liverpool and Martins Ltd*** [1924] 1 KB 775a director paid company cheques into his own account and misappropriated the funds. It was **held** that the fact that the director paid the cheques in his own account rather than the company's account put the bank under a duty to enquire from him or the company. Since the bank failed to make that enquiry, it could not rely on ***Turquand's case*** to assume that he had the authority.

6.3.2 Abolition of Constructive Notice

Section 41 of the Act abolishes **"constructive notice"**. Long before the abolishment of this rule, once a company registered its memorandum and articles, any third party and the public at large were deemed to have seen or read them. The abolishment of that rule therefore grants more protection to third parties who may be defrauded by crooked directors and other company representatives.

6.3.3 Common Seal

Before the Act, it was mandatory for every company to have a common seal, which acts as the company's signature. However, the Act provides that only a Public Company is mandated to have a common seal. It is optional for other types of companies.

6.4 PRACTICE QUESTIONS

1) State what you understand by the **doctrine of ultra vires** in Company Law.
2) How has the Companies Act affected the application of the **doctrine of ultra vires**?
3) How far is the doctrine still important?
4) In relation to the doctrine of *ultra vires* and the rule in ***Ashbury Carriage Co. Ltd vs Riche*** (1875):-
    (a) Give the facts and holding in the ***Ashbury Case.***
    (b) Explain why the ***Ashbury Case*** was problematic.
    (c) How has the Companies Act 2013 dealt with the ***Ashbury Case***?
5) State the rule in the case of ***Royal British Bank vs Turquand***.
6) Comment on any exception to the case of ***Royal British Bank vs Turquand***.
7) State the insider exception to the rule in ***Royal British Bank vs Turquand***.
8) The rule in ***Royal British Bank vs Turquand*** must be considered as being subject to the Companies Act, 2013 which obliges a company not to carry on business for which it is restricted. Do you agree with this statement? Give reasons.
9) Explain what the ***Indoor Management Rule*** is.
10) Section 41 of the Companies Act 2013 abolishes **"constructive notice"**. Explain with reasons why the abolition is important.
11) The Directors of Tiyese Milling Company Ltd had powers to borrow only up to K2 million without leave of the shareholders. The articles of the company expressly provided that any borrowings beyond K2 million had to be subject to prior approval of the shareholders at a general meeting. Investment Bank advanced to Tiyese Milling a K20 million loan on the strength of the directors' representation that they had fully complied with all the formalities to enable them raise the money. The truth of the matter, however, is that the directors had borrowed the money without the said approval of the shareholders. The Bank has sued the company for recovery of the loan. The company argues that directors had no power to procure the loan. **Required:-** Advise Investment Bank Ltd whether its claim will succeed in view of the argument from the management of Tiyese Milling.

CHAPTER 7 : SHAREHOLDERS RIGHTS,LIABILITIES,REMEDIES

7.1 INTRODUCTION

This Chapter is concerned about rights of shareholders. Their duties are also discussed. Most of all, the Chapter discusses the majority rule (*Foss v Harbottle*) which states that decisions in a company are made by the majority however the law also protects minority rights.

7.2 STATUTORY RIGHTS OF SHAREHOLDERS

Under section 84(1) of the Act, a shareholder has the following rights:-

(a) the right to one vote on a poll at a meeting of the company on any resolution;
(b) the right to an equal share in dividends authorised by the Board;
(c) the right to an equal share in the distribution of the surplus assets of the company.
(d) the right to access to information on various matters.

With the consent of a shareholder, the above statutory rights may be restricted, limited, altered, or added to the constitution of the company or in accordance with the terms on which the shares are issued.

7.3 LIABILITY OF SHAREHOLDERS

7.3.1 Liability

The liability of a shareholder is limited to:-

a) Any amount unpaid on a share;
b) A repayment of a distribution received by the shareholder which is in breach of the insolvency test ;
c) Any other amounts expressly provided for in the constitution;
d) Any liability for calls on shares.

7.3.2 Code of Conduct for Shareholders

The Act provides that the Minister may, by order published in the Gazette, publish separate Codes of Conduct for shareholders of private companies and shareholders of public companies. These Codes of Conduct are meant to regulate all the affairs of shareholders in respective companies and where a company or an officer of the company fails to comply with the Code of Conduct, the Court may direct compliance as well as impose a fine in accordance with the prevailing schedule of penalties. This is aimed at entrenching orderly management of companies and general compliance with the minimum international standards on corporate governance.

7.4 SHAREHOLDERS' REMEDIES: *FOSS V HARBOTTLE*

7.4.1 The Rule

The starting point for any consideration of the position of minority shareholders is the rule in ***Foss v Harbottle*** (1843) 2 Hare 461. Directors of a company bought their own land for the company and paid themselves an exorbitant price for it. Two members brought an action on behalf of themselves and other members, except the directors, against the directors to compel them to reimburse the money to the company. It was **held** that as there was nothing to prevent the company from suing the directors if it so wished, the action would fail i.e. the company (general meeting) had to sue by itself and not through individuals.

This rule, which has two strands, precludes a shareholder from bringing an action to pursue wrongs which have been done to the company.

Firstly, the directors have been appointed to manage the company's affairs and they owe their duties to the company; any misfeasance (wrong), appropriation of corporate property or breach of duty on their part is a wrong done to the company and, as a separate legal person, the company is the proper plaintiff in any subsequent legal proceedings.

Secondly, where there are irregularities in the way the company is run and, also, in many cases where directors are in breach of their duties to the company, the majority of shareholders in general meeting may, by ordinary resolution, ratify and adopt what has been done.

In those circumstances, the courts will not allow a minority shareholder to bring an action pursuing a matter which it is competent for the majority to approve on behalf of the company. The majority rule holds that a shareholder who buys shares in a company must accept that the majority (controllers) will prevail.

There are however certain situations where the law will depart from the majority rule and protect the minority. These situations are exceptions to the rule in ***Foss v Harbottle*** which is also called the **majority rule** or **the proper plaintiff rule.**

7.4.2 Basis of the Rule

Four major principles seem to be at the basis of the rule as the decided cases show:-

a) **The right of the majority to rule**; the court has said in some of the cases that an action by a single shareholder cannot be entertained because the feeling of the majority of the members has not been tested, and they may be prepared, if asked, to waive their right to sue. In essence, a shareholder who buys shares in a company must accept that the majority will prevail.

b) **The company is a legal person**; the court has also said from time to time that since a company is a persona at law, the action is vested in it, and cannot be brought by a single member. This has been well discussed in Chapter 4.
c) **The prevention of a multiplicity of action**; this situation could occur if each individual member was allowed to commence an action in respect of a wrong done to the company.
d) **The court's order may be made ineffective***;* it should be noted that the court order could be overruled by an ordinary resolution of members in a subsequent general meeting, provided that the general meeting is not controlled by the wrongdoers. As Mellish LJ said in ***MacDougall v Gardiner***, (1875) 1 Ch D 13 that if the thing complained of is a thing which in substance the majority of the company are entitled to do there can be no use in having a litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes.

7.4.3 Common Law Limits

The problem with the rule is that it may lead to remedial action not being taken for abuse of power by the majority or the board of directors hence there are several exceptions, both statutory and common law, to the application of the rule. We commence with common law limits.

a) ***Ultra Vires* and Illegality** - The principle of majority rule can have no application where a bare majority of shareholders has no right to ratify and adopt a particular act for the company. So, therefore, the rule in ***Foss v Harbottle*** had no application where the company was proposing to do an *ultra vires* or illegal act, since the shareholders could not, even by a unanimous vote, ratify an *ultra vires* or illegal act.
b) **Special Majorities** - The principle of majority rule can have no application where what is done or proposed to be done can only be done a special majority or special resolution. So, for example, in ***Edwards v Halliwell*** [1950] 2 All ER 1064, a member of a trade union was able to obtain a declaration that an alteration to the union contributions was invalid as it had not been made following a two thirds majority vote as required by the union rules.
c) **Personal Action** - More wide ranging is the shareholder's right to enforce personal rights which accrue to him as a shareholder. An example of a shareholder enforcing his rights can be seen in ***Wood v Odessa Waterworks Ltd****,* (1889) 42 Ch D 636, where a shareholder enforced a right in the articles to be paid a dividend, rather than being issued a debenture, which was what the directors proposed.
d) **Fraud on the Minority** - In ***Cook v Deeks****,* [1916] 1 AC 554, a shareholder was allowed to bring an action against directors who were in breach of their duties to the company in diverting to themselves a contractual opportunity which, in equity, belonged to the company. They were not allowed to use their majority voting power in general meeting to prevent an action being brought against them.
e) **Non-Compliance with Procedures –** The rule will not apply where the wrong amounts to a non-compliance with the company's procedure, for example requirements of a special resolution. In ***Baille v Oriental Telephone & Electrical Co. Ltd*** (1915) 1 Ch. 503, an extraordinary general meeting was convened to pass special resolutions to effect alteration of the articles by increasing the director's remuneration. The notice did not give particulars of the remuneration as required by the company's procedures. Mr Baille a minority shareholder sued on his own behalf and on behalf of other shareholders. The lower court applied the rule

in ***Foss v Harbottle*** and dismissed the case but on appeal it was **held** that the action was maintainable by him and the resolutions increasing the remuneration were declared not to be binding on the company. The rationale is that the law will not allow those in control of a company to violate the company's own procedure without remedy. Note however that according to ***McDougall v Gardiner*** (1975-6) L.R. 1 Ch. D. 13, the court will not interfere with a decision of the company which does not comply with internal procedures where the decision can be rectified by the company itself by convening another general meeting or where the decision would not have been different had the company followed the correct procedures.

7.4.4 Statutory Limits

The Act also provides for a number of situations in which the minority can sue.

a) **Derivative Action** – a shareholder or a director may bring proceedings in the name and on behalf of the company or its subsidiary or intervene in proceedings to which the company or any related company is a party. (section 337-340 of the Act)

b) **Personal Actions** - A shareholder may bring an action against the company, a director or a secretary, for breach of a duty owed to him as a shareholder under section 341 of the Act.

c) **Unfairly Prejudicial Conduct -** an individual shareholder can apply to Court for an order under section 343 where the company's conduct is oppressive, unfairly discriminatory or prejudicial. In ***Re H.R. Harmer Ltd*** [1959] 1 WLR 62, Harmer founded a firm which he later incorporated as a company. He and his wife held a majority of shares and so run the company as if it was his exclusive property. He disregarded board of directors and general meetings' resolutions. Shareholders sued the majority shareholders under a section similar to section 343. The court granted an order restraining Mr Harmer from interfering in the company's affairs except in accordance with decisions of the board of directors. ***In the Matter of East Africa Sailing and Trading Co. Ltd*** Com. Court Petition No. 4 of 2012, the High Court, dealing with section 203 of the Companies Act 1984, held that the majority shareholder's conduct was oppressive and unfairly prejudicial on account of, *inter alia,* un-procedural appointment of additional directors and a company secretary. The court ordered the majority to buy out the minority.

   The Court may make such order as it deems fit under section 343 and 344 of the Act and such orders may include the following:-

   i. An order requiring the company or someone to acquire the shareholder's shares; or
   ii. An order requiring the company or any other person to pay compensation; or
   iii. An order regulating the future conduct of the company's affairs; or
   iv. An order altering or adding to the company's constitution; or
   v. An order appointing a receiver of the company; or
   vi. An order directing the rectification or the records of the company; or
   vii. An order putting the company into liquidation; or
   viii. An order setting aside action taken by the company or the Board in breach of the Act or the constitution of the company.

d) **Compulsory Winding Up** - minority shareholders may petition the court for an order for compulsory winding up under the Insolvency Act 2016 on the ground that it is just and equitable. This is clearly illustrated by ***Ebrahimi v Westbourne Gallaries*** [1973] AC 360, where E & N carried on business as partners and later incorporated the partnership, the two of them being directors. Later N's son became an additional director. E & N were involved in a dispute and N and his son (the majority) removed E from his position as director. E sued that it was just and equitable for the company to be wound up. It was held that the company should be wound up because the past relationship between E & N and subsequent events made it unjust that N and his son should remove E from his post. Note that the petitioner will not be granted a winding up order if he has an alternative remedy. The order is discretionary and this happened ***In the Matter of Mapanga Estates Ltd*** Civil Cause No. 109 of 1988, where a company had shareholders who held 49% and 51% of its shares. Differences arose between them and the minority sought an order winding up the company. The court dismissed the petition on the ground that the company was viable and prosperous and instead ordering the minority to sell her shares to the majority.

7.5 TERMINATION OF MEMBERSHIP

Termination of membership is complete when the name of a former member is removed from the register. This may occur by:-

a) transfer of the shares to a purchaser or by way of gift;
b) forfeiture, surrender, or a sale by the company under its lien;
c) redemption or purchase of shares by the company;
d) the registration of a trustee in bankruptcy, or by his disclaimer of the shares;
e) death of the member;
f) rescission of the contract to take the shares arising out of fraud or misrepresentation in the prospectus;
g) dissolution of the company by winding-up or amalgamation or reconstruction;
h) compulsory acquisition;
i) under the provisions of the company's constitution, e.g. expulsion under the articles for competing with the company.

7.6 PRACTICE QUESTIONS

1) What rights does a shareholder have?
2) Explain the meaning of limited liability.
3) How important is the Code of Conduct for Shareholders?
4) Outline/describe/explain the facts and rule in ***Foss v Harbottle.***

5) What is the basis of the rule in ***Foss v Harbottle***.
6) State any **two** advantages of the rule in ***Foss v Harbottle***.
7) What are the exceptions to the rule in ***Foss v Harbottle***?
8) State the principles which have led the courts in relaxing the 'proper plaintiff' rule.
9) The main point of the 'majority rule' with regard to company decisions is that if the majority of members take a decision that is merely foolish, then only the majority can reconsider the matter. Discuss with reasons, the effect of this rule.
10) How may a shareholder bring a minority action?
11) Outline any **five** orders that the High Court may make in the event that a minority shareholder successfully sues that the majority's action is unfairly prejudicial.
12) Explain the importance of ***Ebrahimi v Westbourne Gallaries*** [1973].
13) Outline any **five** ways through which membership of a company is terminated.
14) Last month, Fwasani received an envelope from Mbambande Wholesalers Ltd of which he was a minority shareholder. In it was a letter from the managing director of the said Mbambande Wholesalers Ltd stating that in exercise of his powers of managing the affairs of the company and upon consultation with the rest of the shareholders, he had considered it appropriate to decide to compulsorily acquire all the shares held by Fwasani. Fwasani was disturbed by the news. He had not given his consent to the compulsory acquisition of shares as required by the articles of association and in any case he would not want to cease to be a shareholder of Mbambande Wholesalers Ltd.

    Required:- Advise Fwasani on what to do, giving the grounds for his action and the expected results thereof.

CHAPTER 8 : SHARE CAPITAL

8.1 INTRODUCTION

A company is run on capital, either share capital or loan capital. This chapter is concerned with share capital, types of shares and their transferability.

8.2 THE NATURE OF SHARES

8.2.1 Definition of a Share

The most famous definition of a share, is that of Farwell J in ***Borland's Trustee v Steel***, [1901] 1 Ch 279 where he states that:-

> ... a share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se* in accordance with [s 33(3)].

This definition characterises the shares as a bundle of rights stemming from shareholders' contracts' in accordance with section 33(3) of the Act. Typical of the rights which the shareholder enjoys are the rights to vote, to participate in dividends and to the return of capital when the company is wound up. The share has emerged as a piece of personal, intangible property, that is to say, it is a chose in action. It can be owned, bought and sold, mortgaged and it will form part of the estate of a deceased person.

8.2.2 Par Value (Nominal Value)

Section 87 of the Act has done away with the requirement for shares to have a par value also referred to as a nominal value, previously prevailing under the Companies Act 1984. Companies incorporated before the commencement of the 2013 Act are allowed to continue to issue shares with par value or may at any time convert any class of shares into shares of no par or nominal value. Companies are now allowed to issue shares at a discount provided the same is authorised by a resolution passed in a general meeting of the company and is further sanctioned by the Court. The old common law position was to prohibit issue of shares at a discount.

8.3 CLASSES OF SHARES

A company may issue shares of different classes, conferring different rights in respect of voting, dividends and return of capital in a winding up.

Section 84(3) of the Act states that shares in a company may:-

a) be redeemable;
b) confer preferential rights to distributions of capital or income;
c) confer special, limited, or conditional voting rights; or
d) not confer voting rights.

Below is a discussion of some of the types of shares that are commonly issued by companies.

1. **Ordinary Shares**
    (a) They are the most basic type of shares which a company limited by shares can issue;
    (b) If a company has one class of shares, these will be ordinary shares;
    (c) Where a company has more than one type of shares, it must have at least one ordinary share;
    (d) They are sometimes described as *a residual class* because they consist of rights that remain after the rights of other classes of shareholders (if any) have been satisfied;
    (e) They are also sometimes described as *equity capital* because they represent the owners' stake in the company and almost always carry the right to vote;
    (f) Ordinary shareholders control resolutions at general meetings because they are usually in a majority.

2. **Preference Shares**
    (a) Holders have priority in the receipt of dividends in any financial year;
    (b) The articles may also state that holders shall have priority in the return of capital on the company's winding up;
    (c) If this is not stated the assets of the company will be distributed *pari passu* between the shareholders;
    (d) A preference shareholder has priority over dividends once declared by the company; he cannot compel the company to declare them;
    (e) As a general rule, the right of a preference shareholder to a dividend is cumulative for example if given nothing this year, then the following year he will be given twice as much. Articles may provide that preference shares are non-cumulative. The right to accumulation may cease to exist where the company is going into liquidation.
    (f) The right to vote is usually restricted except in class meetings;
    (g) Preference shares are designed to appeal to investors who want a steady return on their capital with high level of safety.

3. **Redeemable Shares**
    (a) Generally a company cannot buy back its own shares from its members, it can do so only if the shares are redeemable;
    (b) These are shares allotted, paid up and redeemable at the company's option or at the end of a specified period.

4. **Deferred Shares**
   (a) These are shares issued to founders of a company;
   (b) No dividend can be paid to deferred shareholders unless ordinary shareholders are paid a certain amount of dividend in that financial year.

5. **Employee Shares**
   (a) A company may operate schemes whereby company employees are encouraged to take up shares.
   (b) Apart from allowing employees a right to share in the profits of the company's profits, **Employee Share Schemes** may be seen as a means of motivating the workforce to attain corporate goals.

6. **Treasury Shares**
   (a) These are shares that a company has bought back from shareholders but such shares have not been cancelled.
   (b) This can be advantageous to shareholders because it lowers the number of shares outstanding. However, not all buybacks are a good thing. For example, if a company merely buys shares to improve financial ratios such as Earnings Per Share (EPS), then the buyback is detrimental to the shareholders.

8.4 VALUATION OF PROPERTY AND SECURITIES

The Act provides for registered valuers and the Registrar maintains the Register. These valuers may conduct any valuation required under the Act including any property, stocks, shares, debentures, securities or goodwill or net worth of a company or its assets. Otherwise, courts have always maintained the power to value shares.

8.5 THE POWER TO ALLOT SHARES AND PRE-EMPTION RIGHTS

Normally, the Board will have the powers of management given to them by the articles of association. One of the functions of management will be to decide the question of whether the company needs extra resources and how these are to be obtained and one of the obvious ways is by issuing further shares.

Under the Act an offer of a company's shares must first be made to existing shareholders before the shares are open to the public. This is called **rights issue** or **pre-emption rights** i.e. shareholders have a right to further issue of shares. Without any rights of pre-emption, an existing shareholder in a company would run the risk of the directors allotting new shares to others (either to an outsider or another existing shareholder), thus reducing the percentage of votes held by the shareholder and, therefore, the legal control he is able to exercise in general meeting. On the part of the company the pre-emption has the advantage of cutting down on paperwork and other expenses involved in offering shares to the public.

8.6 PAYMENT FOR SHARES

The strict common law position is that a member of a company must pay for his shares in full, and no arrangement between the company and the members can affect this rule. The Act modifies this rule by providing that before a company can issue any shares, the Board is obliged to determine the amount of the consideration for which the shares shall be issued and must ensure that such consideration is fair and reasonable to the company and to all existing shareholders. The rule is that the shares allotted by a company may be paid up in money or money's worth, including cash itself, promissory notes and real property.

8.7 TRANSFER OF SHARES

Unless there are any restrictions placed in the company's articles of association, the shares of a company are freely transferable. It is this liquidity of the share – the ability to realize the value of the share quickly and without high costs – that constitutes one of its most attractive features as an item of property.

Transfer of shares is the voluntary conveyance of the rights and obligations comprised in a share from a member to a person who desires to become a member, for value or as a gift.

The procedure for transfer of shares is as follows:-

a) The transfer must be done by a proper instrument;
b) Once a transfer of shares in a company has been lodged with a company, the company must either register the transfer or give the tranferee notice of refusal to register the transfer, together with reasons for the refusal;
c) A transferor may also make a written request that the name of the transferee of shares be entered in the share register;
d) Dealings in securities may now be evidenced, transferred or recorded electronically.

Transmission of Shares

This occurs where transfer of shares by operation of law, examples include:-.

a) ***Death of a Shareholder****:* Section 140 of the Act allows a personal representative to transfer shares of a deceased person, as if the personal representative himself or herself is a member of the company.
b) ***Shareholder of Unsound Mind****:* transmission also occurs to a manager appointed by the High Court to the estate of a shareholder of unsound mind.
c) ***Bankruptcy of a Shareholder****:* on the bankruptcy of a member, the right to deal with the shares passes to the trustee in bankruptcy, and he can sell them without actually being

registered or he can elect to register subject to any restrictions in the articles. A trustee in bankruptcy may disclaim shares if they are more of a liability than an asset.

Certification of Transfers

If the transfer of shares is of part only of the shares represented by a share certificate, the instrument of transfer together with the share certificate must be delivered to the company for certification. This process prevents fraud by the transferee who may alter the number of shares being sold to him. The company eventually produces new certificates bearing the new transfers.

Register of Members

The Act has relaxed requirements for a register of members. It provides that a private company is not under obligation to keep a share register but it must keep and maintain proper records of shares and debentures that it has issued and transferred.

Other companies, including public limited liability companies, are obliged to maintain an electronic or hard copy share register with the following contents:

a) full name, address and occupation of the shareholder;
b) date of entry in the register;
c) date on which he ceases to be a member;
d) a statement of shares held by each member;
e) amount paid on each share.
f) any restrictions or limitations on their transfers.

These records must cover the last seven years. The register must be capable of search either by electronic means or by physical inspection and the company must give notice to the Registrar of the place where its share register is kept available for physical inspection and of any change in that place.

The entry of the name of a person in the share register as holder of a share is *prima facie* evidence that legal title to the share is vested in that person. As a matter of fact, a share is only issued when the name of the shareholder has been entered on the share register. In that respect a company may treat a shareholder as the only person entitled to exercise the right to vote attaching to the share; receive notices; receive a distribution in respect of the share; and exercise the other rights and powers attaching to the share.

However, this does not prevent rectification of the register. Thus section 151 of the Act provides that where the name of a person is wrongly entered in, or omitted from, the share register of a company, the person aggrieved, or shareholder, may apply to the Registrar for rectification of the share register and where unsatisfied with the decision of the Registrar, he may appeal to the High Court.

Share Certificates

Section 142(1) of the Act provides for duties of a company with regard to certificates. It requires a company to issue relevant share certificates within **60 days** from the date of allotment or within **two months** from the date of transfer, unless otherwise provided by the conditions of issue. In respect of public companies, there is a requirement that within **twenty-eight days** after the issue or registration of a transfer of shares, the company should send a share certificate to every holder of those shares.

The contents of the share certificate include:-

(a) the name of the company;
(b) the class of shares held by that person; and
(c) the number of shares held by that person.

Section 154 (1) provides for replacement of lost or destroyed share certificates.

Share Warrants (or Bearer Shares)

Previously the 1984 Act specifically prohibited a company limited by shares from issuing share warrants in respect of any of its shares. The 2013 Act is silent on the matter. This means that it is now up to individual companies to regulate the issue of share warrants. There are two major differences between a share certificate and share warrant; in the first place a warrant will state that the holder (bearer) and not the person named in it, is entitled to the shares specified in it and in the second place it is a negotiable instrument so that a title to it passes free from defects in the title of previous holders on mere delivery. This makes it an easy target for fraud and so it will not be recommendable to issue the same. That said, the main advantages of share warrants are anonymity, i.e. no one can find out from the company's public records who the owner of a warrant is (as they are not entered in the register of members), and the ease of transfer. Warrants are merely handed to the purchaser avoiding the formality and expense involved in transferring a registered share.

Lien on Shares

The High Court of Malawi defined lien generally in ***Small Holder Farmers Fertilizer Revolving Fund of Malawi v Export Trading Co Limited*** Civil Cause No. 1651 of 2005 as 'a right at common law in one man to retain that, which is rightfully and continuously in his possession belonging to another until the present and accrued claims of the person in possession are satisfied.'

Section 136 provides that where the constitution so provides, a company is entitled to a lien, in priority to any other claim, over every issued share where the share is not fully paid. In that regard the company has a lien over any dividend payable on the share.

8.9 PUBLIC OFFERINGS OF SECURITIES

As observed in Chapter 1, a public company is permitted to offer its securities to the public. All public offers of securities must be made in accordance with the Securities Act. Since it is criminal for a company which is not a public company to offer its securities to the public, the Act provides for circumstances where an offer may be deemed public or private. Under section 258 of the Act, an offer or invitation to make an offer of securities to the public includes the following:-

a) offering securities to a section of the public;

b) offering the securities to individual members of the public selected at random; or

c) offering the securities to a person if the person became known to the offeror as a result of an advertisement.

The Prospectus

The Act does not define the term prospectus. However, a lawful invitation to the public to take shares in a company will involve issuing a document which provides information about the company and shows the benefits of investing in it. This document is called a **prospectus**. It is a document issued by a corporation disclosing its financial information to current and prospective investors. The information should assist an investor to make an informed assessment of the company's financial position and the rights attaching to the securities.

The specific contents of the prospectus include:-

a) the terms of the offer including, the identity of any underwriter and the method of the offer;
b) information about the business and operations of the issuer;
c) the identity of directors, senior management, promoter and auditors;
d) capitalization and indebtedness of the issuer;
e) risk factors;
f) securities market data regarding any trading history of the issuer's share;
g) use of the proceeds of the offer;
h) details of pending litigation;
i) management discussion and analysis of the financial condition and results of the company's business operations;
j) a forecast of estimated profit or loss for the year ending immediately before the date of the prospectus and the year ending immediately after the date of the prospectus;
k) a certificate from the issuer's auditor stating any changes in directors and auditors during the last three years, indicating the reasons for any changes; and
l) audited financial statements for the years and periods as required by the Registrar of Financial Institutions.

The prospectus must be signed by the company's senior management or persons performing similar functions accompanied by a duly verified resolution of the board of directors.

Liability for Misstatements in Prospectuses

The liability for misrepresentations or misstatements in prospectuses may either be criminal or civil. For instance, the Securities Act 2010 prohibits improper trading practices, which includes a prohibition on giving false or misleading statements in connection with sale of securities.

Under common law an innocent party who is affected by a misstatement in a prospectus may either claim damages where the statements are made fraudulently or rescind the contract.

8.10 PRACTICE QUESTIONS

1. What is a share?
2. 'The share has emerged as a piece of personal, intangible property.' Discuss.
3. What is mean by the term **par value/nominal value**?
4. Describe the any **four** types of shares issuable by a company.
5. Compare and contrast employee shares from treasury shares.
6. Explain the meaning of **rights issue** also referred to as **pre-emption rights.**
7. Outline instances of transfer of shares by operation of law.
8. Distinguish between **voluntary** and **involuntary** transfer of shares.
9. What **two** options does a shareholder have if he wants to raise funds using the shares?
10. Outline the procedure that the law provides for the transfer of shares.
11. How may shares be transmitted?
12. What is meant by the term '**Certification of Transfers'**?
13. Outline any five contents of the register of members.
14. **'**The entry of the name of a person in the share register as holder of a share is *prima facie* evidence that legal title to the share is vested in that person.' Explain this statement.
15. What time lines does the Companies Act provide for the issuance of share certificates?
16. What are the contents of the share certificate?
17. Distinguish a share certificate from a share warrant and explain why the Companies Act prohibits the issuance of share warrants.
18. What is a prospectus?
19. List any **five** contents of the prospectus.

CHAPTER 9 : MAINTENANCE OF SHARE CAPITAL

9.1 INTRODUCTION

It is important that the capital of a company be maintained since it enables a company to carry on its business activities. Again, it enables the company to discharge its debts and liabilities on winding up since this could be the only fund available to a company's creditors in that event. This Chapter is concerned with various mechanisms provided by the law for the maintenance of share capital.

9.2 PROHIBITION OF THE RETURN OF CAPITAL

While the company is a going concern it is not allowed to return its paid-up capital to its members or reduce their liability. Capital can only be repaid on winding up after the company's creditors have been paid. There are however two exceptions to this rule; the company can legally redeem its redeemable shares leading to reduction of capital and the company can reduce its capital in an authorised manner under the Act, discussed below. The only other payment by a company to its members is through dividends. In the case of ***Moxham v Grant*** [1900] 1 QB 88, the directors of a company distributed a portion of its capital among its shareholders. On winding up the liquidator applied for a Court Order that the directors should repay the money. It was **held** that the directors were liable to replace the money and since the shareholders received the funds knowing they were made out of the share capital, the shareholders had to indemnify the directors.

9.3 PROHIBITION OF FINANCIAL ASSISTANCE FOR THE PURCHASE OF SHARES

Section 124(1) of the Act prohibits a company from giving financial assistance directly or indirectly for the purpose of or in connection with the acquisition of its own shares. 'Financial assistance' includes giving a loan or guarantee, or the provision of security but does not include a distribution to a shareholder.

A company may, however, give financial assistance for the purpose of or in connection with the acquisition of its own shares if the Board has resolved so under the Act.

9.4 PROHIBITION OF THE ACQUISITION BY A COMPANY OF ITS OWN SHARES

The general common law rule was to the effect that a company had no power to acquire its own shares. However, a company may acquire its own shares under the Act. Section 109(1) of the Act whilst prohibiting a company from purchasing or otherwise acquiring any of its own shares, provides for at least three exceptions to that general rule.

1. the Court may order that a company purchases or acquires its own shares in accordance with the Act.
2. a company may purchase its own shares where, a unanimous approval of shareholders is passed.
3. a company can issue redeemable shares which it may buy back.

9.5 PAYMENT OF DIVIDENDS

9.5.1 Definition of a Dividend

A trading company is formed with the foremost aim of making profit for its members which are distributable in form of a dividend authorised by the Board. A dividend is understood as that portion of a company's profit legally available for distribution among its members which is received by each of them according to the constitution of the company. The following points are worthy noting in relation to dividends:-

a) The Board may only make an authorization to pay dividends where the same satisfies the solvency test.
b) In addition, and subject to the constitution of a company, the distribution may have to be approved by shareholders by an ordinary resolution.
c) For a public company the agenda for the shareholders' meeting in the notice to shareholders must include an item on declaration of dividends.
d) Only when the dividend has been lawfully declared does it become payable and enforceable as a debt against the company.
e) Dividends should only be paid in cash, unless there is a provision to the contrary in the company's articles, and a member can enforce a payment in cash.

A dividend may be interim or final. An interim dividend is one paid between annual general meetings. It is paid by directors. Usually the payment is made in respect of the first half of the financial year based on midyear accounts. The amount will be less than the final dividend as a matter of prudence should the latter half of the year not come up to the expectations. A final dividend is declared at the general meeting usually at the close of the financial year.

9.5.2 Net Asset Restriction on Distribution

In relation to public companies, section 99 of the Act provides rules on **net asset restriction**. A public company is prohibited from making a distribution if, among others, the amount of its net assets is less than the aggregate of its called up share capital and un-distributable reserves

9.5.3 Bonus Shares

Instead of distributing all the distributable profit by way of dividend, the Board may decide to 'capitalise' the profit and issue bonus shares to members. This issue is known as a **'capitalisation issue'**. The profit is transferred to the share capital account, essentially to pay for the bonus shares, which are then issued to the shareholders as either fully or partly paid up. The issued share capital of the company is then increased by that amount. In this way, the shareholders are receiving extra shares rather than cash.

9.5.4 Shareholders Discounts

The Board may resolve that the company offers shareholders discounts in respect of some or all of the goods sold or services provided by the company. A discount scheme may only be approved by the Board where it is fair and reasonable to the company and to all shareholders and made available to all shareholders or all shareholders of the same class on the same terms. The scheme must satisfy the solvency test and it is not considered as a distribution.

9.6 RECOVERY OF DISTRIBUTIONS

It may happen that a distribution is made to a shareholder at a time when the company did not satisfy the **solvency test**. In that situation the company may recover the distribution from the shareholder unless the shareholder received the distribution in good faith and without knowledge of the company's failure to satisfy the solvency test or the shareholder has altered his/her position on reliance on the validity of the distribution or that it would be unfair to require repayment in full or at all. A director may also be personally liable for not following the provisions of the Act, in that regard.

9.7 REDUCTION OF SHARE CAPITAL

According to section 100 of the Act a company may by a special resolution reduce its stated capital to such amount as it thinks fit. The company must issue a public notice of the proposed reduction not less **than thirty days** before the resolution to reduce its stated capital is passed. This affords an opportunity for stakeholders to challenge the reduction, if need be.

A company which has reduced its stated capital is required to notify the Registrar about the reduction within **fourteen days**, specifying the amount of the reduction and the reduced amount of its stated capital.

Where a company alters its constitution or acquires shares issued by it or redeems shares and the same results into a cancellation or reduction of a shareholder’s liability, the cancellation or reduction of liability is considered as a distribution (dividend).

9.8 ALTERATION IN NUMBER OF SHARES

A company may by ordinary resolution **divide** or **subdivide** its shares into shares of a smaller amount if the proportion between the amount paid, and the amount, if any, unpaid on each reduced share remains the same as it was in the case of the share from which the reduced share is derived.

Similarly a company may **consolidate** its shares into shares of a larger amount than its existing shares. Notice of the subdivision or consolidation must be given to the Registrar within **14 days** from the date of alteration, including particulars with respect to the classes of shares affected.

9.9 PRACTICE QUESTIONS

1) 'It is important that the capital of a company be maintained since it enables a company to carry on its business activities.' Discuss.
2) What mechanisms does the law provide for the maintenance of share capital?
3) Share capital is what allows a company to run its business activities. As much as possible, the law provides devices to ensure that issued shares must not generally be reduced except as allowed by law. Discuss the following devices:-
   a. The prohibition against the return of capital while the company is a going concern
   b. The prohibition of financial assistance by the company for the purchase of its own shares
   c. The prohibition of the acquisition by the company of its own shares.
4) Define a Dividend.
5) Distinguish an interim from a final dividend.
6) Explain the following concepts
   i) Net asset restriction.
   ii) Capitalisation issue.
   iii) Shareholders discounts.
   iv) Solvency test.
7) What conditions must be satisfied if a company wishes to reduce its capital and alter its memorandum or articles accordingly.
8) In relation to alteration in number of shares, explain the following terms:-
   a) Division
   b) Subdivision
   c) Consolidation

CHAPTER 10 : LOAN CAPITAL

10.1 INTRODUCTION

Borrowing is an important means by which a company can finance its activities and that the overwhelming majority of companies have the power, express or implied, to borrow money. If a company does not have such a power, any borrowing is technically *ultra vires* but may still be valid as observed in Chapter 6.

Any document by which a company creates or acknowledges a debt may be called a debenture. Loan capital can be divided into two categories. First, sums owed by the company as a debt, such as a loan by an individual or institution, most probably the company's overdraft, and, secondly, marketable loans. Marketable loans are, in essence, potential debts which may be issued to investors. Loan capital may be listed (that is, sold through a stock market) or unlisted. Marketable loans are more relevant for larger companies, whereas the overdraft is a fact of life for companies large and small.

10.2 DEFINITION OF A DEBENTURE

Section 2 of the Act defines a debenture as a written acknowledgment of indebtedness issued by a company in respect of a loan made to it, whether constituting a charge on any of the assets of the company or not. A debenture includes the following:-

a) debenture stock;
b) convertible debenture;
c) a bond or an obligation;
d) loan stock;
e) an unsecured note; or
f) any other instrument executed, authenticated, issued or created in consideration of such a loan.

A debenture does not include the following:-

a) a bill of exchange;
b) a promissory note;
c) a letter of credit;
d) an acknowledgment of indebtedness issued in the ordinary course of business for goods or services supplied;
e) a policy of insurance; or
f) a deposit certificate issued in connection with a deposit, say in a bank.

A debenture is transferable, unless the contract creating it prohibits transfer. A transfer may be by simple delivery from the current holder to the new holder (**a bearer debenture**) or by delivery and the completion of a transfer document. Though not a legal requirement, a prudent lender may insist on having some claim upon the assets of the company if the loan is not repaid or if other terms of the contract are broken by the company, for example, if interest on the loan is not paid, or to ensure re-payment of the principal if the company goes into insolvent liquidation. Where the contract of loan, or a linked contract, provides that, if the company fails to meet its obligations, the lender can have recourse to the company's assets and can obtain the sums outstanding by selling the assets or receiving income generated by those assets, the lender has a **direct security**. The assets of the company covered by this security are said to be charged and the lender may be called a chargee; the person (the company) whose assets are secured can be called a surety or chargor. This Chapter is concerned with company charges.

In addition to or instead of **a contract of direct security**, a lender may have some claim upon a third party if the company does not meet its obligations under the contract of loan. Such a claim may be by way of **indemnity** or by **a contract of guarantee**. A guarantor may also charge his assets to the lender as security for meeting his obligations under the guarantee – this is **a contract of collateral** or **indirect security**. Thus, a company might charge its assets to secure its overdraft with its bank and a director of the company might guarantee that, if the company failed to repay the debt, he would do so and charge his property perhaps his house as security should he be called upon to meet his guarantee.

10.3 TYPES OF DEBENTURES

10.3.1 Debenture Stock

Instead of obtaining the money sought from a number of individuals and issuing a single debenture to each one of them, the loan may be in the form of a fund to which the lenders contribute. This is called a **debenture stock** and each lender is given a **debenture stock certificate** as evidence of the portion of money he advances.

Advantages of debenture stock include the fact that it can be transferred in sub-units whilst a single debenture can only be transferred as a single unit. As far as the company is concerned, in a debenture stock there is no need for separate agreements with lenders; the company simply consolidates the loan into one mass as debenture stock and then issues to each lender a debenture stock certificate representing his part of that loan.

10.3.2 Redeemable and Irredeemable Debentures

A debenture may be redeemable at the option of the company at a fixed date or on the occurrence of a contingency. Once a debenture has been redeemed, the Act restricts its re-issue or issue of a new debenture in its place on the condition that the new debenture must have the same priorities as the previous debenture. In an irredeemable debenture the holder does not have the right to demand repayment of the loan in respect of which the debenture is issued until on the company's winding up but the company may redeem the debenture earlier.

10.3.3 Bearer Debentures

A debenture issued to a bearer is transferable by mere delivery to the transferee. It is considered to be a negotiable instrument so that the bearer is entitled to be paid the money thereby secured although the transfer is not registered by the company. A bearer debenture is therefore an easy target for fraud.

10.3.4 Convertible Debentures

Convertible debentures give the debenture holder the option of exchanging it for fully paid-up shares of the company; therefore the loan ceases to exist.

10.4 REGISTER OF DEBENTUREHOLDERS

Section 129(1) of the Companies Act requires that every company which issues debentures must keep a register of debenture holders at its registered office. The contents of the register include the names and addresses of the debenture holders and the amount of debentures held by them.

The register must be open to the inspection of a debenture holder or a member unless duly closed for a period of no more than **30 days** in a year. Every company is obliged to supply a debenture holder or a member with a copy of the register of debenture holders.

10.5 DEBENTURE TRUST DEED

A trust deed would be important, for instance, where the company issues a debenture stock of K5 billion wherein members of the public can buy units worthy K100,000. It would cause inconvenience and it would be unreasonable to expect every person who has participated in the debenture stock to inter-face with the company for example demand his or her K100,000 every time there is a default on the part of the company hence the need for all the debenture holders to be represented by few trustees through a trust deed.

10.6 THE PERSONAL PROPERTY SECURITY ACT [PPSA] 2013

The PPSA, reforms the law relating to personal security interests in personal property and in particular provides for the creation of security interests in personal property, the perfection of security interests, the determination of priority between securities, the establishment of a registry of security interests in personal property, and enforcement of security interests in personal property.

Section 3 of the PPSA sets out a broad scope for its application. First, subsection (2) clearly states that any person, whether individual or entity, foreign or domestic, may be a debtor or secured party under the PPSA. Thus a company can be registered in the personal property securities registry. For instance, company A may obtain a loan from company B to purchase machinery. Company A may issue a debenture in favour of company B, in terms of the Companies Act 2013. Under the PPSA, the debenture is considered as a form of a **security agreement**. In that event a security interest is created by the debtor and the secured party. At that moment, the security interest becomes effective between the parties only.

However, it is in the interest of company B that its security interest is known and enforceable against the public, hence perfection (third-party effectiveness). Thus, following the execution of the security agreement, company B may perfect its security interest by registration. The company will file a **financing statement** in the personal property securities registry under the PPSA. The security is perfected once the financing statement has been registered on line and the security is searchable by the public. At this point the security interest becomes enforceable against third parties (the general public) and takes priority accordingly.

10.7 SECURITY FOR DEBENTURES

A debenture may be secured or unsecured. A secured debenture holder has a right against specified property of the company if the loan or interest payable by the company is in arrears or not paid at all. Where a charge exists, the property is said to be "charged" with meeting the financial obligation created by the debentures.

A company charge is defined as the right to seize property that a debtor gives to the creditor as security for his indebtedness to the creditor. This form of security is non-possessory in nature because it does not give the creditor immediate possession of the property over which it is created. The property remains with the debtor until he commits a default under the credit agreement and the charge thereby becomes enforceable.

Fixed and Floating Charges

A fixed charge is a charge on a specified and identifiable asset of the company such as a building or motor vehicle. A fixed charge generally prevents the company dealing with the charged asset without the consent of the charge and is, thus, an inappropriate form of security for assets which are constantly changing.

A floating charge is a charge on present or future property of the company for example stock-in-trade. It does not attach to any specific asset but crystallises upon some eventuality. The charge hovers over the property charged.

According to the case of ***Re Yorkshire Woolcombers Association*** [1903] 2 Ch 284 a floating charge is;

a) A charge on a class of assets of a company, present or future;
b) Which is, in the ordinary course of the company's business, changing from time to time;
c) Until the holders enforce the charge, the company may carry on business and deal with the assets charged.

A floating charge does not remain as such forever; there are situations whereby it crystallises. **Crystallisation** is a situation whereby a floating charge becomes fixed to some property. Here are examples of situations where a floating charge may crystallise according to the case of ***Indefund vs Manguluti & Manguluti*** Civil Cause No. 232 of 1985:-

a) the principal or interest payable on it is in arrears; or
b) the security is in jeopardy; or
c) the company commences winding up proceedings; or
d) the company ceases to operate.

Advantages of a fixed charge from a lenders point of view

a) A fixed charge confers on the lender an immediate right to seize the asset over which it is created. Where a company disposes of the charged asset, the company must pay the lender or the subsequent buyer of the asset takes it subject to the charge.
b) A fixed charge gives the lender certainty as to the assets which are his security.

Disadvantages of a floating charge from the lender's point of view

a) A floating charge ranks after a fixed charge (see below);
b) Before crystallisation, the lender does not know for sure which assets constitute his security;
c) Preferential debts of the company must be paid out of the proceeds before the holder of a floating charge is paid;
d) A floating charge created on a company's stock-in-trade may lose priority to the unpaid seller who has reserved his title to the goods ***(Romalpa case)*** (The full title of the case is ***Aluminum Industrie Vaasen BV vs Romalpa Aluminum*** [1976] 1 WLR 676). 'A' sold Romalpa aluminum foil, reserving the right of disposal with these conditions:
    - Property was to pass only when **all** sums owing to A had been paid.
    - Romalpa was to store the foil so that it was shown to be the property of A.
    - Articles manufactured from the foil were to become the property of A as surety for full payment.
    - Romalpa were to hold such articles for A in their capacity as "fiduciary owners", i.e. as it were, as trustees for A, their equitable owner.
    - Romalpa were entitled to sell such articles, but only on condition that they would hand over to A such rights as they possessed against sub-purchasers.

Romalpa duly manufactured articles from the foil, and sold them. Sub-purchasers paid Romalpa, but Romalpa went into receivership owing A money. A sought to recover unused foil, and claimed they had a charge over money received from sub-purchasers. **Held**: By reason of the relationship of bailor and bailee, a fiduciary relationship arose, and A were entitled to claim the proceeds of the sub-sales in priority to general creditors.

10.8 PRIORITY OF CHARGES

The Act does not provide for registration of charges, this means that statutory priority of charges, where appropriate, is determined through the PPSA. In addition, where applicable, common law rules will apply and are detailed below.

Where a company creates more than one fixed charge, the fixed charge that was the first in time will take priority. By its very nature, a floating charge will not attach itself to a particular asset until the date of its crystallization. As such, a fixed charge which is created over a particular asset will take priority to the floating charge. Where a company creates more than one floating charge over a class of assets, the floating charge that was the first in time will take priority. This priority rule applies even where the first floating charge did not include a negative pledge clause. However, application of these rules is subject to any consent given by the person who would otherwise be entitled to priority. So in ***Indefund Ltd v The Registered Trusteees of Sedom and Gep Shoe Co*** [1995] 2 MLR 483, Gep obtained a loan from Indefund. Due to financial problems there was need to get another loan from SEDOM. Indefund despite taking priority consented to ranking *pari passu* with SEDOM. When Gep Shoe Co. made no financial improvements, Indefund appointed a receiver unilaterally. It was **held** by the Supreme Court that since Indefund had agreed to rank *pari passu* with SEDOM, it could only appoint a receiver in consultation with SEDOM.

10.9 RIGHTS AND REMEDIES FOR DEBENTURE HOLDERS

A person lending money to a company has such rights as are given by the contract creating the loan. Typically, the contract will include provisions for repayment of the loan, the payment of interest (if any) and the ability of the creditor to attend company meetings or otherwise influence company policy. A debenture holder should be sent a copy of the company's last financial statements together with any directors' report and auditor's report.

A debenture holder is like any other creditor of the company. His remedies depend on whether he is secured or unsecured.

Remedies for an **unsecured** debenture-holder:-

a. He can sue the company or the guarantor, if any, for the arrears;
b. He can petition the Court for compulsory winding up of the company.

Remedies for a **secured** debenture-holder:-

(a) He can sue the company or the guarantor, if any, for the arrears;
(b) He can petition the Court for compulsory winding up of the company;
(c) He may appoint a receiver through power in the trust deed; or his trustees may apply to court for the appointment of a receiver;
(d) He can apply for foreclosure (selling/taking of the company property by the creditor/debenture holder).

10.10 RECEIVERSHIP

A receiver is the person who is granted the legal right to receive property belonging to others. Coupled with the right to receive, a person appointed as a **'receiver and manager'** of a limited liability company has the power to manage and trade with the company's assets. A person appointed simply as a 'receiver' is appointed without a right to manage, but with the power to sell existing stocks or assets and in this case, the receiver's relevant powers would be set out in the debenture document. A receiver must be a qualified insolvency practitioner in terms of the Insolvency Act 2016.

Receivership is a temporary condition affecting a company which, unlike liquidation, does not necessarily lead to the company's dissolution. After a receiver has been discharged, the directors resume their normal functions in relation to all of the company's affairs.

10.11 THE INSOLVENCY ACT 2016

A good insolvency system ensures the survival of economically efficient companies and reallocation of resources of inefficient ones. Fast and cheap insolvency proceedings result in the speedy return of businesses to normal operation and increases returns to creditors. An efficient insolvency regime thus enhances investor confidence resulting into faster economic turnaround. The Insolvency Act 2016 provides for individual bankruptcies and insolvencies involving companies.

The Act establishes the office of the Director of Insolvency with the following functions:-

a) Keeping under review insolvency law;
b) Receiving and reviewing reports from the Official Receiver;
c) Monitoring performance of insolvency practitioners;
d) Applying for disciplining or removal of insolvency practitioners;
e) Fostering development and training of insolvency practitioners;
f) Conducting research and educating the public about insolvency;
g) Liaising with international insolvency bodies; and
h) Advising the minister generally on insolvency matters.

Company Re- Organisation

Under the Companies Act 1984, a company in financial difficulties would be wound up without resorting to reorganizing the same. Under the Insolvency Act, the Court may make a Re-organisation Order where the company is or likely to become unable to pay its debts. The Court appoints an administrator (an Insolvency practitioner).

The Order may be applied for by the company itself, directors or creditors. The **three objectives** of the Order are as follows:-

a) Rescuing the company as a going concern;
b) Achieving a better result for the company's creditors as a whole than would be likely if the company were wound-up without first being in company reorganization, which may include a sale or a transfer of any business of the company as a going concern;
c) Realizing property in order to make a distribution to one or more secured or preferential creditors.

The company Re-organisation Order creates a "breathing space" for the company – it freezes court actions against the company and repossessions of goods. Once the Order is issued, it is no longer possible to commence winding-up proceedings against the company or enforce charges on the company's assets – this is one of the major advantages of the Order giving the company a fresh financial start if possible, instead of winding it up (see Chapter 14 ahead).

10.12 PRACTICE QUESTIONS

1) What is a debenture?
2) List any **three** items that are included in the definition of a debenture and any **three** items which are excluded from the definition, under the Companies Act 2013.
3) Compare and contrast a debenture with a debenture stock.
4) Explain the following terms in relation to loan capital:-
   (a) Contract of direct security
   (b) Indemnity
   (c) Contract of guarantee
   (d) Contract of collateral
5) Explain the advantage of a debenture stock.
6) Discuss the importance of the Personal Property Securities Act 2013.
7) How important is the creation of a debenture trust in relation to a debenture stock?
8) State **three** differences between a debenture-holder and a shareholder.
9) Define a floating charge.
10) What is the advantage of a floating charge to a borrower?
11) Describe two ways in which debentures issued by a company may be secured.
12) What is a bearer debenture and what is the effect of its transfer without the knowledge of the company?
13) What remedies does a debenture-holder have when the issuer of the debentures has defaulted in payment?
14) What are the remedies available to a holder of a secured and an unsecured debenture against the company?
15) What do you understand by the term 'charge'?
16) Distinguish a fixed from a floating charge.
17) Outline the advantages and disadvantages of a floating charge.
18) State **three** circumstances under which a floating charge will crystallise.
19) State the legal position of priority of charges at common law on;
    (i) fixed in relation to floating charges
    (ii) floating charges in relation to other floating charges
20) Comment on the ***Romalpa case*** [1976].
21) Explain the meaning and relevance of Company Re-organisation.
22) Who can apply for Company Re-organisation Order?
23) What are the three objectives of Company Reorganization?
24) Explain the significance of the Insolvency Act 2016 to company law in Malawi.
25) List any five functions of the Director of Insolvency.

CHAPTER 11 : DIRECTORS AND COMPANY SECRETARIES

11.1 INTRODUCTION

Since a company is an artificial legal person, it needs individuals who can act for it, represent it and make decisions concerning how it is to be run. These individuals are primarily directors who are officers of the company. This Chapter will be concerned with the nature of this office and the appointment to it whilst the duties and responsibilities that go with it are covered in the next Chapter. Within this Chapter we shall also examine the role of the company secretary in a registered company.

11.2 DIRECTORS

11.2.1 Definition of a Director

Section 158(1) of the Act provides that the term 'director' includes a person occupying the position of director of the company by whatever name called, and includes an alternate director.

11.2.2 Types of Directors

a) **A De Jure Director** (meaning a director from law) is a director who is properly appointed to the board and registered with Registrar of Companies. He may also be referred to as a registered director.

b) **A De Facto Director** (meaning a director in fact or in reality) is someone who has not been properly appointed and notified to Registrar of Companies as a director but who nevertheless acts as a director and holds themselves out to third parties as a director.

c) **Alternate Director** – a director is allowed to appoint a fellow director or with the approval of the board, any other person as an alternate director. Such appointment must be in writing and signed by both the appointor and the appointee and lodged with the company. An alternate director acts when the appointor is unable to act for whatever reason. An alternate director can be useful if the director has many outside commitments which may from time to time result in prolonged absences from the board. The appointment of an alternate can solve problems relating to quorum, cheque-signing and so on. An alternate director acts as an officer of the company and not as an agent of his appointor. However, he cannot himself appoint an alternate director. The company cannot pay remuneration to both the alternate director and his appointor.

d) **A Casual Director** – fills a casual vacancy that arises between annual shareholders' meetings because of death or resignation of a director.

e) **A Shadow Director** – is a person in accordance with whose instructions the Board may be required or is accustomed to act. He exerts 'real influence' over the company's affairs. A shadow director does not include a person giving advice in a professional capacity.

f) **A Nominee Director** - occasionally circumstances will arise where a group of people with an interest in a company (for example shareholders or less frequently a creditor) wish to appoint a representative or 'nominee' to the board of directors. The right to make such appointments will sometimes be found in a company's articles of association or in a shareholders or investment agreement.

g) Note that corporate governance requires that a distinction be made between **executive** and **non-executive** directors. A director who is an employee of the company working under a contract of service is called an **'executive director'**. Such a director will be expected to perform a specified role for the company. The articles will usually empower the board of directors to appoint such employees for example the **Managing Director or Chief Executive Officer**. Directors may delegate their duties to the managing director. **Non-executive directors**, on the other hand, are officers of the company who do not have such an employment relationship with the company and are usually only awarded a relatively small fee for rendering their services. Such directors bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments and standards of conduct. Corporate governance therefore, requires that the majority of directors be non-executive.

11.2.3 Management Powers of Directors

The business and affairs of a company are managed, directed and supervised by the Board. The Board must therefore have all the powers necessary for managing, and for directing and supervising the management of, the business and affairs of the company. These powers will usually be found in the company's constitution. It was stated in ***John Shaw & Sons Ltd v Shaw*** [1935] 2 KB 113, that a company is an entity distinct alike from its shareholders and its directors; some of its powers may, according to its articles, be exercised by directors; certain other powers may be reserved for the shareholders in general meetings. If powers of management are vested in the directors, they and they alone can exercise these powers. On the facts of that case it was **held** that the general meetings' decision to interfere with the directors' decision to commence certain court proceedings was wrong.

Powers of management for directors are extensive and may include power to borrow money, issue debentures and charge company property as security for the loan; determine how negotiable instruments and receipts for money paid to the company are to be executed; appoint other directors; pay interim dividends; appoint the managing director; ensure that accounting records are kept and that accounts are prepared and laid before the company in a general meeting; delegate their powers ; issue shares and determine the rights and restrictions which may be attached to them and convening general meetings.

11.2.4 Limits on Management Powers of Directors

Limits on director's powers are derived from both statute and common law. For example, under section 83(1) of the Act a company is permitted to issue shares subject to limitations in its constitution. Shareholders may therefore, for instance, delegate the power to issue shares to the Board, subject to their approval.

On the other hand, under common law if directors exercise their powers in an unfair way, those who are adversely affected can sue. Again directors' powers of management are conferred on the directors collectively as a board. This means that the powers will be exercisable at board meetings of which appropriate notice has been given and at which a quorum is present. In addition, the company in general meetings has the residuary power to exercise director's powers of management if they are unable or unwilling to exercise the powers. In ***Barron v Potter*** [1914] 1 Ch 895, the company's articles gave the board of directors' power to appoint an additional director. However, because of personal differences between existing directors, the board could not meet to make the appointment, consequently, the company in a general meeting appointed the director. It was **held** that the appointment was valid.

11.2.5 Delegation of Powers

The well-known common law maxim of the law of agency – '*delegatus non potest delegare'* (a delegate cannot delegate) – applies to directors, so that they cannot delegate their functions and powers to others without the permission of the law or members or the articles. The Act provides that the Board of a company may delegate to a committee of directors, a director or employee of the company, or any other person, any one or more of the powers conferred on them by the constitution of the company on such terms and conditions as they see fit.

11.2.6 Number of Directors

A private company must have at least **one** director and a public company must have a minimum of **three** directors. In all types of companies at least **one** director is required to be ordinarily resident in Malawi.

Where it appears to the Registrar that a company is operating without the minimum number of directors, the Registrar must direct the company to comply within a specified period, failing which the company and every officer of the company in default is liable to a fine.

11.2.7 Qualification of Directors

Section 164 of the Act 2013 provides for eligibility for appointment to the office of a director. The following are ineligible:-

a) A body corporate, unless the company concerned is a State Owned Company.
b) A person below the age of eighteen (18);
c) In the case of a public company, a person over seventy (70) years of age.
d) An un-discharged bankrupt;

e) A person prohibited from being a director or managing a company;
f) a person adjudged to be of unsound mind;
g) a person who by virtue of the constitution of a company, does not comply with any qualifications for directors. For example where a director is required by the constitution to take up shares in the company and fails to do so within the prescribed time.

The Companies Act 2013, further requires that a person may only be appointed a director of a company after he has **consented in writing** to be a director and certified that he is not disqualified from being appointed or holding office as a director of a company.

11.2.8 Directors Service Contracts

Directors in a public company do usually enter into a service contract. The Act therefore regulates directors' service contracts for public companies.

A director's "service contract", is defined as a contract under which a director undertakes personally to perform services (as a director or otherwise) for the company, or for a subsidiary of the company.

Section 217 of the Actrequires a copy of the contract to be kept available for inspection by shareholders without charge at the company's registered office. The contract must be retained by the company for inspection for at least **one year** after expiry of the contract.

11.2.9 Irregularly Appointed Directors

It may happen that a company inadvertently appoints a disqualified person to the office of a director and questions arise as to the validity of his acts while so acting as a director yet disqualified. The answer lies in section 164(3) which clearly provides that where a person who is disqualified from being a director, acts as a director, he is deemed to be a director for the purposes of a provision of the Act. Section 173 goes on to provide that the acts of a director are valid even though the director's appointment was defective; or the director is not qualified for appointment.

11.2.10 Appointment of Directors

First directors of a company are the ones named as such in the application for registration. All subsequent directors are appointed by an ordinary resolution, unless the constitution of the company otherwise provides.

Changes in the directors and secretary or their particulars such as name or residential address must be notified to the Registrar by the Board in a prescribed form, within **28 days** in the case of an appointment or resignation and when the company becomes aware in the case of death or change of name or residential address.

11.2.11 Powers of the Court to Appoint Directors

The High Court has power to appoint a director where there are no directors of a company, or the number of directors is less than the quorum required for a meeting of the Board; and it is not possible or practicable to appoint directors in accordance with the company's constitution. An application, in that regard, may be made by a shareholder or creditor of the company.

11.2.12 Removal and Vacation of Directors' Office

A director of a public company may be removed from office by an **ordinary resolution** passed at a meeting called for that purpose. This is so regardless of anything in its constitution or in any agreement between it and a director. In contrast, a director of a private company may be removed from office by **special resolution** passed at a meeting called for the purpose that includes the removal of the director.

Apart from the removal of a director, there are a number of situations in which a director ceases to hold office and the office falls vacant.

a) In the case of a public company, where a director reaches 70 years of age;
b) A director may resign by signing a written notice of resignation and delivering it to the address for service of the company.
c) The office of a director falls vacant once he becomes disqualified from being a director, for example he is declared bankrupt or he becomes of unsound mind.
d) The office of a director also falls vacant upon his death. Succession challenges are abound where the sole shareholder and director of a one person company dies. Section 171 (3) requires every one person company to nominate a person to be the secretary of the company in the event of the death of the sole shareholder and director. This can be done when incorporating the company or six months from the date on which it became a one person company. The notice itself must state the full name, residential address and occupation of the person nominated and is accompanied by the consent to act in writing signed by that person.
   The secretary assumes office as secretary of the company upon the death of the sole shareholder and director with the responsibility of calling a meeting of persons who appear to be beneficiaries of the deceased's estate or other personal representative of the deceased for the purpose of appointing a new director or directors.

e) The office of a director falls vacant in accordance to provisions of the constitution of a company. For instance, where a director is required by the constitution to take up shares in the company and fails to do so within the prescribed time.

f) Lastly, under the Insolvency Act 2016, on the appointment of a liquidator, all the powers of the directors generally cease.

The vacation of office does not in any way remove the liability of directors in relation to acts and omissions and decisions made while that person was a director.

11.2.13 Register of Directors

The Act requires that every company keep a register of its directors. The register must contain particulars of each person who is a director of the company including but not limited to names; address: nationality; country of residence; occupation or profession and date of birth. The register must be kept available for search at the company's registered office.

11.3 COMPANY SECRETARIES

11.3.1 The Requirement

The Act exempts private companies from having a secretary. The traditional functions of the secretary in a private company are performed by the company itself, a director, or some authorized person. However, it is mandatory for a public company to have a secretary.

11.3.2 The Function and Duties of the Secretary

According to Lord Denning MR in ***Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd*** [1971] 2 QB 711, a company secretary is a much more important person nowadays than he was when companies were first introduced. He is an officer of the company with extensive duties and responsibilities. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company's business. In that case, a secretary hired cars on the company's behalf, signing relevant car hire documentation as 'company secretary' and informing the car hire company that the cars were to be used for collecting clients from airports. Instead, he used the cars for private purposes. The company refused to pay the car hire charges, claiming that the company secretary had no authority to make the contract on the company's behalf. It was **held** that the company was liable to pay, as the company secretary had acted within the scope of his apparent authority.

That said, there are limits to his roles, for example he cannot without authority borrow money on behalf of the company; commence litigation on the company's behalf, he cannot summon a general meeting himself nor register a transfer without the board's approval nor can he without approval strike a name off the register. These are powers which are vested in the directors.

The Companies Act 2013 specifically provides for various roles that should be performed by the secretary such as keeping and maintaining company records and filing annual returns. The secretary may also have statutory functions conferred on him by other written laws. In most circumstances his basic duties will include, but are not limited to, making sure that the company complies with its constitution; making sure that the company complies with corporate laws. The secretary also organises and manages board meetings and general meetings. The secretary therefore is at the core of corporate governance, making sure the company is compliant. The secretary may also manage the company's intellectual property; he may administer the pension fund and the company's property portfolio; he further handles official communication for the company more especially on legal matters.

A secretary owes fiduciary duties to the company which are similar to those of a director, discussed in the next Chapter. Thus he must not make secret profits or take secret benefits from his office.

11.3.3 Qualifications of Secretaries of Public Companies

Under section 225, directors of a public company are under duty to take all reasonable steps to ensure that the secretary of the company is a person who appears to them to have the requisite knowledge and experience to discharge the functions of secretary of the company. He must have held the office of secretary of a public company for at least three of the five years immediately preceding his appointment as secretary or he must be a member of any professional body of company secretaries in Malawi.

11.3.4 Register of Secretaries

A public company must keep a register of its secretaries. The register contains particulars such as name; address and any other relevant information. The register must be kept available for inspection at the company's registered office and be open for the inspection by members.

11.3.5 Notice of Changes to the Registrar

Where a change occurs in the office of the secretary of a public company, the company must give a notice to that effect to the Registrar within **fourteen days**. Where a secretary for a public company is appointed, the notice of such appointment must be accompanied by the consent by that person to act in that capacity.

11.4 PRACTICE QUESTIONS

1) Define a director.
2) Comment on any various types of directors under the law.
3) 'D*elegatus non potest delegare'* (a delegate cannot delegate) – how relevant is this principle in relation to company directors.

4) List any **five** persons who are disqualified from holding the office of a director.
5) What is the position of the law in relation to irregularly appointed directors?
6) How are company directors appointed?
7) Distinguish the process of removing a director in private company from the one in a public company.
8) What mechanisms does the law provide for managing succession in one person companies?
9) Write a short essay explaining the requirement and qualification for company secretary as well as the function and duties of that office.

CHAPTER 12: DUTIES OF DIRECTORS

12.1 INTRODUCTION

Before the coming into force of the Companies Act 2013, directors' duties were based on the common law (case law). The Act now makes such duties statutory. The **fiduciary duties** imposed on directors require them to act *bona fide* and in the best interests of the company. Additionally, they must exercise their powers for the proper purposes for which they were conferred and not for any collateral or improper purpose.

The general duties specified in the Act are owed by a director to the company and not to shareholders as individuals. This is readily understood if the directors are viewed simply as agents for the company, since the company as a separate entity with its own rights and liabilities is the principal.

12.2 DUTY TO ACT IN ACCORDANCE WITH THE CONSTITUTION

Directors have a statutory duty to act in accordance with the company's constitution. The Company is bound to act *intra vires* thus where the constitution of a company sets out the objects of the company, there is deemed to be a restriction in the constitution on carrying on any business or activity that is not within those objects, unless the constitution expressly provides otherwise.

12.3 DUTY TO USE POWERS FOR A PROPER PURPOSE

In addition to acting in accordance with the company's constitution, a director must only exercise powers for the purposes for which they are conferred. So, in ***Bishopsgate Investment Management Ltd v Maxwell (No 2)*** [1993] BCLC 1282, where a director used his powers to authorise documents transferring the company's assets to a third party in which he had an interest, for no good corporate purpose or reason, the court **held** this as a use of the director's powers for an improper purpose.

12.4 DUTY TO PROMOTE THE SUCCESS OF THE COMPANY

The 2013 Act introduces the concept of **'enlightened shareholder value'** i.e. a requirement that directors must have regard to a range of interests in discharging their duty to promote the success of their company. Thus, section 177(1) of the Act provides that a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. Success in this context would usually mean 'long-term increase in value' where commercial companies are concerned. In so doing the director must have regard to the following factors:-

a) the likely consequences of any decision in the long term;
b) the interests of the company's employees;

c) the need to foster the company's business relationships with suppliers, customers and others;
d) the impact of the company's operations on the community and the environment;
e) the desirability of the company maintaining a reputation for high business standards;
f) the need to act fairly as between members of the company;
g) where appropriate, the directors may also consider the interest of creditors of the company.

12.5 DUTY TO EXERCISE INDEPENDENT JUDGMENT

A director of a company must exercise independent judgment. However this duty is not infringed by a director acting in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors; or in a way authorised by the company's constitution.

12.6 DUTY OF CARE AND SKILL

Under the Act, a director of a company is obliged to exercise reasonable care, skill and diligence. This means the care, skill and diligence that would be exercised by a reasonably diligent person with firstly, the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and secondly the general knowledge, skill and experience that the director has. For example, in the case of ***Re Brazilian Rubber Plantations and Estates Ltd*** [1911] 1 Ch 425, a company was formed with the object of purchasing rubber estates. Its directors knew nothing about rubber estates though they were informed that statements made about an estate which they intended to buy were untrue. They still went ahead to purchase the estate. They were sued when the company went into liquidation. It was **held** that the directors were not liable for the breach. They did not have special knowledge on rubber estates therefore they could not be expected to show skills of an "expert".

12.7 DUTY TO AVOID CONFLICT OF INTEREST

By section 180 of the Act, a director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. In ***Industrial Development Consultants Ltd v Cooley*** [1972] 2 All ER 162, a director resigned in order to clinch a contract for himself for the supply of gas to the company from which he had resigned. He got the contract. When members sued it was **held** that he should account for the benefit made under the contract to the company.

Certain conflict of interests have to be authorized by the company. The authorisation is effective only if any interested director does not form the quorum and does not vote on that decision.

12.8 DUTIES IN RELATION TO SELF INTEREST TRANSACTIONS

There are detailed rules on core disclosure obligations in transactions involving self interest under the Act. In a nutshell, where a director is interested in a transaction he is obliged to declare the same to the Board of directors not its committee. Such transactions may be voided by the company within **six months** from the date of the declaration unless the company has received fair value under it.

Directors' Remuneration

A director is not an employee of the company merely by reason of holding office, further, he is not entitled merely by holding office to any remuneration for the services he performs. He is not, *prima facie*, entitled to any remuneration for his service. Therefore, for a director to get remuneration, he must show some contract or agreement to be inferred from the articles.

Directors are managers and controllers – they are entitled to remuneration as decided from time to time by the general meeting if no decision is made, they are not entitled to anything. A director cannot claim a *quantum meruit* [payment in proportion to work done] from the company if he undertakes work for it as a director but is not paid remuneration under the authority of the articles. This rather harsh position of the law is necessary to prevent directors from helping themselves out of the assets of the company. If the law was not so, how much would directors pay themselves?

12.9 DUTY NOT TO ACCEPT BENEFITS

A director is prohibited from accepting a benefit from a third party conferred by reason of his being a director or his doing, or failure to do, anything as director. After all such benefits may constitute a bribe and are punishable as a criminal offence under anti-corruption laws.

12.10 DUTY TO DECLARE INTEREST

The Act requires that if a director is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors. The declaration may be made at a meeting of the directors or by notice in writing to the directors.

12.11 DUTY AGAINST INSIDE DEALINGS

The general rule is that directors must not exploit information which they have on the company's securities, for their own benefit or someone else's. An example is the New York Court of Appeals decision in ***Diamond v Oreamuno*** 24 N.Y. 2d 494(1969), here, realising that their company's profit had fallen drastically, directors sold their shares on the market at $28 a share, before the fall was made public. Subsequently, the value of the shares dropped to $11 per share. It was held that although the company had suffered no loss from the directors' conduct, the directors were liable to account to it the difference between $28 and $11 per share (i.e. $17).

12.12 DUTY AS TO THE COMPANY'S SOLVENCY (WRONGFUL TRADING)

A director of a company who believes that the company is unable to pay its debts as they fall due is obliged to forthwith call a meeting of the Board to consider whether the Board should appoint a liquidator or an administrator. Where a director fails to call for the meeting and at the time of that failure the company was unable to pay its debts as they fell due and the company is subsequently placed in liquidation, the Court may, on the application of the liquidator or a creditor of the company, make an order that the director be liable for the whole or any part of any loss suffered by creditors of the company as a result of the company continuing to trade.

12.13 DUTY TO COMPLY WITH THE CODE OF CORPORATE GOVERNANCE

The recent financial crisis and continued failure of prominent companies around the globe and within Malawi, has served to highlight the need for the proper governance of business. Given the Board's overall responsibility and accountability for the same, the focus on the need for effective governance has never been greater. Section 70 as read with section 184 (1) of the Act specifically provides for compliance with corporate governance rules. Directors, for both public and private companies, are required to comply with the prescribed code of corporate governance.

12.14 CONSEQUENCES OF BREACH OF GENERAL DUTIES

Remedies for breach of the general duties may include the following:-

a) the Company may **remove** the director from office;
b) The director may be liable to **compensate** the company for subsequent loss;
c) The director may be liable to **account** to the company for any profit made;
d) Any contract entered into between the director and the company may be **rescinded**;
e) the company may generally obtain an **injunction** against the director's breach;
f) the director may be ordered to pay a **fine** or be **imprisoned** in line with the provisions of the Act and section 24 of the Penal Code which provides, in part, that where an offence is committed by any company, every person charged with or concerned or acting in, the control or management of the affairs or activities of such company is guilty of that offence and is liable to be punished accordingly. In ***R v Lutepo*** Criminal Cause No. 2 of 2014, the accused was convicted of money laundering offences where he had, among others, used his companies, to launder stolen government funds in the infamous cash-gate.
g) Under section 331(1) the Minister, the Registrar or the Registrar of Financial Institutions may appoint **inspectors to investigate** the affairs of a public company.

12.15 PRACTICE QUESTIONS

1. What is the meaning of fiduciary duties, in relation to the office of a director?
2. Identify and comment on any **five** statutory duties of directors.
3. What is the meaning of **'enlightened shareholder value'** concept?
4. List any **five** factors that directors must consider exercising their duty to promote the success of their company.
5. Explain the relevance of ***Re Brazilian Rubber Plantations and Estates Ltd*** [1911].
6. Directors have a duty to ensure that the company is solvent all the time. Comment on this duty.
7. Explain the consequences for breach of directors' duties.
8. Comment on ***R v Lutepo*** Criminal Cause No. 2 of 2014.

CHAPTER 13 : ACCOUNTS AND AUDITORS

13.1 INTRODUCTION

If companies are to function properly as vehicles for investment, in which passive investors and creditors can have confidence, then there has to be an accurate, rigorous and verifiable system of accounts. There has been an enormous growth, during the 20th century, in the volume of provisions relating to the preparation and disclosure of accounts. It is also important to examine briefly the set-up of the accounting profession, the role, duties and liabilities of the auditor, who is, of course, closely linked with the company's accounts.

13.2 THE ACCOUNTING PROFESSION IN MALAWI

The accounting profession in Malawi is governed by the Public Accountants and Auditors Act 2013. The Act provides for the establishment of the Malawi Accountants Board (MAB) and for the registration of chartered accountants and diplomate accountants and matters connected therewith.

13.2.1 The Malawi Accountants Board (MAB)

Section 3 of the Public Accountants and Auditors Act established MAB which is a body corporate with perpetual succession. The wide ranging functions, powers and objectives of MAB are covered in Part IV of the Act. The general powers include the following:-

a) Consider and determine applications for registration of chartered accountants and diplomate accountants and maintain a Register thereof;
b) Encourage cooperation between ICAM and other professional bodies and take steps to advance the standing and effectiveness of the accountancy profession in Malawi;
c) Advise Malawi College of Accountancy and ICAM on matters pertaining to examinations and training of accountants;
d) Advise the Minister on accountancy and cognate matters;
e) Hear appeals from decisions of ICAM on admission, improper conduct, costs of the appeals. Appeals from MAB lie to the High Court.
f) Review statutory financial statements and financial reports of public interest entities;
g) Monitor the accuracy and fairness of financial reporting and enforce compliance with accounting standards;
h) Accredit professional accountancy bodies and trainers and oversee their activities including training and examinations;
i) Formulate any syllabus, training requirement or examination structure applicable to its registrants;
j) MAB has the objective of regulating the reporting of financial matters and providing direct oversight over professional accountancy bodies and auditors.

13.2.2 The Institute of Chartered Accountants in Malawi (ICAM)

ICAM is a professional accountancy body in Malawi which was established out of a merger of the Public Accountants Examination Council (PAEC) and the Society of Accountants in Malawi (SOCAM) under the Public Accountants and Auditors Act.

According to section 40 of the Public Accountants and Auditors Act, ICAM's objectives include the following:-

a) Promote the development of the accounting profession;
b) Supervise the accountancy profession in the public interest;
c) Promote the highest standards of professional ethics and business conduct of accountants;
d) Ensure the professional independence of accountants; and
e) Determine the eligibility criteria to become a member of ICAM;

13.3 ACCOUNTS

13.3.1 General Obligations for all Companies Except Private Companies

The board of a company is under obligation to cause accounting records to be kept that, *inter alia*, correctly record and explain the transactions of the company and enable the financial position of the company to be determined with reasonable accuracy.

13.3.2 General Obligations for Private Companies

The Companies Act 1984 required every company to have an auditor. In contrast the Companies Act 2013 does not require private companies to have an auditor. The Act simply mentions that private companies may however resolve to appoint an auditor. An auditor of a private company may resign by written notice to the directors. Where the auditor gives written notice to resign, the directors must call a meeting of shareholders or circulate a resolution to the shareholders as soon as practicable for the purpose of appointing an auditor in the place of the auditor who desires to resign and on the appointment of another auditor, the resignation takes effect. A shareholder who holds at least **five percent** of the shares may initiate change of auditors in the company.

13.3.3 Financial Statements

The board of every company must ensure that, within **6 months** after the balance sheet date of the company, financial statements are completed in relation to the company at its balance sheet date; and dated and signed on behalf of the board by two directors of the company, or, where the company has only one director, by that director.

The financial statements of a company must present a **true and fair view** of the state of affairs of the company at the balance sheet date and of its profit of loss and cash flows for the accounting period. The preparation of the financial statements must be in accordance with International Financial Reporting Standards, the Act and any other written law.

13.3.4 Filing of Annual Report and Accounts for Companies other than Private Companies

The board of every company must, within **six months** after the balance sheet date of the company, prepare an annual report and accounts. That said, the shareholders of a private company may resolve by unanimous resolution that this requirement should not apply to their company. In addition this requirement does not apply to a one person company.

13.3.5 Directors Report

By section 252, a directors' report is required for all public companies. It must be in writing and dated. The board is obliged to send a copy of the annual report and accounts to every shareholder not less than **14 days** before the date fixed for holding the annual meeting of the shareholders and such delivery may be made by electronic means.

13.3.6 Annual Return

Every company must, once in every year, file with the Registrar for registration an annual return which may be in electronic form. The annual return must be completed and filed with the Registrar within **28 days** of the date of the annual meeting of the company. The annual return shall be signed by a director or secretary.

13.3.7 Dormant Companies

As observed in Chapter One, there is provision in the Act for a company to make itself exempt from the audit requirements by the members passing a special resolution at a shareholders meeting, declaring the company to be dormant. A resolution to this effect can be passed where, during the relevant period, no significant accounting transaction occurs. A company ceases to be dormant whenever such a transaction does occur.

13.4 AUDITORS

In order to ensure that a company's accounts serve the purpose for which they were intended, that is, to give both the members of the company and the public accurate information about the financial position of the company, the accounts must be subject to professional scrutiny. The purpose of statutory audit is to provide an independent, external professional opinion that the company's accounts reflect a true and fair view of the company's financial returns.

13.4.1 Appointment of Auditors

The first auditor of a company may be appointed by the directors of the company before the first annual meeting, and, if so appointed, holds office until the conclusion of that meeting. Where the directors do not appoint the first auditor the company must appoint the first auditor at a meeting of the company. Subsequently, a company must appoint an auditor at each annual meeting. The auditor holds office from the conclusion of the meeting until the conclusion of the next annual meeting. An auditor is automatically reappointed at an annual meeting of the company unless the auditor is not qualified for appointment; or the company passes a resolution at the meeting appointing another person to replace him as auditor; or the auditor has given notice to the company that he does not wish to be reappointed.

13.4.2 Qualifications of an Auditor

The qualifications of an auditor are provided for under the Public Accountants and Auditors Act 2013. However, the Companies Act 2013 outlines in section 234(2) a list of disqualified persons, including:-

a) a director or employee of the company or a related company;
b) a person who is a partner, or in the employment, of a director or employee of the company or a related company;
c) a liquidator or a person who is a receiver in respect of the property of the company or a related company;
d) a body corporate;
e) a person who is not ordinarily resident in Malawi; or
f) a person who is indebted to the company, or to a related company unless the debt is in the ordinary course of business.

In terms of sections 25 and 28 of the Public Accountants and Auditors Act 2013 the following, *inter alia*, are not qualified for registration as members of ICAM, hence they do not qualify to be auditors:-

a) an un-discharged bankrupt;
b) a convict of an offence which is disgraceful or dishonourable;
c) a person who has behaved in a manner which is disgraceful or dishonourable;
d) a person of unsound mind;
e) a person removed from a position of trust on account of misconduct;
f) a person convicted of theft, fraud, forgery or perjury;

g) a person disqualified from registration consequent upon any punishment imposed under the Public Accountants and Auditors Act.

13.4.3 Replacement of an Auditor

To enhance the independence of an auditor, the law must provide for security of his tenure. Section 238(1) of the Act provides that a company shall not remove or appoint a new auditor in the place of an auditor who is qualified for reappointment, unless at least **twenty-eight** days' written notice of a proposal to do so has been given to the auditor and the auditor has been given a reasonable opportunity to make representations to the shareholders.

13.4.4 Resignation of an Auditor

An auditor may resign prior to the annual meeting by giving notice to the company calling on the board to call a special meeting of the company to receive the auditor's notice of resignation. The notice may be accompanied by a written statement to be provided to the shareholders setting out reasons for the resignation. The appointment of the auditor terminates at that meeting and the business of the meeting must include the appointment of a new auditor to the company.

13.5 DUTIES AND RIGHTS OF AUDITORS

13.5.1 Duty to Avoid Conflict of Interest

An auditor of a company must ensure that his judgment is not impaired by reason of any relationship with or interest in the company or any of its subsidiaries.

13.5.2 Duty to Make a Report

The auditor is required to make a report to the shareholders on the financial statements which he has audited. The contents of the auditor's report must include the following:-

a) the scope and limitations of the audit;
b) whether the auditor has obtained all information and explanations that the auditor has required;
c) whether, in the auditor's opinion, the financial statements and any group financial statements give a **true and fair view** of the matters to which they relate, and where they do not, the respects in which they fail to do so and whether the financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the Companies Act.

13.5.3 Right to Access Information

The board must ensure that an auditor has access at all times to the accounting records and other documents of the company. Where the board fails to comply with these requirements every director is liable to a fine in accordance with the prevailing schedule of penalties. Under section 20 of the Public Accountants and Auditors Act, 2013 an auditor who certifies accounts where he was in fact denied information or does not comply with the law, commits an offence and may be disciplined.

13.5.4 Right to Attend Shareholders' Meeting

It is the duty of the board to ensure that an auditor

a) is permitted to attend a meeting of shareholders;
b) receives the notices and communications that a shareholder is entitled to receive relating to a meeting of the shareholders; and
c) may be heard at a meeting of the shareholders.

13.6 LIABILITIES OF AUDITORS

Auditors are generally liable for professional negligence. In ***Re Thomas Gerrard and Son Ltd*** [1967] 2 All ER 525 Ch 534, a director of a company falsified the company's accounts by fraudulent entries. The auditors were suspicious and asked the director for an explanation, but made no further investigations. As a result, their estimate of the company's profits was wrong and the company declared dividends which it could not have done, paying tax which would otherwise have not been payable. The company went into liquidation and the liquidator took proceedings against the auditors. It was **held** that damages were recoverable against the auditors and that these damages included the dividends, costs of recovering the tax and any tax not recoverable.

The question whether any persons other than the company which appoints the auditor to office can claim damages for loss was addressed in the leading case of ***Caparo Industries plc v Dickman*** [1990] AC 605. In its decision, the House of Lords examined the statutory requirements for the auditing of accounts and the role of the auditors. The conclusion was that the work done by the auditors was for the benefit of the company, that is, not for the benefit of individual shareholders but for the benefit of the shareholders collectively. Therefore, no duty of care was owed by the auditors to outside investors who may see the accounts before buying shares. Nor, for example, was a duty of care owed by the auditors to a bank which was considering lending money to a company on the basis of the audited accounts. Further, the auditors did not owe a duty to existing individual shareholders.

There would have to be a special relationship between the auditor and the third party in order for a duty of care to arise. To impose a general duty of care on auditors to persons other than the company would be to subject the auditor to a liability 'in an indeterminate amount for an indeterminate time to an indeterminate class'. This line of reasoning compares favourably with the principles earlier seen in the cases of ***Salomon vs Salomon and Co. [1897]*** and ***Foss vs Harbottle (1843)***.

13.7 PRACTICE QUESTIONS

1) Summarize the role of the Malawi Accountants Board.
2) What function does ICAM play under the law?
3) Explain with examples how the Companies Act 2013 has relaxed accounting and auditing requirements for companies in Malawi.
4) What are the general accounting and auditing requirements for companies incorporated in Malawi?
5) How are auditors appointed?
6) What qualifications should an auditor have?
7) List any **five** persons who are disqualified from the office of auditor.
8) Comment on the rights and duties of an auditor.
9) What are the contents of an Auditor's Report?
10) 'There would have to be a special relationship between the auditor and the third party in order for a duty of care to arise.' Substantiate this proposition of the law in relation to auditor's liability.
11) ITL Limited, once a successful company has suddenly gone into liquidation. The shareholders set up a commission of inquiry headed by a High Court judge. The inquiry has revealed that the auditors of the company never followed up or investigated clearly suspicious transactions conducted by the company directors.

    Required:- Advise the liquidator on:- the liability, if any, of the auditor and the remedies, if any, available to the company.

CHAPTER 14: WINDING UP

14.1 INTRODUCTION

The existence of a company is brought to an end by winding up and, ultimately, dissolution. ‘Winding up’ which is synonymous, and is here used interchangeably, with ‘liquidation’ is a process whereby a company’s property and assets are identified and realised to pay off its debts and the surplus, if any, distributed among the company’s members in accordance with their entitlement under the constitution of a company. Thereafter the company is formally dissolved i.e. struck off the registrar of companies. The terminology in English law is that a company does not go bankrupt but an individual; a company may be insolvent and go into liquidation.

The most likely reason for a company to be wound up is that it has become insolvent, that is, unable to pay its debts. This is by no means the only reason, though, and a company can also be wound up when it is quite solvent. The law on winding up of companies is governed by the Insolvency Act 2016.

14.2 THE TYPES OF WINDING UP

There are two basic types of winding up: compulsory winding up and voluntary winding up.

14.2.1 Compulsory Winding Up

This type of liquidation is ordered by the court. An application for a winding up order is by petition and can be made by the following:-

a) company
b) shareholder
c) a creditor
d) a liquidator or
e) a director.

There are a number of grounds for compulsory winding up under section 107(4):-

a) the company has by special resolution resolved that it be wound up by the Court;
b) the company is unable to pay its debts;
c) the company does not commence its business within a year from its incorporation or suspends its business for a whole year;
d) the number of members is reduced below two but this of course does not apply to a one person company;
e) the period fixed for the duration of the company by the memorandum or articles expires or the event on the occurrence of which the memorandum or articles provide that the company is to be dissolved, has occurred; or
f) the Court is of opinion that it is just and equitable to do so.

Under section 182 of the Insolvency Act 2016, there are **four** instances under which a company's inability to pay its debts will be proved:

(a) where the company does not comply with a statutory demand.
(b) where execution issued against the company in respect of a judgment debt has been returned unsatisfied;
(c) where a person entitled to a security interest over the whole of the company property has appointed a receiver under the instrument creating the security interest; or
(d) where an arrangement between a company and its creditors has been put to a vote and has not been approved.

The principal duty of the liquidator of a company which is being wound up by the court is to act in a reasonable and efficient manner and take possession of, protect, realize and distribute the assets or the proceeds of the realization of the assets, of the company to its creditors in accordance with the Insolvency Act 2016.

A liquidator is not a trustee of the company's assets for individual creditors and contributories but he does owe fiduciary duties to the company and, therefore, must act in good faith and not make secret profits. He is acting as an agent of the company; therefore, if, in exercising his functions, he properly makes a contract on behalf of the company, he is not personally liable if there is a breach of that contract. He can be held liable in misfeasance proceedings if he has improperly retained property or had improperly or unnecessarily paid out the company's money, and these proceedings can be instituted by any creditor or contributory.

14.2.2 Voluntary Winding Up

The company can resolve, by **special resolution** that the company be wound up. A copy of the resolution has to be forwarded to the registrar and the company has to give notice of the resolution by advertisement in one daily newspaper and in the *Gazette*.

Voluntary winding up commences at the time of the passing of the resolution to wind up. There are **two** different types of voluntary winding up. A **members' winding up** is a voluntary winding up where a directors' statutory declaration of solvency has been made and a **creditors' winding up** is one where such a declaration has not been made.

14.2.3 Members' Voluntary Winding Up

The **statutory declaration of solvency** essential to this form of winding up is made by the directors, at a meeting, to the effect that they have made a full enquiry into the company's affairs and that they have formed the opinion that the company will be able to pay its debts in full, together with interest, within the prescribed period. To the declaration, must be attached a statement of affairs showing three items namely;

a) the assets of the company and the total amount expected to be realized therefrom;

b) the liabilities of the company; and
c) the estimated expenses of winding-up, made up to the latest practicable date before the making of the declaration.
There are **three conditions** that give effect to the declaration.
a) It must be made at the meeting of directors.
b) It must be made within the prescribed period immediately before the passing of the resolution and
c) It must be lodged with the Director of Insolvency and the Registrar before the date on which the notices of the meeting at which the resolution for the winding up of the company is proposed are sent out.
The company, in general meeting, in a shareholders' winding up appoints a liquidator. This is the advantage of the directors being able to make the statutory declaration of solvency, since, if they control the general meeting, they will be able to appoint a liquidator who they believe will be less inquisitive as regards their own conduct than one appointed by the creditors. On the appointment of a liquidator, all the powers of the directors cease except so far as the liquidator, or, with his consent, the company in general meeting, may otherwise determine.

14.2.4 Creditors' Voluntary Winding Up

This takes place where no declaration of solvency is made. In this type of liquidation, the directors must cause a meeting of its creditors to be summoned before the meeting at which a winding up resolution is to be proposed.

Creditors may nominate a person to be the liquidator of the company. If they do so, then he becomes the liquidator; if they do not, then the directors can nominate someone. If the creditors think fit, they may also appoint a **liquidation committee** consisting of not more than five persons, whether creditors or not. This committee can then liaise with the liquidator without the need for the liquidator to convene full creditors' and members' meetings. The committee must meet at least every six months.

14.3 THE LIQUIDATOR

The liquidator is a person appointed to carry out the winding up of a company. A liquidator must be a qualified insolvency practitioner under the Insolvency Act 2016. In ***Chagwamnjira v Khuze Kapeta -The Liquidator of FBM*** Com. Case No.65 of 2007, Kapanda J. stated that:-

> Essentially the functions of a liquidator are to identify the company's assets, realize them, settle its debts and repay the remainder to its creditors and members. Thus, the major function of a liquidator is to pay off the company's debts. However, before the debt can be paid, it must first be proved against the company. The duty to prove a debt rests on the creditor who alleges the existence of such debt.

The liquidator's statutory powers are covered in section 120 of the Insolvency Act 2016 and include the following:-

a) commence, continue discontinue and defend any action or other legal proceedings in the name and on behalf of the company;
b) carry on the business of the company so far as is beneficial for its winding up;
c) appoint legal practitioner or other agents or experts to assist him;
d) compromise calls and liabilities for calls;
e) sell or otherwise dispose of property of the company;
f) act and execute all deeds and documents in the name and on behalf of the company;
g) prove or claim in the bankruptcy or insolvency of any contributory;
h) draw, accept, make and endorse a bill of exchange or promissory note in the name and on behalf of the company; and
i) borrow money whether with or without providing security over the assets of the company.

A liquidator has a duty to maintain an even and impartial hand between all individuals whose interests are involved in the winding up. If any person is aggrieved by an act or decision of the liquidator, that person may appeal to the High Court, which is given a wide discretion in the order it can make.

The liquidator may be removed from his position either by a special resolution of the general meeting or by the Court. In ***Malawi Development Corporation v Chioko as Liquidator of Plastic Product Ltd*** Civil Cause No. 314 of 2004 Manyungwa J. found that the liquidator had acted in bad faith by failing to account for some assets of the company and threatening to pay unsecured creditors before paying the plaintiff who was a secured creditor. The Court ordered his removal. Again, in ***Re Mtendere Transport*** 8 MLR 255. the court **held** that the liquidator's failure to comply with his statutory duty to call a meeting of creditors was a serious omission and the fact that the assets of the company were insufficient to pay the unsecured creditors was no justification for it since all creditors had a right to know how the liquidation was being carried out and to be told if necessary why they would not be paid. Where the company is insolvent the shareholders have as much interest in the process of liquidation as the creditors.

14.4 DISTRIBUTION OF ASSETS, COMPLETION AND DISSOLUTION

14.4.1 Distribution of Assets

Once the creditors have proved their debts in the winding up, the liquidator must distribute the available remaining assets of the company to those entitled. The property of the company which is subject to a valid fixed charge must be used first to satisfy the debt which is secured by the charge. Then, in outline, the order is as follows:-

a) the costs and expenses of the liquidation, including the liquidator's remuneration;
b) claims by employees such as wages, overtime pay, holiday pay, severance allowance and compensation for unfair dismissal;
c) claims in respect of workers' compensation;
d) tax, duty or rates payable to government;
e) the unsecured creditors;

f) shareholders according to entitlements under the constitution.

14.4.2 Completion and Dissolution

The liquidation of a company comes to an end in the following ways:-

a) **Winding up by the court** – where the liquidator has realized all the property, distributed a final dividend, adjusted the rights of members and made a final return to the members, he may apply to the Court for a **release order** and that the company be dissolved. The liquidator must present to the Court an account showing how the winding up has been conducted and how the property of the company has been disposed of. Where such order is made, the liquidator is released and the company is dissolved from the date of the order. Where appropriate the court may withhold the release.
b) **Voluntary winding up** – where the affairs of the company have been wound up, the liquidator shall firstly make up an account showing how the winding up has been conducted and how the property of the company has been disposed of. Secondly, call for a final meeting of the company and lay the account before the meeting. The notice of the meeting must be published in at least one daily newspaper. The liquidator lodges a notice with the Director of Insolvency that the meeting took place and upon expiry of prescribed time, the company stands dissolved. The Court may defer the dissolution.
c) **Termination by the Court** – the Court may, at any time after the appointment of a liquidator, if it is satisfied that it is just and equitable to do so, make an order terminating the liquidation of the company, or stay the liquidation for such time as the Court thinks fit. An application for such an order may be made by the liquidator, a director, a shareholder, a creditor, the Director of Insolvency and such other person as the Court may authorise.

14.5 PRACTICE QUESTIONS

1. Distinguish winding up from dissolution of a company.
2. On what grounds may a court order the winding up of a company?
3. On whose application can a registered company be wound up compulsorily by a court order?
4. Under what circumstances is a company deemed to be unable to pay its debts?
5. How does voluntary liquidation differ from compulsory liquidation?
6. State any **five** occasions on which the Court will exercise its powers to wind up a company on the ground that it is just and equitable to do so.
7. State the circumstances under which a company may be wound up voluntarily.
8. Distinguish members from creditors' voluntary liquidation.
9. What is the principal duty of the liquidator?
10. Outline any **five** statutory powers of the liquidator as provided for under section 120 of the Insolvency Act 2016.
11. In what circumstances may a liquidator be removed from his position?
12. What payments should the liquidator prioritize according to law?
13. What should the statement of affairs to the declaration of solvency show?
14. State the **three** conditions that give effect to the declaration of solvency.

15. Identify and comment on the **three** ways through which the liquidation of a company comes to an end.

16. What role does the liquidation committee play in a creditors' voluntary liquidation?

17. Chozemba was a director of Mahewu Ltd. He misappropriated a large amount of company funds by making false entries into the books of accounts. The auditor of the company, Maseko, was informed of this but made no investigations. As a result of this, the company declared dividends which it would not have made had the auditor acted otherwise. The company has now gone into liquidation.
Required: Advise the liquidator.

COMPANY LAW (TC12)

TECHNICIAN DIPLOMA IN ACCOUNTING

ICAM THE INSTITUTE OF CHARTERED ACCOUNTANTS IN MALAWI

Institute of Chartered Accountants in Malawi
Stansfield House
Haile Selassie Road
P.O. Box 1
Blantyre

Tel: 01 820 301/318/423 Fax: 01 822 354
Email: icam@icam.mw Website: www.icam.mw

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