A CRITICAL ANALYSIS OF THE UGANDAN COMPANIES ACT, 2012, IN THE SEARCH FOR AN APPROPRIATE LEGAL FRAMEWORK FOR SMALL AND CLOSELY-HELD COMPANIES IN THE LIGHT OF THE EXPERIENCES OF SOUTH AFRICA AND THE UNITED KINGDOM

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DECLARATION

I, Ivan ENGORU [Student Reg. No. ENGIVA001] do HEREBY declare to the Doctoral Degrees Board of the University of Cape Town that save for direct quotes from or reference to existing literature which I have duly acknowledged and referenced in strict keeping with the relevant University Regulations, the work presented in this thesis is my own. It has not been, is not being, nor is it to be submitted for another degree in this or any other university or institution whatsoever.

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DEDICATION

To my dear wife Harriet and my children, Seth, Janice, Elizabeth and Jeremiah; and in loving memory of my dad, Charles Engoru (RIP), Lt Col John Ebitu (RIP), and Dr Moses Ejumu (RIP).

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ABSTRACT

This study set out to determine whether the Ugandan Companies Act, 2012 ('CA 2012') provides an appropriate and effective legal framework for small and closely-held companies ('SCHCs'). In this study, SCHCs are small owner-managed companies with one or a few members with close relations, who are usually natural persons. The study focus follows from a recognition that companies' legislation in Uganda is complex and makes little attempt to provide simple, flexible and accessible law for the operations of SCHCs. Although this gap was highlighted during the enactment of CA 2012, it had also characterised previous companies' legislation in Uganda. The expectation was that CA 2012 would address this gap. However, there is doubt if this has been achieved in CA 2012. To be sure, what amounts to simple, flexible and accessible legislation for SCHCs is not obvious. However, a look at the relevant legislation in the comparable jurisdictions of South Africa and the United Kingdom ('UK') suggests that SCHCs require special recognition and treatment in legislation in the areas of audits; financial reporting; limitation of membership; restriction of members to natural persons; and clear optional provisions. This can be achieved through a distinct corporate form in terms of a separate and distinct legislation for SCHCs or by treating SCHCs as private companies under a single company law statute, but with flexible provisions.

This study examines the various business forms under CA 2012 (ss 2, 4 and 5), and the corporate governance framework (ss 14, 138, 154, and 167). Through doctrinal analysis, it employs the evaluative framework of fewer reporting obligations; limiting membership in SCHCs to natural persons; limiting members who are also usually in management; and clear elective or optional provisions for SCHCs in areas such as company meetings and audits, as best practice on the regulation of SCHCs. The study draws on the experiences of South Africa under the Close Corporations Act 69 of 1984 ('CCA 84'), South African's *Companies Act*, 71 of 2008 ('CA 2008); and the UK's Companies Act, No. 46 of 2006 ('CA 2006') as comparable jurisdictions; and the application of common law in companies' legislation. In the latter, I examine specifically the common law concept of quasi-partnership companies, and its' utility in the SCHCs category, and codification of common law in companies' legislation, as a growing drafting style. I draw some lessons from the UK and South Africa.

The key arguments in this study are that first, the business forms and legal categories under CA 2012 do not align with the known legal definition or characterisation of SCHCs. They are classified along the traditional lines of private versus public or unregistered versus registered companies. The single member company ('SMC') is a new concept in Uganda's company law and is exclusive to single members. This does not cater for SCHCs. Second, the Code of Corporate Governance ('CoCG') (s 14), although optional for private companies, contains complex concepts which are inapplicable to SCHCs. Thus, CoCG's significance to the corporate governance needs of SCHCs is doubtful. Third, the requirements for accounts reporting (s 154) and audits (s 167) are mandatory for all companies irrespective of their size or type. These provisions are elaborate with prescribed formats. Subjecting SCHCs to the same regulatory requirements as the other companies is burdensome and contrary to best practice. Finally, the comparable jurisdictions of the UK and South Africa have codified aspects of common law by way of a restatement of the law in their respective companies' legislation. A restatement serves two purposes. First, it directly integrates common law into statute; and second, affords the courts the flexibility to fill gaps that may exist in statute. The study contends that this tool (also loosely referred to as 'codification') has not been well utilised in CA 2012 with respect to SCHCs.

The study concludes that CA 2012 does not provide an appropriate and effective legal framework for SCHCs. Consequently, in keeping with best practice on the regulation of SCHCs as can be seen in comparable jurisdictions of South Africa and the UK, the study proposes amendments to ss 2, 4, 5, 138, 154, and 167 of CA 2012 to provide for the special regulation of SCHCs either by creating a new type of company and rendering it subject to separate regulatory provisions or to a 'reduced' version of the regulatory provisions applicable to other companies; or by continuing to treat SCHCs as private companies and rendering them subject to a 'reduced' version of the regulatory provisions applicable to other companies.

To give effect to these proposals will require: (1) merging SMC with other smaller companies whose members do not exceed ten to create SCHCs founded on partnership principles; (2) inserting a chapter in CA 2012 with clear provisions which apply to SCHCs; (3) restricting membership of SCHCs to natural persons; and (4) inserting a general statement by way of a substantive provision in CA 2012 to the effect that in its interpretation the common law shall apply as a direct way of integrating the common law in CA 2012, as other jurisdictions have done. The study provides in *Appendix B* a *Schedule* of the proposed amendments and their justification to aid policy reforms and the review of CA 2012 with respect to SCHCs in Uganda.

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LIST OF ABBREVIATIONS

All ER	All England Law Reports
CA	Court of Appeal
CA 2012	Ugandan Companies Act 1 of 2012
CCA 84	Close Corporations Act 69 of 1984
CCs	close corporations
CH	Chancery Division
CIPC	Companies and Intellectual Property Commission
CJRP	Commercial Justice Reform Programme
CLPA	Committee on Legal and Parliamentary Affairs
CMA	Capital Markets Authority
CoCG	Code of Corporate Governance
ESV	enlightened shareholder value
EU	European Union
Exch D	Exchequer Division
FRSC	Financial and Reporting Standards Council
FSME	Federation of Small and Medium-sized Enterprises
GJCMP	Global Journal of Commerce and Management Perspective
HC	High Court
HCU	High Court of Uganda

HL	House of Lords
IJPAMR	International Journal of Public Administration and Management Research
IoDSA	Institute of Directors for Southern Africa
J	Judge
JA	Justice of Appeal
JCMIU	Journal for the Capital Markets Industry, Uganda
JSC	Justice of the Supreme Court
KB	King's Bench Division
LJ	Lord Justice
MFC	Market for Corporate Control
MISC APPL	Miscellaneous Application
MoI	Memorandum of Incorporation
MP	Member of Parliament
MR	Master of Roles
MSMEs	micro, small and medium-size enterprises
MTIC	Ministry of Trade, Industry and Cooperatives
SACA 2008	South African Companies Act 71 of 2008
SCHC	small and closely-held company
SEC	social and ethics committee
SMEs	small and medium-size enterprises

TRP	Takeover Regulation Panel
UBOS	Uganda Bureau of Statistics
ULRC	Uganda Law Reform Commission
URSB	Uganda Registration Services Bureau
WLR	Weekly Law Reports

CHAPTER ONE

INTRODUCTION AND BACKGROUND TO THE STUDY

1.1 Introduction

In 1996 the Government of Uganda ('GoU') set about a massive Commercial Justice Reform Programme ('CJRP') through the Ministry of Justice in liaison with Uganda Law Reform Commission ('ULRC'). A key objective of the CJRP was to carry out a comprehensive review of all commercial laws in Uganda – among which was the Companies Act Cap 110 ('the repealed Act') – to pave way for reforms and ultimately for the enactment of a new companies' legislation that facilitates business.

In so far as is relevant, the new companies' Act was *inter alia* to make corporate form cheap and easily available by putting in place an appropriate and effective legal framework which was simple, certain, modern, accessible, flexible and beneficial to the various business forms – among which were small and closely-held companies ('SCHCs') or 'closely-held firms.'[1] In the present context SCHCs are companies with a few members, usually from one to ten, who are usually also the managers.[2] After wide consultations and bench-marking of South Africa and the United Kingdom ('UK') as comparable jurisdictions, the Ugandan Parliament passed the Companies Act, 2012 ('CA 2012') on 22 March 2012.[3] The law came into effect on 1 July 2013.

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[1] The phrase 'small and closely-held companies' was used in *A Study Report on Company Law* ULRC Publication No 5 of 2004 ('ULRC Report') at 4, with no clear meaning or the context. ULRC is a public body established under art 248(1) of the Ugandan Constitution 1995 and the ULRC Act Cap 25. Its core mandate is to review laws and to advise government on law reforms. See ULRC Report paras 1.2, 1.2.10.

[2] See para 1.2.

[3] Act 1 of 2012, available at https://www.ebiz.go.ug/wp-content/uploads/2016/01/Companies-Act-2012.pdf accessed on 22 July 2022. The Companies Bill, 2009 ('the Bill') was introduced on the floor of the House on 18 August 2009, in the 8th Parliament, for the first reading, before being referred to the Committee on Legal and Parliamentary Affairs ('CLPA'). At the committee stage of the Bill the CLPA carried out wide consultations and bench-marking in South Africa and the UK. The Bill was reprinted and reintroduced into the House in the 9th Parliament on 23 February 2012, and passed into law on 22 March 2012, a gestation period of about two years and eight months. See Hansard, 22 March 2012, 3044, 3045, 3052, 3132; Hansard 21 May 2011, 13888–90.

This study set out to determine through doctrinal analysis whether CA 2012 provides an appropriate and effective legal framework for SCHCs in terms of the stated overall objective of the CJRP. The research focus follows from a recognition that in Uganda, as in various other jurisdictions,[4] SCHCs have distinct characteristics that require special legal recognition and treatment. I will return to these characteristics later in this chapter.

Suffice to say that during the drafting and enactment of CA 2012 it was recognised and highlighted that the companies' legislation in force in Uganda at the time did not adequately address the specific legal needs and requirements of SCHCs. It was noted that companies' legislation in Uganda makes little attempt to provide a simple law for easy operations of SCHCs.[5] Although this problem was highlighted during the CJRP, the inappropriateness of companies' legislation with respect to SCHCs in Uganda is much older and characterised the previous companies' legislation as well.[6]

To put this matter into perspective, the Companies Ordinance No 6 of 1923, the first colonial companies' statute in Uganda and the successive legislation – the Companies Ordinance Cap 33 of 1935, and the Companies Act Cap 1948 which became the Companies Act Cap 110 – have been described as complex in language, lengthy and based on foreign traditions.[7] These assertions are generally fair. The 1935 Ordinance, for example, had 354 sections with nine schedules, containing no specific legal framework for SCHCs. Given this background and the declared key objective of the CJRP, it was expected that that CA 2012 would address this gap. Whether this objective– of a simple, flexible, and accessible law for SCHCs –was achieved in CA 2012 is the central question that this study set out to answer.

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[4] J Armour, L Enriques et al *The Anatomy of Corporate Law: A Comparative Function Approach* 3 ed (2017) 15.
[5] ULRC Report 4.
[6] See JAS Musisi *Company Law in East Africa* (unpublished) 88–92 for a historical analysis of Uganda's company legislation; JW Katende & MR Chesterman *The Law of Business Organisations in East and Central Africa* (1976) 8–20; R McQueen *A Social History of Company Law: Great Britain and the Australian Colonies 1854–1920* (2009) ch 8.
[7] Musisi *Company Law* 88–92.

To be sure, what amounts to simple, flexible and accessible companies' legislation with respect to SCHCs is not obvious. Nevertheless, a look at the relevant legislation in comparable jurisdictions of South Africa and the UK suggests that SCHCs require special recognition and treatment in legislation in regards to audit; financial reporting; limitation of membership; restriction of membership to natural persons; or clear elective or optional provisions which apply to them. These parameters are the evaluative framework employed in this study for purposes of analysis of CA 2012.

An appropriate law for SCHCs can be achieved in two major ways. First, by either creating a new corporate form, separate and distinct from a company, in terms of a new statute, along the lines of South Africa's close corporations ('CCs')–'South Africa model', or, second, providing for special regulation within the existing Companies Act– in the present case CA 2012– by either: (i) creating a new type of company and rendering it subject to separate regulatory provisions or to a 'reduced' or 'flexible' version of the regulatory provisions applicable to other companies; or (ii) continuing to treat SCHCs as private companies and rendering them subject to a 'reduced' or 'flexible' version of the regulatory provisions applicable to other companies– 'single legislation.'

The two jurisdictions respectively have a 'small companies regime' under *Companies Act* No. 46 of 2006 'CA 2006' (ss 381-84) which deals with small companies, ('UK-model'); and *Close Corporations* Act, No. 69 of 1984 'CCA 84'– a distinct legislation for CCs.[8] CCA 84 is lauded for providing a simple and less expensive form for the unsophisticated businessman and has been benchmarked by other countries.[9] There are also changes which were brought about by South African *Companies Act* No. 71 of 2008 'SACA, 2008', worth consideration, notably, less stringent reporting or optional audit requirements for owner-managed private companies, which have been viewed as intended to achieve flexibility in the law to benefit small companies.[10]

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[8] This has since changed on account of s 13 of SACA 2008, see the full discussion in para 5.2.1.2.
[9] M Spisto & H Samujh 'Close corporations in South Africa: A viable option for New Zealand small business corporate law?' (2001) 9 *Waikato L Rev* 153–186 at 153.
[10] D Davis & W Geach (eds) *Companies and Other Business Structures in South Africa* 5 ed (2021) 21; FH Cassim et al *Contemporary Company Law* 3 ed (2021) 12–13.

Due to the prohibition by SACA, 2008, on registration of new CCs or conversion to one[11]–an indication of possible shift to a single consolidated companies' statute–this study contends that option 1 above of a distinct corporate form in terms of a distinct legislation is problematic. The study is inclined to option 2, in which I propose to merge SMC with other smaller companies whose members do not exceed 10 to create SCHC as a label within CA 2012. SCHC will be a private company subject of either (a) separate regulatory provisions or (b) to a 'reduced' version of the regulatory provisions applicable to other companies by way of a distinct Chapter *albeit* within CA 2012. The proposed chapter will contain clear 'opt-in' 'opt-out' provisions on legal and corporate governance aspects of SCHCs in account and reports, audit, meetings; and a revised and simplified Code of Corporate Governance 'CoCG') to make it user-friendly for SCHCs.

Since the two comparable jurisdictions were bench-marked during the enactment of CA 2012, one expected outcome was that the drafters of the Companies Bill, 2009 ('the Bill') and indeed, Parliament, would have drawn on their experiences on the regulation of SCHCs to enrich the Bill on that question.

Finally, the study explores the common law concept of 'quasi-partnership companies and its' potential for addressing the distinct regulatory needs of SCHCs.[12] I argue that first, although the concept does not address the same kind of regulatory requirements as are provided for in legislation,[13] it nevertheless serves as an acknowledgement by courts in common law jurisdictions that certain SCHCs do have certain features that require, and justify, distinctive treatment.[14] Second, courts have granted equitable remedies founded on personal relationships of members in SCHCs on

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[11] Section 13 of SACA 2008. See the discussion in para 5.2.1.2.
[12] D Milman 'Legal characterisation of commercial relationships in the UK: The quasi-partnership example' 3–4, available at https://eprints.lancs.ac.uk/id/eprint/134809/1/characterisation.pdf accessed on 29 August 2022 and in (2019) 40(10) *Company Lawyer* 312–319; D Milman 'Regulating close companies in corporate law-towards formal recognition' (2017), available at Close_companiesrevisitedsagepdf.pdf (lancs.ac.uk) (accessed 29 August 2022).
[13] S Mayson et al *Company Law* 23 ed (2007)68; E Ferran *Company Law and Corporate Finance* (1999) 5.
[14] *Ebrahimi v Westbourne Galleries Ltd and Others* (1972) 2 All ER 492; *Scottish Co-operative Wholesale Society Ltd v Meyer and Another* (1958) 3 WLR 404; *In re HR Harmer Ltd* (1958) 1 WLR 62; *In re American Pioneer Leather Company, Limited* (1918) I Ch 556; *In re Yenidje Tobacco Company, Limited* (1916) 2 Ch 426.

grounds of fairness, equity, and utmost good faith in cases of deadlock.[15] Third, quasi partnership company structure protects minority members from oppression.[16] In developing an appropriate and effective legal framework for SCHCs, I explore the possibility of incorporating aspects of quasi partnership companies in CA 2012.

In discharging this task, I examine the business forms and legal categories under CA 2012 (ss 2, 4, and 5), and the corporate governance framework (ss 14–with the Code of Corporate Governance or 'CoCG'–*Table F*), 138, 154, and 167. I then draw on South Africa's CCA 84, CA 2008, and UK's CA 2006 on the regulation of SCHCs.

The key arguments advanced in this study are that first, SCHCs require special regulatory recognition and treatment. Elfin has proposed that 'if the close corporation is to be treated differently from other corporations, a prerequisite for separate treatment is a clear definition.'[17] The discussion of business forms under CA 2012 reveals the absence of a clear legal characterisation of SCHCs; and broad classification along traditional line of private *vis-à-vis* public or unregistered *vis-à-vis* registered companies (ss 2, 4,5). The converse is that SCHCs are understood by controversial time-bound characteristics of small employee size, turnover and asset value.[18] These parameters are by no means founded in CA 2012.[19] Section 2 of CA 2012 defines a company as 'a company formed and registered under this Act or an existing company or a re-registered company under this Act.' The requirements for registration of a company under ss 4, 5,

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[15] Ibid.
[16] Ibid, particularly *Scottish Co-operative Wholesale Society Ltd v Meyer* 404.
[17] R Elfin 'A critique of the proposed statutory close corporation supplement to the model Business Corporation Act' (1983) 8(3) *J Corp L* 439–460 at 439.
[18] The Ministry of Trade, Industry and Cooperatives ('MTIC') Ministerial Policy Document, June 2015 ('MTIC 2015 Policy Document') at 2, 31, citing the Uganda Bureau of Statistics ('UBOS') 2010/11 Statistics, defines micro, small and medium enterprises ('MSMEs') to '[i]nclude all types of enterprises irrespective of their legal form (such as family enterprises, sole proprietorships or cooperatives) or whether they are formal or informal enterprises to ensure inclusiveness … in quantitative terms, micro enterprises are those businesses employing not more than 5 and have a total assets not exceeding UGX 10 million. On the other hand, small enterprises employ between 5 and 49 and have total assets between UGX 10 million but not exceeding 100 million. The medium enterprise therefore employs between 50 and 100 with total assets more than 100 million but not exceeding 360 million.' Available at REPUBLIC OF UGANDA (ugandainvest.go.ug) (accessed 28 March 2017).
[19] In terms of s 4(5) of the Income Tax Act, Cap 340 (as amended). However, presumptive tax is based on the turnover of a company whose income in the year of the tax is less than UGX 150 million. Presumptive tax is outside the scope of this study.

6 and 7 do not classify companies based on employee size, turnover or asset value or in any way, recognise the need for differential treatment of small firms in their operations.

Although CA 2012 does contain specific regulatory relief provisions relating to single member company ('SMC'), a new concept introduced into Ugandan companies' law which was presumably a legislative attempt to respond to the specific requirements of SCHCs, there are some weaknesses with SMC. First, the application of these provisions is restricted to companies having only a single member. This business form does not help a multitude of SCHCs with more than one member but nevertheless qualify as small companies. Second, corporate entities can be members in SMC. Regulation 3 of SMC Regulations[20] defines a 'single member company' to mean a company incorporated under the Act with one person; whether natural or corporate.

This study contends that personal relationships among members is a key consideration in formulating an appropriate regulation for SCHCs. This can be problematic to achieve where a juridical person is a member of a SCHC with other natural persons.[21] This is on the assumption that SCHC can have more than one member.[22] By opening membership in SMC to corporate entities, CA 2012 has departed from best practice and undesirably given big companies leeway to operate under a legal framework intended for small and unsophisticated businesspersons.[23]

Further, the classification of private companies of between 1 to 100 members is too broad. It lacks the requisite specificity on small companies thereby falling short on addressing the legal and corporate governance needs of SCHCs. This leaves public companies and unlimited companies as the other options–to which I contend are equally not suitable vehicles for SCHCs. By their nature, SCHCs are prohibited from making public offers. This puts public companies out of option for SCHCs. Unlimited company

[20] SI 72 of 2016 ('SMC Regulations, 2016').
[21] *Scottish Co-operative Wholesale Society Ltd v Meyer and Another* (1958) 3 WLR 404.
[22] Para 1.2.
[23] SJ Naude 'The South African close corporation' (1984) 9 *J Juridical Sci* 117–131 at 127, cited in JJ Henning 'Close corporation law reform in Southern Africa' (2001) *J Corporation Law* 918–950 at 931.

on the other hand has a significant limitation– the lack of corporate form–[24] which as noted above, was a key consideration under the CJRP.

In second place, special regulatory requirements for SCHCs relate primarily to optional audit requirements; less financial reporting; limitation of membership; restriction of members in SCHCs to natural persons; and clear optional provisions. This study demonstrates that CA 2012 subjects all private companies to the same accounts and reporting requirements (s 154); and requires all companies to appoint an auditor (s 167). This is burdensome and contrary to best practice on regulation of SCHCs.

Third, the corporate governance framework is not drafted with SCHCs' in mind. CA 2012 has enacted the CoCG (s 14: *Table F*) which although optional for private companies–the category where SCHCs fall, contains complex concepts which are inapplicable to SCHCs and thus of less significance to their corporate governance needs. To improve on its' efficacy, this study contends that the CoCG requires simplification in terms of the legal needs of SCHCs.

To realise the simplification, it is proposed to insert in the CoCG a *schedule* of simplified accounting principles for SCHCs drawn with support of professional bodies such as the Institute of Certified Public Accountants of Uganda ('ICPAU').[25] This intervention is consistent with a proposal in this study to insert a substantive chapter in CA 2012 which is specific and directly applicable to SCHCs. On this aspect, the study draws on the King Code in South Africa and UK experiences on corporate governance to suggest further interventions upon which to improve the content of CoCG.

In the fourth place, the common law plays an important role in filling gaps in companies' legislation in terms of flexible corporate governance structure, and equitable remedies outside of corporation law, as will be shown of quasi-partnership companies. I contend that its' (common law) application could be strengthened in CA 2012 by way of

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[24] LCB Gower *Gower's Principles of Modern Company Law* 10 ed (2016) 1, for arguments on the benefits of corporate form over other business forms.

[25] ICPAU is a public body established under the Accountants Act 19 of 2013, accessed electronically on 26 March 2023 at Accountants Act, 2013.pdf (icpau.co.ug) see discussion in para 6.5.3.

codification (re-statement of the law) in line similar interventions in comparable jurisdictions of South Africa and United Kingdom, to cater for the interests SCHCs. To that end the study proposes the insertion of a substantive provision to the effect that the common law shall apply when interpreting CA 2012. This intervention will allow for the application of common law principles, such as the concept of quasi-partnership companies, which potentially benefits SCHCs.

Fifth, CA 2012 lacks a clear optional or elective framework for SCHCs. Apart from company meetings (s 138), which are optional for private companies, the SCHC category remains subject to the same regulatory requirements as other companies. This study demonstrates that an 'opt out' or 'opt in' or 'reduced' version of regulatory provisions applicable to other companies with respect to SCHCs is a drafting style which has been applied in companies' legislation to achieve flexibility in the law to meet the legal needs of SCHCs. I contend that this tool has not been clearly utilised in CA 2012. This set of affairs, Naude has asserted, brings about sham compliance by SCHCs.[26]

Moreover, allowing all private companies to opt out of the company meeting is itself problematic. Company meeting is and remains an integral part of corporate governance. This is so where there is a distinct board from shareholders. The reason for excepting SCHCs from company meetings' is because in SCHCs, where members and directors are one and the same, it is inappropriate, and it would be a futile exercise to insist on company meetings when in fact none will be had at all.[27] To that end, it is proposed to amend s 138 with this underlying concept in mind so that only SCHCs can opt out or opt in of the formalities of company meetings. The other private companies with a separate board and members must comply as a matter of course.

Finally, I contend that quasi-partnership structure relieves SCHCs of the burden of strict application of corporation law on their internal operations in two ways. First, they benefit from '[l]egislation permitting private companies to opt out of certain

[26] Naude 'The South African close corporation' 117–118.
[27] Naude ibid 117–119; JJ Henning 'Close corporation law reform in South Africa' (2001) *J Corp L* 918–950 at 922–923.

administrative requirements.'[28] Second, under the doctrine of freedom of contract,[29] members are in position to establish 'a relationship of equality, mutuality, trust and confidence between them which constitutes the very essence of the company.'[30] Finally, courts are able to offer broader remedies beyond corporation law founded on equity.

The key findings of this study are that; (i) business forms under CA 2012 do not align with known legal definitions or characterisation of SCHCs; their classification is broad along traditional lines of private vis-à-vis public or unregistered vis-à-vis registered companies. SMC is exclusive to a single member. Further, in Uganda, SCHCs remain variously understood by time-bound characteristics of small employee size, turn over and asset value which parameters lack statutory basis in CA 2012. (ii) although optional for private companies, CoCG is not drafted with small companies in mind. It contains complex concepts which are inapplicable to SCHCs and thus of less significance to their legal and corporate governance needs. (iii) The accounts reporting (s 154); and audit function (s 167) are mandatory for all companies. These provisions are elaborate with prescribed format for their compliance. This study has determined that subjecting SCHCs to the same regulatory requirements as other companies is burdensome and contrary to best practice. Finally, common law gives companies' legislation the necessary flexibility and adaptability, which would otherwise, be curtailed if statute was to be applied strictly.

The study concludes that in its' current form CA 2012 does not provide an appropriate and effective legal framework for SCHCs as was contemplated of the CJRP to which I suggest some reforms. Notably, (1) to amend ss 2, 4, 5, 138, 154, and 167 of CA 2012 to provide for a clear legal framework for SCHCs in Uganda in keeping with best practice as follows: *(a)* To merge SMC with other smaller companies whose members do not exceed 10 to create SCHC as a corporate label with a corporate

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[28] Ferran *Company Law* 5; Gower 10 ed 691–693.
[29] Sir George Jessel (MR) in *Printing and Numerical Co v Sampson* (1875) LR 19 Eq 465.
[30] Gannon J in *Re Murph's Restaurant* (1979) ILRM 141 (HC), cited in Dunne D 'The Position of the 'Quasi-Partnership' Type Private Company in Irish Law (2004) 4(1) *J. Studies Inst. J*. 108 at 109-110 herein Dunne 'The position of the "quasi-partnership."

governance structure founded on principles of partnership; *(b)* To restrict membership of SCHC to natural persons; *(c)* To insert a Chapter in CA 2012 with clear provisions which apply to SCHCs for ease of reference. To that end, I provide in *Appendix B* a *schedule of draft amendments* to inform proposed reforms of CA 2012. Next, I briefly consider, for purposes of this study, the definition and legal characteristics of SCHCs.

1.2 Definition and legal characteristics of SCHCs

There is no legal definition or prescription of legal characteristics of SCHCs in CA 2012. The common classification used outside of the Act in government policy documents and commentaries is more economic in terms of employee size, turn-over and asset value, than is legal.[31] Moreover, there is no universally agreed definition of SCHC.[32] The terminology is applied variously as: 'small companies', 'small and closely-held companies',[33] 'closely-held firms', 'incorporated partnerships',[34] 'close corporations' or 'small and medium-size enterprises' ('SMEs').[35] The latter is a much broader classification and somewhat inaccurate for present purposes.[36] I will return to this subject later in this section. Nevertheless, there is agreement convergence that these companies comprise a few members who have a close relationship with each other.[37]

Henning contends that the term 'close corporation' is derived from the expression 'closely held corporation'[38] and 'refers inter alia to the limited number of members of the corporation and the closeness of their relationship'.[39] He asserts that the term has

31 MTIC 2015 Policy Document 2, 31. The economic importance of SCHCs is outside the scope of this study.
32 Elfin 'A critique' 439 n 2.
33 Ferran Company Law 640 n 8.
34 Elfin 'A critique' 440.
35 MTIC 2015 Policy Document 2, 31.
36 Ibid.
37 Spisto & Samujh 'Close corporations in South Africa' 154.
38 JJ Henning 'Closely held corporations: Perspectives on developments in four jurisdictions' (1995) 58 J Contem Roman-Dutch L 100, cited in Henning 'Close corporation law reform in southern Africa' 926 n 51.
39 Ibid.

been used by company lawyers at least as far back as the nineteenth century and 'internationally it is a widely accepted concept'.[40] This suggests that providing specifically for small companies is not new save for the difference in the name and approaches. Naude supports this claim.[41]

To return to SMEs a term which is also not found in CA 2012. Gibson and Vaart[42] argue that SMEs can 'more meaningfully be defined by their functional and behavioural attributes than by Procrustean quantifications of employees, assets, and turnover'.[43] Their characteristics include: (1) formal; (2) more often managed by their owners, more centralised in their management, with substantially weaker delegation and departmentalisation; (3) more focused on short-term needs and medium-term survival than on long-term profitability or market share; and (4) less able, and less inclined, to prepare and follow business plans.[44]

Generally, functional and behavioural attributes of a firm entail looking at its legal characteristics and function.[45] This does not mean that economic parameters are completely ignored in the small company paradigm. Gower suggests that the classification of companies based on economic size is a useful indicator for the purposes of reduced accounts and reporting requirements.[46] Unlike a definition, for the internal operations of small companies (and where it is not desirable to create many distinct company labels within the same legislation), the 'quantitative indicators of the economic size of the company'[47] of employee numbers, asset value and turnover offer an alternative tool in achieving flexibility in certain aspects of corporate governance in

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[40] Ibid.
[41] Naude 'The South African close corporation' 119–124; J Armour, L Enriques et al *Anatomy of Corporate Law* 3 ed (2017) 15.
[42] T Gibson & HJ van de Vaart 'Defining SMEs: A less imperfect way of defining small and medium enterprises in development countries' Brookings Global Economy and Development (2008) 1–29 at 10, available at https://www.parliament.go.ug/cmis/browser?id=ab1f51b4-118a-4d2b-9113-465484ac49d7%3B1.0 (accessed 25 July 2022).
[43] Ibid.
[44] Ferran *Company Law* 4.
[45] Armour et al *The Anatomy of Corporate Law* 1–14.
[46] Gower 10 ed 689–694.
[47] Ibid 691.

SCHCs. Gower opines that '[o]ver the years, what is required of large companies by way of accounts and reports has expanded. By contrast, the recent tendency has been to reduce the reporting requirements of small companies.'[48]

While the 'UK model' may have some shortcomings in terms of the legal definition of a small company,[49] it provides economic perspectives upon which their differential treatment in accounts and reporting obligations can be achieved, with the result that small companies should not be subjected to the same reporting requirements as large companies.[50] In terms of s 381 of CA 2006, a company qualifies as small if *(a)* its turnover is not more than £5.6 million; *(b)* the balance sheet total is not more than £2.8 million; and *(c)* the number of employees is not more than 50.[51] The trouble with this model is the difficulty in consistently keeping within the threshold.[52]

Given the various viewpoints about the nature of SCHCs, this study adopts the approach of O'Neal and Thompson[53] as its working definition of SCHCs:

> An entirely different set of assumptions and practical realities applies to the closely held corporation. Shareholders in closely held corporations often expect to participate in the corporation's management, and closely held corporations usually distribute the bulk of their profits in the form of salaries rather than dividends. Indeed, shareholders may invest well in a closely held corporation for the purpose of providing themselves with jobs and salaries.[54]

Drawing on the above passage, it is asserted that SCHC has the following key legal characteristics: (1) fewer members; (2) members are also the persons in management; and (3) the members earn salaries as opposed to dividends. Commentators agree on these attributes.

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[48] Ibid 690.
[49] Gibson & Van de Vaart 'Defining SMEs' 11–14; Gower 10 ed 17.
[50] Section 381 of CA 2006; Gower 10 ed 690; s 30(2)*(b)* of SACA 2008.
[51] MTIC 2015 Policy Document 2, 31; see para 5.3.1.
[52] Gower 10 ed 692; s 30(2A) of SACA 2008.
[53] HF O'Neal & RB Thompson *O'Neal's Close Corporation* (1988) 2, cited in RA Ragazzo 'Toward a Delaware common law of closely held corporations' (1999) 77 *Wash UCQ* 1099–1151 at 1102.
[54] Ragazzo ibid 1103; Elfin 'A critique' 440.

According to Elfin, '[t]he transfer of shares in a close corporation to outsiders is generally restricted. Furthermore, no established market exists for the sale of shares.'[55] In addition, '[a]nother characterisation of the close corporation is to refer to it as an incorporated partnership—*a business that would have used the partnership vehicle except for a desire to have certain tax and limited liability advantages*.'[56] Under this corporate form, the fusion of management and ownership is a distinct feature and therefore it is impractical to separate ownership from management.[57]

Henning's proposition on closely-held entities supports this claim. He opines thus:

> [a] closely held entity in which all or most members are usually actively involved. In principle there is no separation between ownership and control. No board of directors nor general meeting is required; every member is entitled to participate in the management of the business and to act as agent for the corporation, every member owes a fiduciary and a duty of care to the corporation; the consent of all the members is required for the admission of a new member.[58]

Although it is widely held that SCHCs have few members, the exact number varies from one jurisdiction to another. In South Africa, for example, the membership of a close corporation – a legal form with similar characteristics as SCHCs – is capped at ten.[59] This position has since been altered by s 13 of SACA 2008, which came into force on 1 May 2011.[60] In terms of this provision, one or more persons may incorporate a for-profit company. Besides prohibiting the registration of close corporations or conversion into one after the effective date, s 13 has in effect lifted the ten-member ceiling for companies that incorporate under SACA 2008. This however does not apply to close corporations existing prior to SACA 2008.[61]

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[55] Elfin ibid.
[56] Ibid (emphasis added).
[57] Armour et al *Anatomy of Corporate Law* para 1.3.1; Ferran *Company Law* 5.
[58] JJ Henning et al 'Close corporations' (1996) 4(3) *The Law of South Africa* 497–500, cited in Henning 'Close corporation law reform in South Africa' 920.
[59] Section 18 of CCA 84 (as amended).
[60] Geach *Guide to the Close Corporations Act and Regulations* 2.
[61] Ibid; Third Schedule to CA 2008. See also para 5.2.1.2.

Companies have also been classified by variables other than member limitation to accord them regulatory flexibility. The UK has enacted, in its CA 2006, 'qualifying conditions' based on a company's turnover, balance sheet total, and number of employees, so that small companies can benefit from the 'small companies regime'.[62] This position is replicated in SACA 2008. In terms of s 30(2A), a company's compliance for purposes of corporate reporting and audits is determined by its turnover, the size of its workforce, and the nature and extent of its activities.[63] This is a departure from the position in CCA 84, which applied the one-to-ten members rule for purposes of CCs. While these parameters have some weaknesses, notably the regulator having to deal with fluctuations in asset value, turnover or even employee attrition,[64] it nevertheless shows another perspective to easing the compliance burden for small companies.[65]

A further legal characteristic of this type of company is that '[i]n principle, *membership is limited to natural persons*. It may have a single member, as is presently the case with approximately seventy five percent of all close corporations.'[66] Section 29(1) of CCA 84 provides that subject to sub-s (1A) or (2)*(b)* and *(c)*, only natural persons may be members of a corporation and no juristic person or trustee of a trust *inter vivos* in that capacity shall directly or indirectly (whether through the instrumentality of a nominee or otherwise) hold a member's interest in a corporation.

Membership in close corporations is restricted to natural persons because it is generally agreed that the Act (CCA 84) is designed along the lines of partnership law.[67] Under partnership law, juristic persons are generally excluded from being partners.[68] If a juristic person was allowed to be a member of a close corporation, two challenges

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[62] Sections 381, 382 and 383 of CA 2006. See the full discussion in para 5.3.1.1.
[63] Section 30(2)*(b)(i)* and (7) and reg 28 of the Companies Regulations, 2011.
[64] Gibson & Van de Vaart 'Defining SMEs' 11–14.
[65] Para 5.3.1.
[66] Henning et al 'Close corporations' 497 (emphasis added), cited in Henning 'Close corporation law reform in South Africa' 920.
[67] Naude 'The South African close corporation' 117, 119, cited in Henning 'Close corporation law reform in South Africa' 918; Elfin 'A critique' 440.
[68] Section 2(3)*(a)* and *(b)* of the Uganda Partnership Act 2 of 2010.

would arise. First, the principle of 'equality, mutuality, trust and confidence'[69] – which is the very essence of close corporations or quasi-partnership companies[70] – would be eroded. The natural member would have to deal with a representative of the juristic member, with whom they have no direct contractual relationship. The second issue is the agency problem.[71] Here, the actions of the representative of the juristic member (the agent) are expected to align with those of the juristic member of the close corporation (principal) as a matter of course and less with those of the other natural members – therefore generating consensus in decision-making would be problematic.[72]

The legislative provisions for SCHCs must therefore moderate the well-known principles of corporate law and corporate governance which are considered burdensome,[73] to achieve less bureaucratic procedures and ensure low costs for company operations,[74] and to avoid sham compliance.[75] In this study, therefore, SCHCs are those companies with a small number of members, usually between one and ten; their members are in management; the transfer of shares to the public is restricted; membership is limited to natural persons; and corporate governance is designed along partnership lines, espousing personal relationships between members, and the principle of mutual trust and utmost good faith. These characteristics also define quasi-partnership companies[76]—a subject I will return to later in this study. It is on this account that the study draws on the concept of quasi-partnership companies.'

Next, I briefly state the objectives of the CJRP.

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[69] *In Re Murph's Restaurant* at 141; Mayson et al *Company Law* 68.
[70] Ibid.
[71] For an exposition on the agency problem, see Armour et al *The Anatomy of Corporate Law* 29–30; M Jensen & W Meckling 'Theory of the firm: Managerial behaviour, agency costs, and ownership structure' (1976) 3 *J Fin Econ* 305–60, cited in HD Robison & R Santore 'Managerial incentives, fraud, and monitoring' (2011) 46 *Financial Review* 281–311 at 282; *Scottish Co-operative Wholesale Society Ltd v Meyer and Another* (1958) 3 WLR 404.
[72] Elfin 'A critique' 440.
[73] Gower 10 ed 5–6; Naude 'The South African close corporation' 117–118.
[74] H de Soto *The Other Path: The Invisible Revolution in the Third World* (1989) 132–151, cited in W Kiryabwire *The Design of Micro Credit Contracts and Micro Enterprise Finance in Uganda* (2010) 94.
[75] Naude 'The South African close corporation' 118.
[76] WS Hochstetler & MD Svejda 'Statutory needs of close corporations – An empirical study: Special close corporation legislation for flexible general corporation law?' (1985) *J Corp Law* 849–1049.

1.3 Objectives of company law reform

In broad outline, the stated objectives of the CJRP were to reform the existing Ugandan company law to rid it of outdated policies and to bring the law into line with present day policies, international obligations, globalisation and technological developments; to achieve compatibility with the modern rules of business; to support private sector development and encourage private investment; and to enact a law which would match modern times and provide investor and stakeholder protection.[77]

The launch of the CJRP was followed by two consultancy studies commissioned by the government, which were undertaken initially by Reid and Priest and later by Clare Manuel. These studies culminated in the Reid and Priest Report (1998) and the Clare Manuel Report (1999), which were later revised by the ULRC, leading to the ULRC Report (2004).[78] These reports culminated in the Companies Bill, 2009 ('the Bill'). Importantly, these reports highlighted the inadequacies of Ugandan company legislation in addressing the legal and corporate governance needs of SCHCs and, in many ways, provided the foundation upon which CA 2012 was enacted. An examination of CA 2012 would therefore be incomplete without a brief mention of the highlights of the CJRP Reports on the inadequacies of the repealed Act.

Five major areas were identified for reform. First, given SCHCs' critical role of job and wealth creation in Uganda,[79] they needed to be provided with simple, flexible and accessible company legislation to ease their operations and improve their access to the law.[80] However, it was by no means clear upon which parameters a simple, flexible and accessible company law would be assessed. Second, private companies needed to be relieved of many of their burdensome obligations with respect to corporate governance

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[77] Hansard, 21 March 2012, 3044–5; Hansard, 21 May 2011, 13888–90; Kiryabwire *Company Law* 8–16.
[78] These reports are, together with the ULRC Report, referred to as the 'CJRP Reports'. Where necessary, each report is referred to separately as 'the Clare Manuel Report', 'the ULRC Report', and 'the Reid & Priest Report' ('Uganda Institutional Capacity Building Project Legal Sector Component CR-2736-UG Consultancy for Reform of Commercial and Related Laws that Affect Private Sector Economic Development: Special Business Forms Legislation Final Reports, the Reform of Company Law in Uganda, Lot 1' (1998)) (hard copy available on file).
[79] The potential of SCHCs to create wealth and jobs is beyond the scope of this study.
[80] ULRC Report 4.

and reporting.[81] Third, the type and number of persons who could be members of private companies had to be restricted.[82] Fourth, private and public companies had to be differentiated so that the former category did not have to comply with the same requirements as public companies.[83] In the private and public companies divide this study contends that a further classification of private companies was necessary. SCHCs also needed to be clearly defined so that they could be accorded separate treatment from other corporations.[84]

Finally, the CJRP espoused a corporate law which was stakeholder-orientated and where the pursuit of wealth and social welfare was maximised. This was a rather dramatic departure from the predominantly shareholder value approach in the repealed Act. The stakeholder concept is a broad subject and is explored in this study only in so far as it is relevant to the alternative enforcement of the CoCG outside of CA 2012.

From the above it is clear that CA 2012 was intended to be an overhaul of the existing company legislation. The main task of this study is to determine whether CA 2012 achieves its stated objective with respect to SCHCs – a simple and flexible legal framework. In the next section I briefly describe the SCHC industry in Uganda.

[81] Reid & Priest 3.
[82] Ibid.
[83] Ibid 7.
[84] Elfin 'A critique' 439.

1.4 SCHCs in Uganda

Earlier surveys estimate that there are 1.5 million SCHCs in Uganda.[85] Some accounts assert that 'Ugandan SMEs constitute up to 90% of the private sector, employing more than 2.5 million people and contributing over 70% to the total Gross Domestic Product (GDP).'[86] Uganda's GDP in 2021/2022 was estimated to be USD 45.6 billion.[87] This empirical data suggests that SCHCs constitute a multimillion-dollar industry in Uganda. In the ULRC Report the subject of SCHCs is broadly stated thus:

> Small and closely held companies play a major role in Uganda's economy. Evidence suggests that small firms are the main job creators and not only are they crucial to Uganda's competitiveness but they also lie at the heart of Uganda's economic strategy. Company law however makes little attempt to respond to the peculiar needs of small firms either in accessibility and simplicity of operation or in substantive provision. The start-up and development of such business is a particularly important process for which the law should provide an optimal climate.[88]

Much earlier, similar claims about the economic importance of small companies were made with some differences in context. In 1976, Katende and Chesterman observed:

> In developing countries, several governments have in their statements of objectives, policies and programmes, given additional weight to the importance of small enterprises …. There is a desire to give a new and broader significance to the conception of Africanisation. In this broader sense, Africanisation is viewed as the building up of new indigenous undertakings in major economic activities which so far have been dominated by foreign or expatriate interests. No self-respecting government would leave such racial imbalances as are observable in the fields of

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[85] Turyahahikayo 'Challenges faced by small and medium enterprises' 22.
[86] G Kidimu 'UIA giving a lifeline to SMEs' (2013), cited in C Okuonzi 'Follower voice behaviour and influence over leadership competencies of SME owner-managers in Uganda: A preliminary analysis' (2016) 5(1) *Global J Comm & Management Perspective* 35–46 at 35.
[87] Uganda Bureau of Statistics 'Statistical Abstract, 2021/22' available at https://www.ubos.org/wp-content/uploads/statistics/AGDP_Publication_Publication_Tables_October_2022.xls (accessed 9 May 2023).
[88] ULRC Report 4.

> industry, trade and commerce in many parts of Africa go uncorrected. For mere political freedom (in the sense of an indigenous government in place of an alien one) without economic advancement of all sections of the population would be untenable.[89]

One could, of course, argue that Katende and Chesterman's proposition above was aligned to the circumstances at the time. In 1976, and immediately afterwards, African countries were undergoing or emerging from liberation struggles for self-determination. Indisputably, independence sloganeering of all forms, political, economic or otherwise, was attractive to indigenous people. Yet, 45 years later, Katende and Chesterman's view is still true of SCHCs and is replicated in policy documents.

To put this matter into perspective, the MTIC 2015 Policy Document employs the terminology of 'micro, small and medium-size enterprises' ('MSMEs') and describes them as 'the engine of growth for the economic development of Uganda and indeed the world at large'.[90] MSMEs are classified as firms with five to 50 employees, and with capital investment of 10 million to 100 million Ugandan shillings.[91]

In the quote from the ULRC report above, the definition of SCHCs or the context in which the term is used is not clear. Similarly, the so-called 'peculiar' needs of small companies are also not set out – and nor are the parameters upon which the law will be assessed for simplicity or accessibility for SCHCs. While it is publicly acknowledged that SCHCs play a strategic role in job creation in Uganda, they are not defined in the law, and neither do they have a legal status. They are variously called 'small and closely-held companies', MSMEs or SMEs only in policy statements outside of CA 2012. The classification of SCHCs based on employee numbers or capital investment is not founded in the law.[92] As noted earlier, a clear statutory definition or prescribed legal

[89] Katende & Chesterman *Business Organisations* 33.
[90] MTIC 2015 Policy Document 1.
[91] Ibid 31.
[92] Ibid 1, 31.

characteristics of SCHCs in CA 2012[93] is critical in remedying the inadequacies in the law on SCHCs.

Next, I briefly look at the history of company law in Uganda.

1.5 History of company law in Uganda

Company law in Uganda is a legacy of British colonial rule, which started in 1894. By virtue of the 1902 Order-in-Council ('O-I-C') Uganda was placed under His Majesty the King's government.[94] In terms of s 12 of the O-I-C (the reception clause) '[a]n Ordinance may apply to Uganda any Act or law of the United Kingdom, or of any legislature in India, or of any colony, subject to any exceptions and modifications.'[95] In terms of s 13, the enactments described in the First Schedule to the Foreign Jurisdiction Act, 1890, applied to Uganda as if it were a British colony or possession, but subject to the provisions of the O-I-C, and to the exceptions, adaptations and modifications following.[96] Indeed, by virtue of the reception clause, the first company legislation in Uganda (as applicable law) was the Indian Companies Act 6 of 1882.[97]

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[93] Elfin 'A critique' 439.

[94] See s 1 for the territories comprising Uganda; GW Kanyeihamba *Constitutional and Political History of Uganda from 1894 to the Present* (2002) 10–12. Section 13 of the O-I-C provided that '[t]he enactments described in the First Schedule to the Foreign Jurisdiction Act, 1890, shall apply to Uganda as if it were a British Colony or Possession, but subject to the provisions of this Order, and the exceptions, adaptations, and modifications following.'

[95] Kanyeihamba *Constitutional and Political History* 10–12; JO Onyango 'An overview of the legal system in Uganda' (2015) Presentation at the China-Africa Legal Forum, 25 November 2015 (unpublished, hard copy on file). For an exposition on the 'reception clause' and the 'reception date' for Uganda (11 August 1902) see Katende & Chesterman *Business Organisations* 8–9; WB Harvey *An Introduction to the Legal System in East Africa* (2004) 540–541.

[96] The listed exceptions in the text are not relevant for present purposes and are omitted.

[97] Section 2 of the Companies Ordinance No 12 of 1935 ('Cap 33') provided that 'Articles' means 'the articles of association of a company, as originally framed or as altered by special resolution, including, so far as they apply to the company, the regulations contained in Table A in the First Schedule annexed to the Indian Companies Act, 1882, as applied to the Protectorate, or in the First Schedule annexed to the Companies Ordinance, or in Table A in the First Schedule to this Ordinance.' It went on to provide that 'existing company' means 'a company formed and registered under the Indian Companies Act, 1882, as applied in the Protectorate, or under the Companies Ordinance'. See Musisi *Company Law* 84.

The Indian Companies Act '[w]as itself a replica of the English Companies Consolidation Act of 1908. It remained in operation for about 40 years.'[98] It was replaced by the Companies Ordinance No 6 of 1923, which was the first colonial local legislation.[99] The Companies Ordinance, 1923, was repealed on 31 December 1935 by the Companies Ordinance No 12 of 1935.[100] This was amended in 1946 and it became the Companies Act, Cap 85 in 1960.[101] In 2000, under the Laws (Revised Edition) Act, 1994, the ULRC revised the laws and issued revised editions of the laws of Uganda. As a result, the Companies Act Cap 85 became the Companies Act, Cap 110 (the repealed Act)[102] which was 'a re-enactment of the British Companies Act of 1948'.[103]

A review of these legislation suggests that the law was complex in language and of great length (it still is), based on English traditions and arguably not tailored to suit local circumstances.[104] The account by Katende and Chesterman[105] of the '[d]escriptions of commercial groupings–the intended consumers of these laws–under customary law and practice in various tribes in Uganda'[106] reveals that businesses were informal. They opine that '[i]n the pre-colonial economy, every man had worked on his own account, for himself and his family. Regular employment was unknown … joint ownership was equally rare.'[107]

The informal business practices in Uganda later manifested in *Kayanja v Mawogola Farmers & Growers Ltd*[108] which showed that the law was not aligned with the traditional ways of indigenous business groups. Moreover, the problem of the

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[98] Musisi *Company Law* 84. The Companies (Consolidation) Act 1908 Cap 69 was a consolidation and an amendment of the Companies Act, 1862. The amendment took effect on 21 December 1908. See the long title to the Companies (Consolidation) Act, 1908. Therefore, logically, the Indian Companies Act of 1882 could only have been a replica of the English Companies Act, 1862 and not the English Companies (Consolidation) Act 1908 – which came after the Indian Companies Act, 1882.
[99] Ibid.
[100] Section 353.
[101] ULRC Report 7.
[102] Reid & Priest 1.
[103] ULRC Report 7.
[104] Kiryabwire *Company Law* 13–15; Gower 7 ed 53.
[105] Katende & Chesterman *Business Organisations* 2–8.
[106] Ibid.
[107] Ibid 7.
[108] HCCS No 257 of 1969 (unreported), cited in Musisi *Company Law* 70.

complexity of company legislation for small business forms is not unique to Uganda. It has been acknowledged of the current company legislation in the UK and South Africa. The complexity of the law was a major consideration in the proposals for a different legal framework for small companies in the two jurisdictions.[109]

Commenting on early company legislation in Uganda, Musisi argues that '[w]ith the incredible level of illiteracy there has been a problem of understanding the statutes themselves which are bulky and are in the English language.'[110] Spry also '[a]dvocated for a simplified legislation however imperfect it may be because it is better to have an imperfect statute that is understood and observed than a theoritically [sic] better statute which is largely ignored.'[111]

Spry also pointed out that 'it is unrealistic to expect an ordinary businessman to read and understand such legislation since it is only large corporations which can afford to employ professional staff.'[112] To illustrate this point further, the Companies Ordinance No 12 of 1935, for example, had 353 sections, several of which had an average of four to six subsections and paragraphs.[113] The repealed Act is very similar: it had 407 sections with up to ten schedules.

As noted above, the issue of company legislation being abstract and bulky for the unsophisticated Ugandan businessman featured in *Kayanja v Mawogola Farmers & Growers Ltd*.[114] The appellant company was incorporated with a capital of 500 shares of shs. 20/– each. Before its incorporation, the promoters held meetings and collected money from some of the respondents for shares. The other respondents paid for their shares after incorporation. However, no shares were allotted to any of the respondents.

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[109] Naude 'The South African close corporation' 119; Gower 10 ed 12–14; Mayson et al *Company Law* 17-1.
[110] Musisi *Company Law* 89.
[111] JF Spry 'Company legislation' in PA Thomas (ed) *Private Enterprise and the East African Company* (1969), cited by Musisi *Company Law* 88 n 22. (The error is in the original text.)
[112] Musisi *Company Law* 89, 90.
[113] See s 79 with eight sub-sections; s 95 with five sub-sections; s 104 with seven sub-sections; and long schedules.
[114] HCCS No 257 of 1969 (unreported), cited in Musisi *Company Law* 70. See also discussion in para 4.3.

After incorporation the company purported to hold meetings and to file returns with the Registrar, showing that its shares had been consolidated, its capital increased, and all its shares allotted to other persons. The respondents brought a suit in the High Court praying for orders that their shares be allotted to them and that the company's register of members be rectified. The trial judge found that the purported meetings and allotments were invalid and that there was a contract between the company and the respondents; the judge found for the respondents. On appeal by the company, it was held that (1) there was sufficient evidence of a contract; (2) the shares should be allotted to the respondents; and (3) the purported allotments to other persons were void. The company's register of members was not conclusive evidence of the company's shareholding.

This case is significant because of the way in which the court dealt with the question of non-compliance with statutory formalities, which were pointed out at the trial. It was established that the company had no share register; had never issued any shares; had no share certificates; had no minutes of meetings; had not issued a prospectus or statement in lieu; and had not convened a statutory meeting. Goudie J remarked that 'the affairs of the company were in a chaotic state', observing further that:

> I do not propose to review in detail the somewhat fantastic manner in which the affairs of the company have been conducted. Suffice it to say that to describe the proceedings as irregular in the extreme is a vast understatement and the meetings were held without notices to shareholders, directors were supposed to have been discharged and replaced in an entirely unauthorised manner, and that nobody seems to have taken the elementary precautions to ensure that a quorum was present or to keep proper minutes of attendances of members or decisions purported to have been taken or even notify members of the date, time and place of meetings.[115]

On appeal[116] Mustafa JA (Sir Duffus P and Lutta JA concurring) observed that:

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[115] Ibid.
[116] *Mawogola Farmers & Growers Ltd v Kayanja* (1971) EA 272.

> I am not persuaded that this view of the law, if it is a correct statement, is appropriate to Uganda or East Africa, *taking into consideration the conditions obtaining here. It is well known that very many local companies in East Africa carry on their affairs without strict compliance with all the requirements of the Companies Act and such a strict view may cause injustice.* If a person has paid for his shares and has been issued with a share certificate but his name is not in the register, such a person should be allowed to prove he is a member despite the absence of his name in the register, or the absence of a register. I much prefer the proposition set out in BUCKLEY ON COMPANIES ACT, 12th edn, where dealing with the same section it is stated on pp. 56 and 57: 'The register is most important but not conclusive …'.[117]

Drawing on the above case, this study asserts that, historically, company legislation has not been an appropriate and effective legal framework for the ordinary businessman in Uganda. The complexity of company legislation for local companies in Uganda is an established problem and judicial notice has been taken of the issue. In both decisions cited above, the courts chose a flexible interpretation which would uphold substance, as opposed to technical rules of procedure, because they were aware of the local conditions obtaining in East Africa and, by extension, Uganda, at the time.[118]

The above decision was recently cited and applied in *Mathew Rukikaire v Incafex Limited*[119] where the Supreme Court of Uganda upheld the principle that the presence of an individual's name on the register is not the only way in which shareholding can be proved. This finding accords with the Constitution. Article 126(2)*(e)* of the Constitution of Uganda, 1995, enjoins the courts in Uganda in adjudicating cases of both a civil and criminal nature to administer substantive justice without undue regard to technicalities.

Further, the recommendation by Clare Manuel for a 'core company approach' of 'adopting a Companies Act that addresses only core aspects of company law devoid of other extraneous matters such as secured transactions, insolvency, public securities and

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[117] Ibid 275 (emphasis added).
[118] Ibid. See chapter 4 on the principles of statutory interpretation.
[119] SCCA No 03 of 2015 (unreported) (Tibatemwa-Ekirikubinza JSC, lead judgment).

prospectuses'[120] has not helped to realise simplicity in the law. While insolvency was not included in the Act,[121] Chapter 3 seeks to demonstrate that the so-called 'core company approach' has not mitigated the problem of complexity of the law for SCHCs. CA 2012 has 298 sections and lengthy schedules, and three statutory instruments: the Companies Regulations, 2023;[122] the Companies (Powers of the Registrar) Regulations, 2016;[123] and the Companies (Single Member) Regulations, 2016.[124] Undoubtedly the application of these regulations requires some basic knowledge of corporation law.

To be sure, while the registration process for companies has been simplified,[125] this study demonstrates in Chapter 3 that CA 2012 remains a complex legislation for SCHCs in many respects. Moreover, an empirical survey on the causes of small business failure in Uganda in the towns of Bushenyi and Mbarara revealed that SMEs – which in the definition adopted in this study are SCHCs – face many leadership problems which contribute to their early demise before they have operated for a year.[126] Therefore, it is doubtful if SCHCs with leadership deficiencies will find CA 2012 in its current form useful to their operations. However, the *Mawogola*[127] and *Rukikaire*[128] cases suggest that, in the absence of specific legal framework under CA 2012 for SCHCs, the courts in Uganda are willing to adopt a liberal interpretation which upholds substantive law as opposed to procedural technicalities.[129]

This study argues that company legislation in Uganda has historically been characterised by bulky and complex statutes influenced by developments in company legislation in the UK, which are hardly aligned to local conditions.[130] It is unsurprising

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[120] ULRC Report 9.
[121] The Insolvency Act 14 of 2011 came into force on 1 July 2013.
[122] Act 74 of 2023 repealed the Companies (General) Regulations SI No 7 of 2016.
[123] 71 of 2016.
[124] 72 of 2016.
[125] Kiryabwire *Company Law* 12.
[126] CT Kazooba 'Causes of small business failure in Uganda: A case study from Bushenyi and Mbarara Towns' (2006) 8(4) *African Studies Quarterly*, cited by Okuonzi 'Follower voice behaviour' 35.
[127] (1971) EA 272.
[128] SCCA No 03 of 2015.
[129] Article 126(2)*(e)* of the Constitution, 1995.
[130] Katende & Chesterman *Business Organisations* 2.

that most, if not all, considerations for the reform and eventual repeal of Cap 110 – the Repealed Act – were driven by external factors and less by domestic forces, particularly the reviews of the UK's Companies Act, 1948.[131]

To put it into perspective, art 2 of the memorandum to the Bill provides: 'As is well known, the current law on companies in Uganda is based on the United Kingdom Companies Act of 1948, which has been revised several times in the United Kingdom since its passage.' Article 3 provides: 'The Companies Act of Uganda has, however, not been revised in a comprehensive manner since its enactment except for a few isolated amendments. In 1996 the Capital Market's Authority Act revised only the registration and regulation of public companies. As currently written, the Companies Act, Cap 110, while it will not obstruct private investment, nevertheless reflects an older jurisprudence and needs an overhaul to make it compatible with modern rules of business.' Article 4 states: 'Due to the passage of time, some aspects of the law have become outdated, especially in the light of the present-day policies, international obligations, globalisation and technological developments.'[132]

Drawing on the memorandum to the Bill, it is contended that the legal challenges faced by SCHCs in Uganda were not given due consideration at a critical stage of the law reform process. One cannot find a declared objective or statement of policy in the Bill or in the CLPA Report to the House[133] that speaks directly to the problem of bulky and complex companies' statutes for SCHCs. This is surprising, given that by the time of the Bill and the CLPA Report, the inadequacy of companies ' legislation for the legal and corporate governance needs of SCHCs had been noted and documented during the CJRP's consultation process, as evidenced in the ULRC Report.[134]

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[131] Hansard, 21 March 2022, 3045.
[132] Article 2 above is replicated in the CLPA Report to the House, in Hansard, 22 March 2011, 3045.
[133] The CLPA Report is captured in Hansard, 22 March 2011, 3045.
[134] But see paras 1.5 and 1.8.

By contrast, in South Africa and the UK, SADTI Report[135] and Company Law Review Steering Group ('CLRSG')[136] respectively provided clear plans of action for small companies. Although not all the recommendations were adopted,[137] one is left in no doubt about the policies that were mooted for small companies in light of the inadequacies of the existing legal framework. The SADTI Report stated that:

> while a close corporation offers a viable alternative for smaller businesses, which have no need for more onerous reporting, the Close Corporations Act is still highly formalistic in nature, making it difficult for unsophisticated entrepreneurs to commence business and ensure its effective management.[138]

The CLRSG, on the other hand, under the mantra of 'think small first',[139] proposed 'simplifying and modernising the law for small companies.' [140] Ferran's view is that the latter phrase was 'intended to mean that the companies' legislation should be drawn up with the small company in mind as the basic entity with additional requirements being added on, with discrete layers, for larger, more sophisticated or exceptional entities.'[141]

Chapter 5 shows specific interventions that were introduced in the company legislation of the two jurisdictions which are attributable to the above policy statements. In the next section I summarise the legal needs of SCHCs in Uganda.

1.6 Legal needs of SCHCs in Uganda

The established legal and corporate governance needs of SCHCs – which for the present purposes should also be construed as their problems – as set out in the CJRP Reports can

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[135] 'South African Company Law for the 21st Century: Guidelines for Corporate Law Reform Report' (2004) at 12 herein 'SADTI Report.'
[136] DTI 'Modern company law for a competitive economy' March 1998, also cited in C Ajibo 'A critique of enlightened shareholder value: Revisiting the shareholder primacy theory' (2014) 2 *Birkbeck L Rev* 37–58 at 38, 43, 44.
[137] Gower 10 ed 17.
[138] SADTI Report 15–16.
[139] Ibid.
[140] Ibid.
[141] DTI 'Modern company law' para 2.25, cited in Ferran *Company Law* 640.

be summarised into five major areas: (1) a reduced or lesser compliance burden;[142] (2) low-cost registration and operations; (3) quick and easy decision-making procedures; (4) simple and flexible legislation; and (5) certainty of the law.

The discussion of South African and UK experiences later in this thesis points to similar considerations as the motivation for the differential treatment of SCHCs already alluded to in the two jurisdictions: the lack of an appropriate legal framework; the promotion of small businesses; a simpler and less expensive legal form; minority protection from majority oppression; and less burdensome legislation.[143] This speaks to the relevance of this study from a policy and legal perspective and is the context in which the examination of CA 2012 with respect to SCHCs is undertaken in this study.

The study focus is on the following issues: how, why and for which matters SCHCs should be regulated differently, and where should that regulation be housed – should it be in a close corporation law or by means of an amendment to CA 2012? As noted earlier, this study proposes that a substantive chapter on SCHCs should be inserted into CA 2012 in answer to these critical questions.

In the next section, I briefly explore the applicable laws in Uganda.

1.7 Applicable laws in Uganda

The applicable laws in Uganda in their order of precedence are as follows. The Constitution, 1995 is supreme.[144] Article 2(1) provides that the Constitution is the supreme law of Uganda and shall have binding force on all authorities and persons throughout Uganda. Article 1(2) provides that if any other law is inconsistent with any of the provisions of the Constitution, the Constitution shall prevail, and that other law or

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[142] WS Kalema 'Enhancing government/business relations and mobilizing the business sector to develop productive capacities in least developed countries' UNACTAD Report, cited by Kiryabwire *Company Law* 14, where it is observed that the 'regulatory burden is one of the factors that hinders MSMEs from transitioning from the informal to the formal sector'.

[143] HJ Delport & JT Pretorius *Introduction to the Close Corporations Act* (1989) 1–2.

[144] https://media.ulii.org/files/legislation/akn-ug-act-statute-1995-constitution-eng-2018-01-05.pdf (accessed 30 September 2022).

custom shall, to the extent of inconsistency, be void. Further, the Constitution contains the National Objectives and Directive Principles of State Policy ('Principles of State Policy') and the preamble to the Constitution, which have been cited in the interpretation of the Constitution and statutes.[145] I discuss the principles of statutory interpretation in chapter 4. The preamble and the Principles of State Policy give the courts in Uganda some flexibility to deal with unique situations in their adjudicatory role.[146] The discussion in chapter 4 will reveal that in interpreting the Constitution and statutes (including the adjudication of matters of company law), the courts in Uganda have drawn from and applied the decisions of other jurisdictions, particularly, the United States ('US'), the UK and South Africa.

Below the Constitution are statutes (enactments of Parliament),[147] case law ('judge-made law'),[148] common law and principles of equity. The common law in Uganda is applicable with some qualifications. I explore this subject in some detail in chapter 4.[149]

Finally, the history of the equity principles in Uganda is similar to that of the common law. At present, doctrines of equity apply in Uganda by virtue of s 14(1) and (2)*(b)* of the Judicature Act.[150] It is generally agreed that equity developed to mitigate the harshness of strict application of the common law.[151]

1.8 The court structure in Uganda

Under art 132(1) and (2) of the Constitution, the Supreme Court is at the apex of the administration of justice in Uganda. Except in presidential petitions, where it enjoys

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[145] Egonda Ntende J (as he then was) in *Maj Gen David Tinyefuza* at 11, 12.
[146] F Mukasa *Towards Legal Certainty in Uganda's Commercial Adjudication: Managing the Tension between Formalism and Flexibility* (PhD thesis, Exeter, 2019) available at https://ore.exeter.ac.uk/repository/handle/10871/40553.
[147] Section 13 of the Judicature Act, Cap 6.
[148] Harvey *An Introduction* 526–527.
[149] See para 4.3.
[150] Ibid.
[151] G Williams *Learning the Law* 11 ed (1982) 26–27.

original jurisdiction, the Supreme Court is only an appellate court, and the final court of appeal. It entertains appeals from decisions of the Court of Appeal in its appellate jurisdiction on matters of law; and mixed fact and law of both a civil and criminal nature. It is also the Constitutional Court of Appeal.[152] Below the Supreme Court is the Court of Appeal, which is an appellate court, except for constitutional matters under art 137 where it exercises original jurisdiction. It entertains appeals from decisions of the High Court sitting as both an appellate court and as a court of first instance.[153] This is followed by the High Court which has both original and appellate jurisdiction. Below the High Court are magistrates' courts, which comprise Chief Magistrates, Magistrates Grade I and Magistrates Grade II.[154]

Administratively, the High Court is divided into the Civil, Family, International War Crimes, Criminal, Land, Anti-Corruption Court, and the Commercial Divisions. This is only for the greater Kampala Metropolitan Area, which covers the districts of Wakiso and Kampala. The rest of Uganda runs High Court circuits which adjudicate on all matters, civil and criminal, as set out in the Constitution.[155] The Commercial Court is of interest for the present study.

The establishment of the Commercial Court is attributed to the CJRP; the court is intended to make commercial justice easier and more accessible.[156] Regulation 2(2) of the instrument establishing the court provides that '[i]n the furtherance of the work of the commercial division, it has been decided to establish a commercial court capable of delivering to the commercial community an efficient, expeditious and cost-effective mode of adjudicating disputes that effect directly and significantly the economic, commercial and financial life of Uganda.' The Commercial Court is therefore at the heart of the administration of commercial justice in Uganda.[157]

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[152] Article 132(3).
[153] Article 134(1) and (2).
[154] Section 4(1) and (2)*(a)*, *(b)* and *(c)* of the Magistrates Courts Act, Cap 16 (as amended).
[155] Article 139.
[156] Established under the Constitution (Commercial Court) (Practice) Directions SI No 6 of 1996; ULRC Report 2; Kiryabwire *Company Law* 13–16. See also para 4.3.
[157] Ibid.

The decisions of the Supreme Court, the Court of Appeal and the High Court are decisions of superior courts of record and bind all the other courts below them in that order.[158] They are considered to have the force of law to that extent.[159]

1.9 Problem statement

SCHCs in Uganda lack a simple, accessible and flexible law. This problem is acknowledged and yet not reflected in companies' legislation. Moreover, although identified during the enactment of CA 2012, the problem can be traced to as far back as the first applicable companies' legislation in Uganda, the Indian Companies Ordinance 1882.[160] The companies' legislation was too bulky, complex and inappropriate for SCHCs. This continued to be the case with successive companies' legislation.[161] Given the overall objective of the CJRP, which Uganda undertook from 1996, culminating in CA 2012, it was expected that the problem of inappropriateness of companies' legislation with respect to SCHCs would be addressed. However, there is doubt if this objective has been achieved in CA 2012. At present, with the exception of optional company meetings for private companies (s 138 of CA 2012), all private companies – including those that would be regarded as SCHCs – are subjected to the same legal requirements. This is seen in the accounting and reporting obligations; the mandatory audit requirement; the classification of business forms and legal categories which does not take into account the special legal needs of SCHCs; and the CoCG, which, although optional for private companies, contains complex concepts which are inapplicable to or inappropriate for SCHCs. This is burdensome for SCHCs and leads to sham compliance. On account of the gaps in CA 2012, the declared objective of the CJRP to enact a companies' law which benefits various business interests in Uganda has not been fully achieved with respect to the legal needs of SCHCs which calls for policy reforms.

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[158] Article 129(2) of the Constitution.
[159] Ibid.
[160] Section 2(1) of the Companies Ordinance Cap 33.
[161] See para 1.5.

Drawing on this background, the key problems in CA 2012 with respect to SCHCs are the following:

- The CA 2012 does not provide for the (unique) legal needs of SCHCs as was declared in the CJRP;
- There exist gaps in the legal and corporate governance framework under CA 2012 with respect to SCHCs in Uganda; and finally,
- The CA 2012 did not adopt international best practice in the regulation of SCHCs despite having bench marked the United Kingdom and South Africa, as comparable jurisdictions.

In view of the above, the CA 2012 is a complex legislation for SCHCS. It does not deliver on the declared objective of the CJRP of a simple, flexible, and accessible law for SCHCs and as such requires reforms.

1.10 Objective of the study

The main objective of this study is to determine whether CA 2012 provides an appropriate and effective legal framework for SCHCs in Uganda. The specific research objectives are thus:

- to determine the legal needs of SCHCs in Uganda in light of the declared objective of the CJRP for a simple, flexible and accessible companies' legislation for SCHCs;
- to identify (in view of the above) gaps in the legal and corporate governance framework under CA 2012 with respect to SCHCs in Uganda; and
- to explore best practice on the regulation of SCHCs with focus on the UK and South Africa, as comparable jurisdictions.

1.11 The research question

The primary question that this study seeks to answer is whether CA 2012 provides an appropriate and effective legal framework for SCHCs. In answering this question, I ask the following specific questions:

- What are the (peculiar) legal needs of SCHCs in Uganda?
- What are the legal and corporate governance gaps in CA 2012 with respect to SCHCs?
- With focus on the UK and South Africa, as comparable jurisdictions, what is best practice on the regulation of SCHCs?

To answer the above research questions the study reviews the objectives of the CJRP as can be discerned from the CJRP Reports and from Hansard of the Ugandan Parliament when the Bill was being considered, to ascertain the gains and losses for SCHCs and the probable push and pull factors that influenced the final text of CA 2012. The answers form the basis for suggestions for policy interventions to improve the text of the law to achieve a simpler and more accessible corporate law for SCHCs in Uganda, as originally proposed in the CJRP. In answering the above questions, I seek to demonstrate that SCHCs in Uganda require special regulatory recognition and treatment under CA 2012. I show why, how and for what aspects SCHCs should be regulated differently.

In answering the first Research Question above, the study also answers the following specific sub-questions: (1) What in law are SCHCs? (2) What are their legal characteristics? (3) Why should legislation provide a different regulatory framework for SCHCs? (4) What challenges do SCHCs face under CA 2012? (5) what are the parameters for a simple and accessible company law for SCHCs? And finally, (6) What interventions can remedy the legal challenges faced by SCHCs under CA 2012? The answers to these questions provide basis for the study to explore best practice in the UK and South Africa, as comparable jurisdictions, on the regulation of SCHCs; and drawing thereon, the study suggest possible interventions in CA 2012.

1.12 Research structure and scope of the study

The focus of this study is an examination of the CA 2012 with regard to the legal needs of SCHCs in Uganda. The discussion of the Companies Acts in South Africa and the UK is limited to aspects that are relevant to small companies or close corporations, as well as the common-law concept of quasi-partnership companies, to illustrate best practice on regulation of SCHCs. This thesis comprises seven chapters as set out below.

Chapter 1 introduces and provides a brief background to the study problem. It then defines SCHCs and states their legal characteristics for the purpose of aiding the resolution of the primary research question, namely whether CA 2012 is an appropriate and effective legal framework for SCHCs. The chapter provides a brief restatement of the objectives of the CJRP and a brief history of company law in Uganda, tracing it to the Ugandan Order-in-Council, 1902, a legal instrument which placed Uganda under the British 'protectorate', thereby paving way for the transplanting of the British legal system to Uganda. The chapter then briefly discusses Uganda's legal system, the applicable laws and the court structure in Uganda. The chapter then provides the problem statement, the objectives of the study, the research questions, the research structure and the scope of the study, the research methodology employed in answering the research questions, and the motivation for the study.

Chapter 2 explores the theoretical framework and the basic corporate structure. It highlights the salient aspects of existing corporate theories, how and why they influence the regulatory models of firms, the associated problems of each, and what this might mean for SCHCs, which have unique or special regulatory and corporate governance needs. These theories include the concession, contractarian, organic, stakeholder and shareholder value theories. The study builds on these theories to develop the desired legal framework for SCHCs under CA 2012. This is achieved by 'grafting' aspects of the concession theory (providing for SCHCs in statute), the contractarian theory (allowing SCHCs to design their corporate governance structure) and the stakeholder approach with respect to CoCG, similar to the King Code in SA.

Chapter 3 examines, first, the various business forms and their legal characteristics – the single member company ('SMC'), the private company, the unlimited liability company and the public company – to show why they are not suitable vehicles for SCHCs. The chapter then considers the legal and corporate governance framework under CA 2012 and its suitability for the legal needs of SCHCs. The chapter focuses on ss 2, 4, 5, 14, 138, 154 and 167 of CA 2012. Finally, the chapter underscores the importance of the CoCG and the fact that it seeks to achieve good corporate governance across the board. I contend that the CoCG contains complex principles which are largely inapplicable to SCHCs.

Chapter 4 explores the application of common law in filling the gaps in company legislation. The chapter briefly considers the origin of common law before examining how it has moderated the strict application of corporation rules in small companies to provide them with equitable remedies outside of company legislation, and flexible corporate governance structure through enforceable private shareholder agreements, as the discussion of quasi-partnership companies will show. I propose that the common law be integrated into CA 2012 by enacting an express provision to the effect that the common law shall apply in the interpretation of CA 2012, or by restating the common law in the statute.

Chapter 5 explores best practice on the regulation of SCHCs in South Africa and the UK, as comparable jurisdictions. The discussion draws on South Africa's CCA 84 (as amended by SACA 2008) and the UK's CA 2006 to suggest specific regulatory interventions for SCHCs under CA 2012: (1) capping the number of members in SCHCs at ten and barring juristic persons from becoming members of SCHCs; (2) less or exempt account reporting obligations for SCHCs; (3) optional audit requirements; and (4) clear optional provisions for SCHCs. I then explore the possibility of Limited liability partnerships ('LLPs') as an option for small companies.

Chapter 6 discusses the possibility of the enforcement of the CoCG outside of CA 2012 on account of its weaknesses as noted in chapter 3. The discussion proposes that a stakeholder approach in terms of the King Code in South Africa has the potential to

broaden the enforcement of the CoCG beyond CA 2012. Alternatively, should the government elect to retain the CoCG under CA 2012, specific amendments must be made to address some weaknesses in the CoCG, notably its amendment process, and to dispense with the dual reporting obligations to the Registrar and the Capital Markets Authority ('CMA').

Finally, chapter 7 contains a summary of key findings and recommendations and offers a way forward. The conclusion is that CA 2012 is not an appropriate and effective legal framework for SCHCs. The problematic areas identified in this study are the lack of a definition or clear legal characteristics for SCHCs, inflexible accounting and audit requirements, and a CoCG with complex principles that are inapplicable to SCHCs. A key recommendation is the insertion of a chapter in CA 2012 with clear provisions that are applicable to SCHCs. I have proposed the amendment of ss 2, 4, 5, 138, 154 and 167 in *Appendix B*. I have also proposed that some key aspects of SCHCs together with quasi-partnership companies be codified in CA 2012.

1.13 Research methodology

This research is largely doctrinal. I examined legislation – mainly CA 2012, judicial precedents (from Uganda, South Africa, the US and the UK), and government reports, particularly Reid and Priest, Clare Manuel, and the ULRC Reports. As noted earlier, these reports contain background information on the policy considerations for the CJRP in Uganda. I also reviewed Hansard of the Parliament of Uganda for the years 2011 and 2012, which contains the debate on the Companies Bill, 2009, in order to better understand the legislative intention in enacting CA 2012 in its present form. I then compared the South African corporate law experience under SACA 2008 and CCA 84, the UK experience under CA 2006, and quasi-partnership companies.

Using the comparable jurisdictions of the UK and South Africa, the study demonstrates that best practice on the regulation of SCHCs entails: (1) less reporting obligations; (2) limiting the membership of SCHCs to natural persons; (3) optional audit

requirements; (4) limiting the members of SCHCs who are also usually in management; and (5) clear elective or optional provisions for SCHCs. These variables formed my evaluative framework in determining whether CA 2012 provides an appropriate and effective framework for SCHCs. The choice of South Africa and the UK as comparable jurisdictions was informed by the fact that during the enactment of CA 2012, the Parliament of Uganda benchmarked corporation law in South Africa and the UK.[162]

The other reason for the choice of the UK and South Africa is that, as noted earlier, 'the history of company law in Uganda is synonymous with her history whose roots lie in the British legal system and common law jurisprudence.'[163] This history is significant because common law is applicable in Uganda. The SADTI Report, itself a precursor to SACA 2008, reveals that South Africa's first corporate law was largely British-orientated.[164] On account of this common history, it is accepted that developments in UK corporate law are significant for Uganda's legal system – indeed, this is reflected in the memorandum to the Bill.[165] The study therefore draws from the developments in the UK and South Africa on the regulation of SCHCs.

Finally, the SADTI Policy Report and scholarly commentaries on the UK's DTI policy document[166] are critical in this study because they provide insight on policy considerations by the two jurisdictions as to why SCHCs should be regulated differently.[167] This question is at the centre of this study.[168] The secondary literature was readily available through the e-library platform of the University of Cape Town's collections of journals, e-text books and government reports. I also used internet sources. These resources give the study a broader comparative insight into various policy positions and best practice on the regulation of SCHCs in Western Europe, the US,

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[162] Hansard 3045.
[163] ULRC Report 7.
[164] SADTI Policy Report 12.
[165] See notes 134 and 135.
[166] Keay 'Corporate objective' 589.
[167] See the discussion in paras 5.3.1 and 5.2.1.2.
[168] See paras 1.9 and 1.10.4.

Australia, New Zealand, Canada, Japan and South Africa from which policymakers in Uganda can draw inspiration to address the gaps in CA 2012 with regard to SCHCs.

1.14 Motivation for the study

While the CJRP noted the need for SCHCs to be regulated differently from the other companies not much has been done in terms of legislation. SCHCs remain predominantly informal in their operations with a largely uncoordinated structure.[169] This set of affairs has been brought about by three factors: first, the complex nature of the companies' legislation; second, an overlayed law; and third, subjecting SCHCs to the same legal requirements as other companies, making the law burdensome for SCHCs. These factors manifest variously in CA 2012. This casts doubt on whether CA 2012 in its current form addresses the lack of an appropriate and effective legal framework for SCHCs in Uganda. A key motivation of this study is to contribute to policy formulation for an appropriate and effective legal framework for SCHCs in Uganda.

In the next chapter, I examine the corporate theories on corporate structure and corporate governance. This discussion will show that in designing an appropriate and effective company legislation for SCHCs, there must be 'grafting'[170] of strict corporation law with contracts and partnerships laws. The former gives SCHCs corporate status while the latter allow members of SCHCs to design their internal corporate governance structure through contract to achieve flexibility in their operations.

[169] MTIC Policy Document 7–8.
[170] Armour et al *Anatomy of Corporate Law* 15.

CHAPTER TWO

THEORETICAL FRAMEWORK ON CORPORATE GOVERNANCE

2.1 Structure of corporate form

Corporate form has three foundational aspects. First, upon registration a company is identified by five major attributes:[171] corporate personality, limited liability, delegated management through the board elected or appointed by members, investor ownership, and investor protection. This obtains in all cases irrespective of the size of the firm.[172] These attributes will not be discussed in any detail here given the existing body of literature on the subject.[173] These attributes, particularly the last three, are not all present in SCHCs.[174] In SCHCs, because members are also managers, the separation of ownership from management, which is a characteristic of corporate form, becomes artificial.[175] Equally, members in SCHCs do not require as much protection in the form of detailed internal corporate governance rules as their counterparts in big firms.[176]

Second, corporate form is made easily available, apparently to facilitate business, which essentially is to promote shareholder value.[177] The shareholder value corporate structure subordinates, and sometimes rejects altogether, the consideration of corporate stakeholder interests, as much as it abhors regulation.[178] Where stakeholder interests are considered, the caveat is unequivocal: they must promote shareholder value and managers should exercise their power to achieve this objective to avoid reprisals from

[171] *Salomon v Salomon & Co. Ltd*, (1897) AC 22 (HL).
[172] Gower 10 ed 10.
[173] Armour et al *Anatomy of Corporate Law* 5–15.
[174] Ibid 1.
[175] Cassim et al *Contemporary Company Law* 65–66; Gower 10 ed 5; Hochstetler & Svejda 'Statutory needs of close corporations' 854.
[176] Reid & Priest 8; Hochstetler & Svejda 'Statutory needs of close corporations' 854.
[177] Gower 10 ed 11.
[178] H Hansmann & R Kraakman 'The end of history for corporate law' (2011) 89 *Geo LJ* 439 at 442.

shareholders.[179] Traditionally, corporate law does not contemplate stakeholder intervention in the corporate governance of firms.[180] Corporation statutes essentially mirror this structure.[181] Apart from creditors,[182] the basic argument is that corporate stakeholders 'should have their interests protected by contractual and regulatory means rather than through participation in corporate governance.'[183] This corporate structure views managers as the sole 'custodians'[184] or the 'situs of corporate power',[185] with wide discretion on the corporate governance of firms. Apparently, this is because managers are 'disinterested'[186] and naturally '[a]lign their interests to shareholder value'.[187]

The stakeholder-oriented manager model, apparently, does not work because it leaves managers with 'too many masters and no master'.[188] That, managerial duty, although legalistically and primarily owed to the firm, is ultimately for shareholder value.[189] Until recently, corporation law did not regard managerial duty as extending directly to corporate stakeholders.[190] A contrary action by managers is regarded as 'corporate deviance.'[191] Although these basic principles are expounded upon in the next section, the stakeholder manager model is subsequently considered only on its

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[179] A Keay 'Tackling the issue of the corporate objective: An analysis of the United Kingdom's enlightened shareholder value approach' (2007) 29 *Sydney L Rev* 577–612 at 597.
[180] IM Esser & P Delport 'The protection of stakeholders: The South African social and ethics committee and the United Kingdom's enlightened shareholder value approach: Part 1' (2017) 50 *De Jure* 97 at 98 n 1.
[181] Gower 5 ed 7–8.
[182] SJ Ziegel 'Creditors as corporate stakeholders: The quiet revolution – An Anglo-Canadian perspective' (1993) 43 *U Toronto L J* 511–531 at 517; Hansmann & Kraakman 'The end of history' 442.
[183] Hansmann & Kraakman 'The end of history' 441.
[184] GR Sullivan 'The relationship between the board of directors and the general meeting in limited companies' (1977) 93 *LQ Rev* 569–580 at 574.
[185] MT Bodie 'Workers, information, and corporate combinations: The case for nonbinding employee referenda in transformative transactions' (2007) 85 *Wash U L Rev* 871–929 at 879.
[186] Hansmann & Kraakman 'The end of history' 444.
[187] M Jensen & W Meckling 'Theory of the firm: Managerial behaviour, agency costs, and ownership structure' (1976) 3 *J Fin Econ* 305–360, cited in DH Robison & R Santore 'Managerial incentives, fraud, and monitoring' (2011) 46 *The Fin Rev* 281–311 at 282.
[188] Bainbridge 'The means and end of corporate governance' 581 at 582–583; Loughrey et al 'Shaping corporate governance' 109.
[189] A Keay 'Shareholder primacy in corporate law: Can it survive? Should it survive?' (2010) 1, available at http://ssrn.com/abstract=1498065 (accessed 25 January 2018).
[190] Ziegel 'The quiet revolution' 514–515.
[191] J Macey *Corporate Governance* (2008) 2, cited in Keay 'Shareholder primacy' 5.

application on the CoCG. This discussion draws on the King Code in South Africa[192] to demonstrate the possibility of enforcing the CoCG outside of CA 2012. It is argued that under the King model – of a broad membership – a reconstituted body which is member-based with an expanded mandate of review of the CoCG will not only benefit from the wider member expertise and competencies beyond the current duality of the CMA and the Minister,[193] but will also provide a neutral platform – comprising the public and private sector players – for future reviews and standard-setting of the CoCG.

Finally, the courts are said to be less inclined to decide business policy.[194] This has given rise to common-law principles such as the 'internal management rule' in *Foss v Harbottle*,[195] and its allied rules,[196] where the courts are less inclined to interfere with a decision of the company which has been arrived at by a majority in a proper meeting,[197] and derivative actions.[198] Nevertheless, this study shows that there is a departure from these principles in the case of quasi-partnership companies and generally SCHCs where courts have been prepared to extend to SCHCs equitable remedies outside of statute law.[199] In the next section I briefly explore the basic corporate governance framework and corporate theories to lay a basis for the analysis of CA 2012 in the subsequent chapters in deciding whether the Act provides an appropriate and effective legal framework for SCHCs.

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[192] Cassim et al *Contemporary Company Law* 644.
[193] Section 14(6) of CA 2012.
[194] Ziegel 'The quiet revolution' 514–515 and 517, for a historical perspective to the decision in *Salomon*; *Hogg v Cramphorn Ltd* (1967) Ch 254; *Percival v Wright* (1902) Ch 421; Hansmann & Kraakman 'The end of history' 442.
[195] See Mayson et al *Company Law* 657.
[196] Ibid 657; *Shuttleworth v Cox Brothers and Co (Maidenhead) Ltd* (1927) 2 KB 9 at 22–24, cited in Mayson et al *Company Law* 659.
[197] Mayson et al *Company Law* 657.
[198] Reisberg 'Shareholders' remedies' 231–243.
[199] *Ebrahimi v Westbourne Galleries Ltd and Others* (1972) 2 All ER 492; *Scottish Co-operative Wholesale Society Ltd v Meyer and Another* (1958) 3 WLR 404; *In re HR Harmer Ltd* (1958) 1 WLR 62; *In re American Pioneer Leather Company, Limited* (1918) I Ch 556; *In re Yenidje Tobacco Company, Limited* (1916) 2 Ch 426. See discussion in Chapter 4 para 4.3.2.

2.2 Corporate theories and basic corporate governance framework

In this section I explore three key corporate governance issues: the purpose for which the firm is formed; the control of corporate power; and for whose benefit it should be employed. The examination of the concession, contractarian and stakeholder theories offers insights into these questions. It highlights the operational and organisational dynamics of corporate structure and how they impact the internal corporate governance of firms. The other concepts reviewed are the organic theory, and a brief discussion of derivative actions in common-law jurisdictions. The discussion shows how each of these theories influences the corporate governance of firms upon which I propose that legislation can be grafted to provide an appropriate and effective legal framework for SCHCs.

I argue that under the concession theory, there are two fundamental outcomes: first, the creation of company labels, and second, the justification for demanding that corporate firms are run well. Under the contractarian theory, I demonstrate that the gaps which exist under the concession theory (statute law) are filled by members exercising their right to design an internal corporate governance structure to suit their internal needs. This has been employed in quasi-partnership companies and SCHCs.[200] Finally, although stakeholder theory is not the subject of this thesis, I propose that given the weaknesses associated with the enforcement mechanism of the CoCG under CA 2012, the alternative is the stakeholder-participatory approach akin to the King Code model in South Africa. In the next section, I explore the specific theories.

2.2.1 Concession theory

The basic concept in the concession theory is that corporate form is a product of regulation. The attributes or existence of a firm, or the benefits accruing from and under

[200] See para 5.4.

a corporate firm, are derived from regulation by or under the authority of the state.[201] Tracing the origin of the corporation to 1725, Tudway argues that

> the proliferation of the corporate form in the nineteenth century and a head of limited liability legislation reflected the view that company incorporation as a separate legal personality came as a *concession* from the state for certain types of commercial and industrial undertaking. The implication was that incorporation was granted in recognition that the company would be undertaking functions beneficial to the public good, as well as the investors. This is an important understanding. Incorporation thus continued to convey upon the company, as in earlier times, a 'public character' that could be used to justify state intervention to monitor public benefit.[202]

In this passage, Tudway opines that from inception, corporate form, as it is known today, was a prerogative of the Crown or the state in modern times. It was a concession. The incorporators had to perform 'functions beneficial to the public good'. In the 1930s, Dodd[203] supported this view. He argued that 'it may well be that law is approaching a point of view which will regard all business as affected with a public interest.'[204] I shall return to this statement shortly. Under the concession theory the law must confer rights and privileges on a firm. These privileges extend to firm managers and other officers in the course of their legitimate duty.[205] Gower describes this as the 'enabling function' of regulation, which essentially sets standards for firm operations.[206] The concession theory is also referred to as the 'communitarian doctrine of the corporation'[207] to suggest that the firm is 'an instrument for the state to utilise'.[208]

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[201] See Gower 5 ed 37–54 for a historical exposition on the development of English company legislation and the role it plays in firm management; Ziegel 'The quiet revolution' 517 on the import of the decision of the House of Lords in *Salomon v Salomon & Co* on the UK's CA 2012.
[202] R Tudway 'The juridical paradox of the corporation' (2003) 2 *Int'l Corp. L* 65 at 70 (emphasis added).
[203] EM Dodd 'For whom are corporate managers trustees?' (1932) 45 *Harv L Rev* 1148–1150 at 1149; A Berle 'Corporate powers as powers in trust' (1931) 44 *Harv L Rev* 1049; A Berle 'For whom corporate managers are trustees: A note' (1932) 45 *Harv L Rev* 1365–1372.
[204] Dodd 'For whom are corporate managers trustees' ibid.
[205] *Salomon v Salomon and Co Ltd* (1897) AC 22 (HL).
[206] Gower 5 ed 7.
[207] Tudway 'The juridical paradox of the corporation' 67.
[208] J Dine *The Governance of Corporate Groups* (2000) 17.

To return to Dodd's public interest argument above: while replying to Berle's[209] assertion that 'all power granted to a corporation or to management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the stakeholders as their interests appears',[210] Dodd remarked that 'public opinion, which ultimately makes law, has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as a profit-making function.'[211] Dodd attaches societal function[212] or 'the social welfare function' to the firm.[213] This proposition is widely quoted in the modern stakeholder commentaries.[214]

Dine[215] opines that 'the concession theory leads to the conclusion that the state's rights extend to a right to ensure that the company is properly run according to the notions of equity and fairness, embedded in particular in public law concepts.'[216] Case law on the 'proper purpose rule' on the exercise of corporate power partially supports the concession theory proposition that there has to be some form of regulation of business forms.[217] This is to prevent 'fraud on a power'.[218]

Furthermore, Braithwaite and Drahos[219] assert that the corporation as a '*persona ficta*' is granted a legal identity as a corporate person by the state. '[B]y definition, regulation therefore creates corporations (as well as shapes their form) because state law is necessary for the authoritarian designation of a group of individuals as a corporate

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[209] Berle 'Powers in trust' 1049; Dodd 'For whom are corporate managers trustees?' 1147.
[210] Berle ibid.
[211] Dodd 'For whom are corporate managers trustees?' 1148.
[212] SADTI Policy Report para 3.2.3.
[213] Dodd 'For whom are corporate managers trustees?' 1148.
[214] Keay 'Has it got what it takes' 5.
[215] Dine *Corporate Groups* 122.
[216] Ibid.
[217] See DJ Bakibinga *Analysis of Some Recent Trends Affecting the Legal Powers, Duties and Functions of Company Directors* (PhD thesis, University of London, 1981) 157–178, cited in DJ Bakibinga *Company Law in Uganda* 2 ed (2012) 4.
[218] Lord Parker in *Vatcher v Paull* (1915) AC 372, 378, cited in Bakibinga *Analysis of Some Recent Trends* 164.
[219] J Braithwaite & P Drahos *Global Business Regulation* (2000) 145.

form.'[220] They further observe that 'once that recognition had been granted, the corporation could own land, enter into contracts, sue and be sued and ultimately be held criminally responsible.'[221]

The state recognition of firms has of course changed to what it is today, where most regulations require only the registration of incorporation documents with the company office so as to commence business.[222] The concessionary nature of the firm has, however, remained intact in the incorporation process, namely, legal recognition and the authority of the state to operate as an incorporated firm.

The scholarship on concession theory points to one fundamental question which has endured in the academic discourse: is the corporation an 'economic institution' with 'societal duties'? If so, by whom and how should the corporation's societal duties be enforced? The answer is not obvious. That said, the one argument advanced under the 'economic concept' of the firm is Dine's view about 'the right to ensure that a company is run properly'.[223] The proper running of the affairs of the company is an invaluable public good for which the state is the 'guardian'.[224] The codification of the common-law manager duty seen in company legislation speaks to this public good.[225]

The 100-employee hypothetical case, cited during the debate on the Bill, explains the facets of the public duty of the firm further.[226] From that case, it is asserted that the reasons cited for the collapse of firms and the number of employees who would be affected as a result became a public concern. The 100 employees gave a private firm a public character because 'in reality, they have become part and parcel of the public by employing 100 people from the public.'[227] Arguably, the House was more concerned

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[220] Ibid.
[221] Ibid.
[222] Ibid 151; s 21 of CA 2012; Ziegel 'The quiet revolution' 517.
[223] Dine *Corporate Groups* 29.
[224] Ibid 30.
[225] Hansard, 21 March 2012, 3048.
[226] Ibid.
[227] Ibid.

about the plight of the 100 people than about the losses that shareholders may suffer when firms collapse.

Baums and Scott assert that the corporate governance of firms 'includes the regulations issued by governmental agencies, and the statutes enacted by parliamentary bodies.'[228] Under the concession theory, therefore, the managerial pursuit of private profit can sometimes be constrained in the public interest, 'without in any way affecting the proposition that the sole function of such managers is to work for the best interests of the stockholders as their employers or beneficiaries.'[229] Therefore, the so-called 'private bargains' which are discussed later in this section under the contractarian theory remain the subject of public law in given circumstances.[230]

Thus, despite controversies about their enforcement, legislative interventions such as the CoCG,[231] the SEC requirements under SACA 2008,[232] the EVS provisions in the UK's CA 2012,[233] the constituency statutes in the US,[234] or codetermination in Germany,[235] where managerial duty has been broadened beyond shareholder value or allowed stakeholder participation, suggest that, after all, the 'state has a right to regulate corporate behaviour',[236] including setting standards for managerial behaviour.[237]

Gower, while discussing the functions of company legislation, argues that 'the regulatory function prescribes the conditions which have to be complied to obtain incorporation and the rules that thereafter have to be observed to protect members,

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[228] T Baums & K Scott 'Taking shareholder protection seriously? Corporate governance in the United States and Germany' (2005) 53 *Am J Comp L* 31–74 at 33.
[229] Dodd 'For whom are corporate managers trustees?' 1153.
[230] Ibid 1150.
[231] Section 14.
[232] Esser & Delport 'Part 1' 107.
[233] R Williams 'Enlightened shareholder value in UK company law' (2012) 35(1) *UNSWLJ* 360–377 at 360–363.
[234] Keay 'Corporate objective' 594–597.
[235] TC Hodge 'The treatment of employees as stakeholders in the European Union: Current and future trends' (2010) 38 *Syracuse J Int'l L & Comp* 91–171 at 92–7.
[236] Dine *Corporate Groups* 106.
[237] Gower 5 ed 7; *Re Rolus Properties Ltd and Another* (1988) 4 BCC 446, cited in Dine *Corporate Groups* 22.

creditors and the public against the dangers inherent in such a body.'[238] This study is sympathetic to Gower's proposition. The regulation of corporate firms does not, and ought not, stop at granting corporate status. Governance, organisational and operational corporate problems usually emerge long after incorporation, with no obvious effective remedy under corporation law, but may require complimentary public law interventions to direct business policy.[239] Therefore, the public interest vitiates the contractarian concept of the corporation as 'a non-regulable nexus of contracts',[240] or a 'private institution governable only by rules of commercial law and not [an] appropriate vehicle for regulation.'[241]

In the House, while referring to a hypothetical case above, a member remarked:

> If a company has been formed by five people or maybe two and now it is employing 100 people, if that company collapsed, 100 people with families will be unemployed. How can we safeguard these companies? In reality, they have become part and parcel of the public by employing 100 people from the public. How do we safeguard them so that these companies are run in such a way that they can survive? Let them collapse in an economic sense but let them not collapse because of individual mismanagement. This brings problems to the 100 people they have employed, who could have been employed elsewhere but have been stuck in this company for the rest of their lives.[242]

This extract suggests that regulation has consistently been employed to set standards and direct the governance policy of firms despite their being 'private institutions'[243] within the context of a given society so as to align the law to local peculiar needs. Black et al[244]

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[238] Gower 5 ed ibid.
[239] F Zona et al 'Antecedents of corporate scandals: CEOs' personal traits, stakeholders' cohesion, managerial fraud, and imbalanced corporate strategy' (2013) 113(2) *J Bus Ethics* 265–283 at 266.
[240] Tudway 'The juridical paradox of the corporation' 65.
[241] Ibid 66.
[242] Ibid.
[243] Ibid; Tudway 'The juridical paradox of the corporation' 66.
[244] Black et al 'Corporate law from scratch' 245–246.

argue that a complete reconstruction of corporate law may be necessary, especially for 'an emerging market'.[245] They remark:

> Newly privatising or developing countries should not simply copy the corporate laws of developed Western economies. The corporate laws of developed countries depend upon highly evolved market, legal, and governmental institutions, and upon cultural norms that often do not exist in emerging economies .... [T]here would be a case for not doing so before first taking, a hard look, since these laws are likely to be as much the product of idiosyncratic historical developments in their countries of origin as of purely functional imperatives.[246]

In this passage, Black et al[247] counsel policymakers to localise the law in their situations by adopting a new law for appropriate regulatory intervention in corporation problems. A localised CoCG to fit the peculiar needs of closely-held firms in Uganda potentially improves on its efficacy and utility within the policy framework proposed in the CJRP Reports.[248]

The third aspect of the firm as an economic institution is the 'social responsibility'[249] of the firm. This subject has been debated since the time of Dodd and Berle.[250] But, before the much-quoted debate took place between Dodd and Berle, the case of *Hutton v West Cork Rly Co* was heard.[251] Bowen LJ observed, with respect to the disputed payments to the former directors of the company, that '[t]he law does not say that there is to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.'[252]

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[245] Ibid 246.
[246] Ibid.
[247] Ibid.
[248] ULRC Report 4.
[249] Ibid; Dine *Corporate Groups* 16.
[250] Berle 'Powers in trust'; Berle 'For whom corporate managers are trustees' 1365–1372; Dodd 'For whom are corporate managers trustees?' 1148–1150.
[251] (1883) 23 Ch D 654 (CA), also cited in Ajibo 'A critique' 597.
[252] Ibid 673.

Earlier, in *Hampson v Price Patent Co*,[253] the court had observed that 'the company might lawfully expend a week's wages as gratuities for their servants, because that sort of liberal dealing with servants eases the friction between Masters and Servants, and is, in the end, a benefit to the company.'[254]

The *dictum* of Bowen LJ above suggests that 'cakes and ale' is a familiar phrase in enhancing shareholder value 'within certain limits'.[255] The mandate to determine when 'cakes and ale' is to be employed in shareholder value is discretionary and falls under the internal business policy of the firm.[256] The social responsibility of firms in its original form, if there ever was an original form, in employing 'cakes and ale', did not seek to displace shareholder value. Rather, it preserves and enhances it. The *dictum* in *Hutton's* case has endured to date, except that in some cases, the social responsibility of the firm is now provided for under legislation, as earlier seen with the constituency statutes in the US,[257] the EVS provisions in the UK, and the SEC requirements for prescribed firms under SACA 2008 in South Africa.[258]

During Dodd–Berle times, business executives understood their role as 'trustees to the public, in addition to, of course, shareholders and employees'.[259] Dodd, in answering Berle's call for 'increased emphasis on the doctrine that managerial powers are held in trust for stockholders as sole beneficiaries of the corporate enterprise',[260] argued that the corporation is 'an economic institution which has a social service as well as a profit-making function'.[261] Dodd opined that 'this view has already had some effect upon legal theory, and that it is likely to have a greatly increased effect upon the latter in the near future.'[262] In his view,

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[253] 24 WR 754, cited with approval in the *Hutton* case (1883) 23 Ch D 654 at 673.
[254] Ibid.
[255] Ibid 671.
[256] Griffith 'Good faith business judgment' 9–12.
[257] Keay 'Shareholder primacy'; Keay 'Has it got what it takes?' 5.
[258] Section 72(4) of SACA 2008. See para 6.3.
[259] Dodd 'For whom are corporate managers trustees?' 1154.
[260] Berle 'Powers in trust'; Dodd ibid 1147.
[261] Dodd ibid 1148.
[262] Ibid.

> business is permitted and encouraged by the law primarily because it is of service to the community rather than because it is a source of profit to its owners. Where it appears that unlimited private profit is incompatible with adequate service, the claim of those engaged therein that the business belongs to them in an unqualified sense and can be pursued in such manner as they choose need *not be accepted by the legislature*.[263]

Dodd further argues that '[i]f incorporated business is to become professionalized, it is to the managers, and not to the owners, that we must look for accomplishment of this result.'[264] In chapter 6, I propose that the reviews of the CoCG should include all SCHCs through SCHC-oriented organisations like the Federation of Small and Medium-sized Enterprises and other stakeholders, to mirror the King Code model.

2.2.2 Contractarian theory

The contractarian theory, sometimes referred to as 'corporate nominalism'[265] or the 'aggregate theory',[266] views a corporate firm as a contract.[267] The argument is that 'the firm is a network of commercial contracts'[268] or 'a nexus of contracts among the various factors of production'.[269] Bainbridge suggests that the phrase 'nexus of contracts' can be attributed to Coase.[270] The other contractarians understand the firm as 'a private institution governable only by rules of commercial law and not an appropriate vehicle

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[263] Ibid 1149 (emphasis added).
[264] Ibid 1153.
[265] I Katsuhito 'Persons, things and corporations: The corporate personality controversy and comparative corporate governance' (1999) 47(4) *Amer J Comp L* 583–632 at 586, available at http://ssrm.com/abstract=1861919.
[266] S Bottomley 'Taking corporations seriously: Some considerations for corporate regulation' (1990) 19 *Federal L Rev* 203 at 204, cited in Dine *Corporate Groups* 3.
[267] Tudway 'The juridical paradox of the corporation' 73.
[268] RH Coase *The Firm, the Market and the Law* (1988), cited in Tudway ibid 66.
[269] H Hansmann *The Ownership of Enterprise* (1996) 18, cited in Bainbridge 'The means and ends of corporate governance' 552; SM Bainbridge *Corporation Law and Economics* (2002) 119–120, cited in Bainbridge 'The means and ends of corporate governance' 547; AM Eisenberg 'The conception that the corporation is a nexus of contracts, and the dual nature of the firm' (1999) 24 *J Corp L* 819 at 830, cited in Bainbridge 'The means and ends of corporate governance' 553.
[270] R Coase 'The nature of the firm' (1937) 4 *ECONOMICA* (NS) at 386, cited in Bainbridge 'The means and ends of corporate governance' 547.

for regulation'.[271] The presumption under the theory is the existence of negotiations in the typical contractual sense.[272] The contractarian theory presents three key attributes of the firm. First, the firm is 'born out of a pact' – a contract. Under this head, the parties to the corporate contract, if they are to be called that, are deemed to have freely entered into a binding contract. This is the ideal conceptual tradition of commercial bargains and agreements as espoused by Sir George Jessel in *Printing and Numerical Registering Co v Sampson.*[273]

The contractarian theory 'denies that shareholders own a corporation'.[274] The contractarians claim that 'the shareholders are merely one of the many factors of production bound together in a complex web of explicit and implicit contracts.'[275] In the strict contractarian sense, therefore, the firm is a product of commercial bargain and, as such, shareholder 'ownership' of the firm is difficult to place in the theory. That is all well and good. However, there is little controversy about the context in which shareholders are referred to as the 'owners' of the firm. Shareholders contribute the initial capital and are the only constituency with a residual claim on firm property.[276]

Second, apparently, the firm is a private enterprise not subject to regulation.[277] Sugarman and Rubin opine that 'the logical outcome of the theoretical base is to limit the social responsibility of the company to create an entity remote from regulatory inference because any denial of the right to use the free enterprise tool which is available tends to interfere with the concept of the company.'[278] To their credit, the decision-making process in the firm is well established as a contractual matter.[279] This

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[271] Tudway 'The juridical paradox of the corporation' 66.
[272] J Beatson *Anson's Law of Contract* 27 ed (1998) 4, 16.
[273] [1875] LR 19 Eq 462 at 465, cited in Beatson ibid 16, 348.
[274] Bainbridge 'Means and ends of corporate governance' 547.
[275] FH Easterbrook & DR Fischel *The Economic Structure of Corporate Law* (1991) 12, cited in Bainbridge ibid 548.
[276] G Haydon & TM Bodie 'Shareholder democracy and the curious turn toward board primacy' (2010) 51 *Wm & Mary L Rev* 2071–2121 at 2083–2085.
[277] Tudway 'The juridical paradox of the corporation' 66.
[278] Dine *Corporate Groups* 4.
[279] Griffith 'Good faith business judgment' 10–11.

proposition is supported by principles such as Bainbridge's 'rules of the corporation',[280] which are considered later in this chapter. To that extent, the theory aligns well with deregulation in free market economies so as not to burden private enterprises with compliance costs.[281] In designing an appropriate and effective legal framework for SCHCs, as already noted above, a key consideration is a less onerous compliance burden.

However, under the above proposition, two topical issues arise. First, there are no economies completely without regulation of the market.[282] Though writing from a financial regulation perspective, Cranston opines that 'even the most ardent free marketeer accepts the need for controls to minimize fraud.'[283] While I must be clear that fraud is outside the scope of this study, the revelation by Cranston suggests that there are clear instances where regulation is justified.

Third, not all aspects of corporate business are the subject of contracts. The 'stakeholder capitalism' that is discussed under 'Project Syndicate'[284] by chief executive officers ('CEOs') of large firms in the US, the SEC requirements for prescribed firms in South Africa, the ESV requirements in the UK, and the constituency statutes in the US reveal that the contractarian theory is limited in scope.

In the case of Project Syndicate, regardless of the outcome, the CEOs' conversation about stakeholder relationships outside any known legal or contractual framework in the US suggests managerial awareness of the issues around the Dodd–Berle debate on social welfare in shareholder value as a factor of business life. To adopt Hansmann and Kraakman's persuasive arguments on shareholder value based on the

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[280] See para 2.2.1.
[281] Reid & Priest 3; Kiryabwire *Company Law* 14.
[282] R Cranston *Principles of Banking Law* 2 ed (2002) 68.
[283] Ibid.
[284] M Roe 'Why America's CEOs are talking about stakeholder capitalism: Project syndicate' reported in Daily Monitor Publication Newspaper No 309 of Wednesday, 6 November 2019, at 28. The original text is available at www.project-syndicate (accessed 6 November 2019).

'force of example',[285] South Africa, so far, has shown that public policy can sometimes transcend private bargains where statutes assign firms a public duty.[286]

Third, 'the Board of Directors is not a mere agent of shareholders, but rather a *sui* generis body – a sort of Platonic guardian – serving the nexus for the various contracts comprising the corporation.'[287] Here, apparently, the board of directors is in charge of the contracts. From a director primacy perspective, they are correct. In *Percival v Wright*[288] directors' duties are owed to the company and not to its members, either collectively or individually, or to anyone else 'interested' in the company.[289] In the strict sense, therefore, 'directors are not *per se* agents of the shareholders.'[290] However, ultimately the popular view is that directors must promote shareholder value.[291]

The other weakness of the contractarian theory relates to 'statutory contracts'. In the 2012 Act, the relevant provision is s 21,[292] which provides:

> **21. Effect of memorandum and articles**
>
> (1) Subject to this Act, the memorandum and articles shall, when registered, bind the company and the members of the company to the same extent as if they had each been signed and sealed by each member and contained covenants on the part of each member to observe all the provisions of the memorandum and articles.[293]

The analogous provision in SACA 2008 is s 15(6).[294] This provision is explored in detail later in this section.

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[285] Hansmann & Kraakman 'The end of history' 449–450.
[286] See ss 7(b)(iii), (d); 72(4) of SACA 2008.
[287] Bainbridge 'The means and ends of corporate governance' 550–551, 560, 577 and 605; *R v Camps*; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378.
[288] [1902] 2 Ch 421.
[289] Ibid.
[290] See *Kuwait Asia Bank v National Mutual Life Nominees Ltd* (1991) 1 AC 187.
[291] Hansmann & Kraakman 'The end of history'; Keay 'Corporate objective' 600–601; Ziegel 'The quiet revolution' 517.
[292] Ibid.
[293] Ibid.
[294] Ibid.

Indisputably, s 21 above contains aspects of the contractarian theory. The contract thereunder is sealed upon the registration of the constitutive documents. The parties are the members themselves, on the one hand, and the members and the company, on the other. The strict application of the contractarian theory to the above provision, however, reveals some controversies, as illustrated below:

The contract under the said provision is 'sealed' once. Thereafter, it applies not only to the subscribers to the memorandum and articles of association, but also to those in the future and who are yet to join the company.[295] In this sense, the 'original' incorporators have bargained for themselves and for future members. In consequence, under the law of contract, members who join the firm subsequently cannot be said to have bargained. They become parties to the contract by operation of the law, thereby vitiating the notion that the firm is a 'private institution not regulable'[296] or 'a non regulatable nexus of contracts.'[297]

Ferran argues that the 'idea of negotiation and bargain does not seem an entirely apt description of the dynamics of many typical relationships within a company'.[298] Meanwhile, Dine[299] opines that 'a further consequence is that the focus on the contract between *members* and the company has the inevitable effect of excluding other participants in the economic enterprise, thereby giving us a limited model serving the shareholders alone.'[300] The exclusion of other participants under contractarian theory has been the subject of a line of judicial decisions which suggest that there are 'outsiders' and 'insiders' – where 'outsiders' are non-shareholders while 'insiders' are shareholders.

In *Eley v Positive Government Life Assurance Co*,[301] the articles provided that Eley should be the company's solicitor for life, removable only for misconduct. Eley drafted the company's documents for registration and became a shareholder several

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[295] *Kelner v Baxter* (1866) LR 2 CP 174.
[296] Tudway 'The juridical paradox of the corporation' 66.
[297] Ibid 65; Dine *Corporate Groups* 4.
[298] Ferran *Company Law* 11.
[299] Dine *Corporate Groups* 6.
[300] Ibid. The italics appear in the original text.
[301] (1876) 1 Ex D 83, cited in Bakibinga *Company Law in Uganda* 59; Dine *Corporate Groups* 4.

months after incorporation. He sued the company for breach of contract for not employing him as its solicitor, pursuant to the articles. It was held that while the relevant article could be a stipulation which bound the members or a mandate to directors as to the appointment of a solicitor, it did not of itself constitute a contract between the plaintiff in his capacity as a solicitor and the company.[302] This same position was later reiterated in *Hickman*'s case.[303] There it was made clear that third parties cannot enforce an analogous provision to s 21.[304]

Drawing on Dine's line of argument above, it is asserted that the contractarian theory presents the in-built inequity in the corporate structure founded on commercial bargains. In essence, the contractarian theory is invariably an articulation of the shareholder value corporate model which posits the view that the firm is principally about profit maximisation.[305] An earlier exposition of the concessionary theory suggests that it is not feasible to have an exclusively contractarian corporation law.[306] The argument is that the pursuit of shareholder value is the subject of public policy.[307]

The second problem associated with the statutory contract is the difficulty in tracing particular commercial bargains. While, for example, creditors and employees will respectively have loan and employment contracts with clear terms on what is due, such as the repayment mode for creditors or salary obligations on the firm in the case of employees, there is an acute hardship in the contractarian perspective in ascertaining a particular bargain for individual shareholders in the statutory contract.[308] The subject matter in the contract appears to be 'covenants on the part of each member to observe all the provisions of the memorandum and articles'.[309]

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[302] Ibid; *Wood v Odessa Waterworks Co* (1889) 42 Ch D 636.
[303] *Hickman v Kent or Romney March Sheep Breeders' Association* (1915) 1 Ch 881, cited in Bakibinga *Company Law in Uganda* 59; *Salmon v Quin & Axtens Ltd* (1909) 1 Ch 311.
[304] Katende & Chesterman *The Law of Business Organisations* 323.
[305] Hansmann & Kraakman 'The end of history' 468.
[306] Dine *Corporate Groups* 29–30.
[307] Dodd 'For whom are corporate managers trustees?' 1149.
[308] Section 21.
[309] Ibid.

Accordingly, there is no clear economic bargain arising from the above phrase. Conversely, the provision commits the members collectively to ensure that the firm shall be run on principles espoused in the law and in terms of the memorandum and articles of association, as presented. Arguably, the section gives the firm a public character and is hence subject to public scrutiny, including regulation. For example, one cannot easily place the continued mandatory filing of annual returns,[310] or keeping audited books of accounts in a prescribed manner,[311] in the contractarian theory. These easily fall under public law, as demonstrated in chapter 3.

Moreover, in the case of breach of contract, while employees and creditors, for example, can sue the firm under their respective contracts, shareholder options are limited. Judicial opinions suggest that what is considered enforceable by a shareholder under the statutory contract must relate to corporate governance and specific conditions for the overall good of the firm.[312] The available literature suggests that shareholders face legal hardships in pursuing a breach of contract under s 21.[313]

A further problem which arises from the proposition that 'the board of directors is … a *sui generis* body' relates to modification of the statutory contract in provisions analogous to s 21 to include directors as parties to the contract. It leaves no one 'in charge' of the contracts. This is the position in South Africa.

Section 15(6) of SACA 2008 provides that '[a] company's Memorandum of incorporation, and any rules of the company, are binding–*(a)* between the company and each shareholder; *(b)* between or among the shareholders of the company; and *(c)* between the company and– (i) each director or prescribed officer of the company; or (ii) any other person serving the company as a member of a committee of the board, in the exercise of their respective functions within the company.'

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[310] Section 132 of CA 2012.
[311] Sections 154–160 of CA 2012.
[312] Griffith 'Good faith business judgment' 10–11.
[313] PL Davies 'Directors' fiduciary duties and individual shareholders' in E McKendrick (ed) *Commercial Aspects of Trusts and Fiduciary Obligations* (1992) 86–87, 90–91, cited in Reisberg 'Shareholders' remedies' 231.

Undoubtedly, the above provision has widened the parties to the contract, hitherto exclusively shareholders, to include 'directors or prescribed officer of the company and any other person serving the company as a member of a committee of the board'.[314] In my view, given its natural meaning, directors lose the *sui generis* status.

Under the said provision, there are four species of contracts: first, contracts between the company and members; second, contracts between the members *inter se*; third, contracts between individual directors or prescribed officers of the company and the company; and fourth, contracts between any other persons serving the company as members of a committee of the board and the company.

The literal construction of this provision reveals that individual directors or prescribed officers, or any other persons serving the company as members of the committee of the board, join the club of 'insiders' who can enforce the contract. This development is a departure from judicial precedents in cases such as *Hickman*, *Wood*, *Salmon* and *Welton* where it appeared settled that only members could enforce the provisions and largely on matters of the firm business.

Given this background, it is not immediately clear whether it is the legislative intention in SACA 2008 to broaden the *locus standi* in the statutory contract under s 15(6) beyond remedying wrongs suffered by the company. But from the wording of the last part of the provision, 'in the exercise of their respective functions within the company', this is probably not the intention. I am inclined to the earlier submission that the contract under s 21 (or s 15(6) of SACA 2008, for that matter) does not confer any particular economic benefit on the parties in the typical contractarian sense. Rather, it connotes a public duty that the 'parties to the contract' shall run the affairs of the firm in

[314] K Idensohn 'The meaning of "prescribed officers" under the Companies Act 71 of 2008' (2012) 129 *SALJ* 717–735 at 718.

accordance with its constitutive documents and the law. The reference in the section to the 'respective functions' of the parties supports this conclusion.[315]

Kraakman et al suggest that 'by explicit or implicit reference, the charter can also become part of the contract between the firm and its employees or creditors.'[316] This further confirms my view that the economic bargain in the contractarian theory is not intended under s 15(6) or s 21 above. It is proposed that the two provisions are more aligned to the judicial opinion in *Lennard's Carrying Co v Asiatic Petroleum Co*[317] about the company's 'active and directing will' and the 'mind and will of the corporation and the very ego and centre of the personality of the corporation', than to an economic bargain as posited in contractarian terms.[318] I contend that, for that reason, directors, prescribed officers and members of committees of the board of directors were added to the list of parties to the statutory contract under s 15(6) of SACA 2008.

Third, contractarians 'reject any notion of the firm as an entity, arguing that one must avoid reifying the firm'.[319] This view does not go far in light of the legal requirements for corporate status. Kraakman et al have dealt with this aspect.[320] On the basis of the arguments therein, the attempt by contractarians to downplay the entity notion of the firm is deficient. The existence of a corporate firm cannot be divorced from regulation and it is not a matter of contract.

Fourth, the available remedies under the contractarian theory are inadequate. As already discussed, there are public policy considerations in the statutory contract under s 21. For this reason, specific breaches of statutory provisions have specific penal sanctions. This is public law and is at odds with the claim that the firm is 'a private institution governable only by rules of commercial law and not an appropriate vehicle

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[315] See Dine *Corporate Groups* 122; Esser & Delport 'Part 1'; IM Esser & P Delport 'The protection of stakeholders: The South African social and ethics committee and the United Kingdom's enlightened shareholder value approach: Part 2' (2017) 50 *De Jure* 221.
[316] Kraakman et al *The Anatomy of Corporate Law* 19.
[317] [1915] AC 705.
[318] Bainbridge 'The means and ends of corporate governance' 572.
[319] AK William & JC Coffee Jr *Business Organisation and Finance: Legal and Economic Principles* 7 ed (2000) 108–109, cited in Bainbridge 'The means and end of corporate governance' 553.
[320] Kraakman et al *The Anatomy of Corporate Law* 1–4.

for regulation'.[321] In addition, there is the limitation on the *locus standi* of the various parties. The creditors and employees, for example, their various contracts with the firm notwithstanding, have no *locus standi* under the statutory contract.[322]

It is contended that a corporate structure designed solely in terms of the contractarian theory loses its traction on a number of fronts. First, contractarians do not provide a measure of what amounts to 'minimum interference'.[323] The theory offers little explanation on public policy which binds the firm outside of the contractarian spectrum. Second, shareholders who are the only parties to the contract with the firm under s 21 of CA 2012, or its equivalent in SACA 2008, suffer severe limitations under the law in enforcing the contract.[324] Finally, pressure from stakeholder constituencies such as communities who are affected by a firm's activities and to which firms have to respond cannot be attributed to contract.

However, the discussion in chapter 4 shows that these limitations do not cut across the company divide. The quasi-partnership companies or limited liability partnerships ('LLPs') are business forms which are founded on private contracts and mutual trust among the members. In some instances, the discussion shows that courts have over-looked corporation law in favour of equitable remedies founded on private contracts. To that extent, private contracts are complementary to legislation in formulating a corporate structure for SCHCs.

2.2.3 Stakeholder theory

The stakeholder discourse in corporate law in its basic form is on the centre of power within the firm's corporate governance structure and the purpose of the firm. Kraakman et al[325] offer some insight into this question. The old orthodoxy is that the firm is run for

[321] Tudway 'The juridical paradox of the corporation' 66.
[322] See para 2.2.1; Ziegel 'The quiet revolution' 517–521; Bainbridge 'Director primacy' 1.
[323] Dine *Corporate Groups* 107.
[324] See para 2.3; generally, Reisberg 'Shareholders' remedies.'
[325] Kraakman et al *The Anatomy of Corporate Law* 28–29; Ajibo 'A critique' 40–48.

the sole benefit of shareholder value and that shareholders should have ultimate control of the firm.[326] In the shareholder value model, shareholders cede corporate power to managers to be exercised for the shareholders' benefit – shareholder primacy.[327]

On the other hand, Ho[328] has suggested that the 'state corporate laws – as a rule – generally do not give non-shareholders any means of directly influencing corporate affairs, nor do they mandate management attention to stakeholder interests.'[329] The limitations, according to Ho, relate to 'the rights of shareholders to elect directors, vote on major corporate transactions, ratify interested transactions, submit proposals for inclusion in the corporate proxy, sue derivatively and benefit from court-enforced director and fiduciary duties, [and] are – with few exceptions – not extended to other corporate stakeholders.'[330]

The stakeholder-oriented management model seeks to redefine the purpose of the firm as known in shareholder value[331] to suggest that managers are obliged to consider non-shareholder interests in corporate decisions for long-term corporate objectives.[332] The theory contests the 'ownership' claim under shareholder primacy,[333] and the assertion that shareholders have a higher stake than other constituencies in the corporation,[334] or that corporate stakeholders are much more protected than shareholders under statute.[335] At the onset, however, it ought to be observed that the place of non-shareholder constituents in corporate governance and the enforcement of their interests remains a controversial subject in corporation law in Anglo-America.[336]

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[326] Hansmann & Kraakman 'The end of history' 468; Bainbridge 'The means and ends of corporate governance' 573.
[327] Ajibo 'A critique' 40–41.
[328] VH Ho 'Enlightened shareholder value: Corporate governance beyond shareholder-stakeholder divide' (2010) 36 *J Corp L* 59–112 at 76.
[329] Ibid.
[330] Ibid 77.
[331] Dodd 'For whom are corporate managers trustees?' 1160.
[332] Section 172(1)*(a)* of CA 2006.
[333] See G Haydon & TM Bodie 'Shareholder democracy and the curious turn toward board primacy' (2010) 51 *Wm & Mary L Rev* 2071–2121 at 2083–2085.
[334] Ibid 2087.
[335] Hansmann & Kraakman 'The end of history' 441–442, also cited in Ajibo 'A critique' 41.
[336] Hansmann & Kraakman ibid 447–449.

In the present discussion, the following conceptual issues under the stakeholder-oriented model are explored: (1) the purpose of the firm;[337] (2) the scope of managerial duty to stakeholders; (3) deficiencies in corporate governance in Anglo-America;[338] and, not least, (4) stakeholder enforcement models that have evolved, upon which the proposition in chapter 6 for the enforcement of the CoCG outside the CA 2012 framework is founded. It is contended that the stakeholder manager model is an overlap between concession and contractarian theories. However, the 'best interest of the company'[339] test is central in formulating any stakeholder management model.

Thus, it is proposed that, despite the stakeholder manager model being applied largely in large public corporations, its application in SCHCs need not be exclusively reliant on the physical size of the firm. The SEC requirements under SACA 2008 suggest that the stakeholder manager model may be employed in firms based on other policy considerations.

Second, the study explores two enforcement models: the representative model, where stakeholders participate directly in corporate governance. The King Code in South Africa falls into this category and yet it has application in both public and private companies. I therefore propose that the review of the CoCG be broadened beyond the Minister and the CMA and be led by a member-based entity outside of CA 2012.[340] The second enforcement model is the fiduciary model,[341] where stakeholders' interests are left to the value judgment of managers, and the implications for corporate governance in SCHCs. I argue that where corporate law is deficient on stakeholder remedies, combined stakeholder social pressure from the affected broader public forces managers to adopt responsive board strategies in order to survive. I conclude that despite opposition from

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[337] Anabtawi 'Some skepticism' 561–565. See *Dodge v Ford Motor Co* 170 NW 668 at 684 (Mi. 1919), cited in LA Bebchuk 'Federalism and the corporation: The desirable limits on state competition in corporate law' (1992) 105 *Harv L Rev* 1435–1510 at 1492.
[338] Keay 'Has it got what it takes?' 3.
[339] Esser & Delport 'Part 1' 105; s 172(1) of CA 2006, reproduced in J Lowry 'The duty of loyalty of company directors: Bridging the accountability gap through efficient disclosure' (2009) 68(3) *CLJ* 607–622 at 614–615.
[340] See the full discussion in para 6.5.
[341] Hansmann & Kraakman 'The end of history' 447–449.

shareholder value proponents, policy intervention in the US, Germany, the UK and South Africa points to the stakeholder debate transcending the academic discourse.

2.2.3.1 Key aspects of the stakeholder-oriented model

In stakeholder theory, firms have obligations beyond shareholder value, and must consider other legitimate corporate stakeholders such as employees and creditors.[342] The reasons for this are diverse and include ethical and economic considerations.

The stakeholder model views the firm as an economic institution with a public duty.[343] In a sense, 'managers were no longer attorneys for stockholders; they were becoming trustees of an institution.'[344] The notion of the firm 'as an institution'[345] is the entry point for corporate stakeholders and, conversely, the point of departure and the epicentre of the tension for shareholder primacists. Corporate stakeholders have a stake in the firm, or are affected by or can affect the operations of the firm in the same way as shareholders.[346] The corporate stakeholder list is broad and has grown to include employees, creditors, suppliers, consumers, non-governmental organisations ('NGOs'), the press and environmentalists.[347] A forward-looking firm cannot afford to ignore these groups in order to exclusively prefer shareholder value.[348]

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[342] ER Freeman 'Stakeholder theory' (1984), cited in D Thomas & EL Preston 'The stakeholder theory of the corporation: Concepts, evidence, and implications' (1995) 20(1) *The Academy of Management Review* 65–91 at 65, available at http://www.jstor.org/stable/258887; Keay 'Has it got what it takes?' 11; J Heath & W Norman 'Stakeholder theory, corporate governance and public management: What can history of state-run enterprises teach us in the post-Enron era?' (2004) 53 *J Bus Ethics* at 247–265; J Dean *Directing Public Companies: Company Law and the Stakeholder Society* (2001) 11, 14, 93.
[343] Campbell 'Why regulate the modern corporation? The failure of "market failure"' in J McCahery et al (eds) *Corporate Control and Accountability* (1993) 103, cited in Dine 'Corporate groups' 23; JE Parkinson *Corporate Power and Responsibility* (1993) 23, cited in Dean *Stakeholder Society* 5.
[344] Dodd 'For whom are corporate managers trustees?' 1154.
[345] Ibid 1148–1150.
[346] Freeman 'Stakeholder theory' 25, cited in Dean *Stakeholder Society* 99.
[347] Keay 'Has it got what it takes?' 9.
[348] Sections 5 and 7 of SACA 2008.

Dean categorises stakeholders as 'primary' and 'secondary' stakeholders. According to her,

> primary stakeholders are all those who count on a 'strictly' business basis, without whom the business simply could not function. They consist of managers …, customers, employees, shareholders and suppliers. These participants all require day to day and month to month attention from directors and legally, this needs to be acknowledged in any new Companies Act. Secondary stakeholders have influence and effect in specific, important situations of concern to them. The national and local media …, the community and the environment, all of which can be essential to success at critical times, fall in this category.[349]

Dean's classification above underscores the proposition that corporate governance structures which seek to define corporate stakes based only on contractual relationships or shareholder value are limiting in scope.

Moreover, the stakes are diverse, and conceptually it would be erroneous to treat them as a 'means to an end'.[350] Rather, corporate stakes are 'ends'[351] in their own right. It is contended that the firm need not adopt a uniform stakeholder intervention in respect of the various stakeholder interests, since their interests are not the same.[352] Some stakeholders, such as employees and creditors, expect monetary gain, while others, like the community, are satisfied when the corporation's activities do not affect their lives negatively. This classification answers, in part, counter-arguments about the problem of 'too many masters and no master'.[353]

In stakeholder theory, the foundational concept is a stake and not a master, as it were. The view, therefore, that the pursuit of shareholder value aligns with the firm's interests, as a reason for the priority of shareholder interests over other stakeholder

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[349] Dean *Stakeholder Society* 103.
[350] Freeman 'Stakeholder theory' 67.
[351] Ibid 73. See the related arguments by Dean *Stakeholder Society* 19.
[352] AB Carroll *Business and Society: Ethics and Stakeholder Management* 3 ed (1996) 73.
[353] Keay 'Has it got what it takes?' 36.

interests, is contested. Judicial opinions suggest that 'there is not absolute congruence between the interests of shareholders and the interests of the company.'[354]

It is averred that shareholding in a firm is an ascertainable interest with no peculiarity to justify preferential consideration over and above what is contractually due under it, namely, dividends. The grant of veto powers and voter rights to employees (very much shareholder status) through codetermination statutes in Germany over the constitution of management boards in large public companies,[355] or where 'contracts drafted by creditors of the corporation frequently restrict the implementation of shareholder primacy'[356] supports this assertion.

Thomas and Preston summarise stakeholder theory in '[t]heir central theses' as being descriptive, instrumental and normative.[357] These adjectives mean, respectively, 'the way things are, interdependence of corporate participants';[358] 'focus on the business objectives, analysis to aid profitability';[359] and 'pronouncements on ethics, principles of participation in business.'[360] Under the theory, the concept of a 'stake' in the firm is definitive. The stake is much broader, and encompasses 'an interest',[361] 'a share in an undertaking',[362] 'a claim',[363] 'an assertion to a title or right to something',[364] or 'a demand for something due or believed to be due'.[365]

Carroll opines thus:

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[354] Dine *Corporate Groups* 31; Keay ibid 3.
[355] Kraakman et al *The Anatomy of Corporate Law* 101.
[356] F Tung 'The new death of contract: Creeping corporate fiduciary duties for creditors' (2008) 57 *Emory LJ* 809 at 853, cited in Keay 'Shareholder primacy' 3.
[357] Thomas & Preston 'The stakeholder theory' 67.
[358] CWL Hill 'Stakeholder-agency theory' (1992) 29 *J Management Studies* 131, cited in Dean *Stakeholder Society* 97.
[359] LE Preston & HJ Sapienza 'Stakeholder management and corporate performance' (1990) 19 *J of Behavioural Economics* 361, cited in Dean ibid.
[360] LK Harrington 'Ethics and public policy analysis: Stakeholders' interests and regulatory policy' (1996) 15 *J Bus Ethics* 375, 379–380, cited in Dean ibid.
[361] Carroll *Business and Society* 72.
[362] Ibid.
[363] Ibid.
[364] Ibid.
[365] Ibid.

> The idea of a stake, therefore, can range from simply an interest in an undertaking at one extreme to a legal claim of ownership at the other extreme. In between these two extremes is a right to something. This right might be a legal right to certain treatment rather than a legal claim of ownership such as that of a shareholder. A stakeholder, then, is an individual or group that has one or more of the various kinds of stakes in a business. Just as stakeholders may be affected by actions, decisions, policies, or practices of the business firm, these stakeholders also may affect the organisation's actions, decisions, policies, or practices. With stakeholders, therefore, there is a potential two-way interaction or exchange of influence.[366]

Citing Freeman,[367] Carroll concludes that 'in short, a stakeholder may be thought of as any individual or group who can affect or is affected by the actions, decisions, policies, practices, or goals of the organisations.'[368]

The passage from Carroll suggests that the stakeholder-oriented model overlaps with other theories on corporate governance: the communitarian and concession theories. The nexus with stakeholder theory is that the communitarian theory '[s]ees the grant of company status not only as a concession by the state but as creating an instrument for the state to utilise'.[369] The concession theory, on the other hand, posits that the firm is 'a concession by the state, a product of legislation which is subject to, and can be shaped by regulation'.[370] Thus, read together, these two theories give the firm a public character with a social duty, whose affairs can be shaped by public considerations outside shareholder value.[371]

Parkinson states that

> [s]ince the public interest is in the foundation of the legitimacy of companies, it follows that society is entitled to ensure that corporate power is exercised in a way which is consistent with that interest. To describe companies as social enterprises is

[366] Ibid.
[367] Freeman 'Stakeholder theory'.
[368] Carroll *Business and Society*.
[369] Dine *Corporate Groups* 17.
[370] Braithwaite & Drahos *Global Business Regulation* 145.
[371] Dodd 'For whom are corporate managers trustees?' 1153.

> thus to make a claim about the grounds of their legitimacy, and its practical significance is to hold that the state is entitled to prescribe the terms on which corporate power may be possessed and exercised.[372]

The above passage resonates with the remarks by Dodd alluded to earlier.[373] The two scholars illustrate the potential tension between those who regard themselves as having a stake, and those who are affected by the operations of the corporation. In either case, the pursuit of shareholder value can be constrained by the state on possession and exercise of corporate power. The stakeholder theory seeks to demonstrate the importance of stakeholder relationships for the overall good of the enterprise.[374]

2.2.3.2 Stakeholder theory in historical perspective

There are conflicting accounts about the identity of the original proposer of today's stakeholder theory. Keay has referred to some of these accounts.[375] According to Keay, the theory is sometimes attributed to Edward Freeman, and at other times it is suggested that stakeholder theory can be traced back to the work of a German social theorist, Johannes Althusius, who lived in the seventeenth century.[376] Keay also refers to J Maurice Clark in 1916[377] and Mary Parker Follet in 1918.[378] Keay further asserts that

> it is possible to see this theory in some incipient form in the work of Professor E. Merrick Dodd in the early 1930s, and a form of it was applied by academics like Edward Mason and Carl Kaysen in the 1950s as well as being practised by many successful American companies in the period from the 1920s to the 1950s.[379]

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[372] JE Parkinson *Corporate Power and Responsibility* (1993) 23, cited in Dean *Stakeholder Society* 5.
[373] Dodd 'For whom are corporate managers trustees? 1149.
[374] Keay 'Has it got what it takes?' 10.
[375] Ibid 5–6.
[376] Ibid 5.
[377] Ibid.
[378] Ibid.
[379] Ibid.

Keay must be referring to Dodd's seminal article, 'For whom are corporate managers trustees?'[380] Keay, however, suggests that 'the development of the theory in its organised form is usually traced to R. Edward Freeman.'[381] He is correct. This latter assertion is corroborated by Thomas and Preston.[382]

According to Thomas and Preston,[383] '[t]he idea that corporations have stakeholders has now become commonplace in the management literature, both academic and professional.'[384] They add that 'since the publication of Freeman's landmark book, *Strategic Management: A Stakeholder Approach* (1984), a dozen books and more than 100 articles with primary emphasis on the stakeholder concept have appeared.'[385] Freeman's most quoted proposition is that a stakeholder is 'any individual or group who can affect or is affected by the actions, decisions, policies, practices, or goals of the organisations.'[386]

Nevertheless, whatever the history of stakeholder theory, the central thesis in the theory appears to be that the application of shareholder value to define the notion of a 'stake' or purpose of the firm has been qualified or, at least, modified. The stakeholder-oriented model evolved initially as corporate social responsibility– still is in some respects. The stark difference is that the theory today enjoys some legislative as well as judicial recognition in some jurisdictions.[387]

The literature reviewed suggests that what has come to be known as 'the debate' between Dodd[388] and Berle[389] in the 1930s is an easy reference point for the history of the foundational aspects of stakeholder theory and, in particular, the purpose of the firm.

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[380] Dodd 'For whom are corporate managers trustees?'
[381] Keay 'Has it got what it takes?' 5.
[382] Thomas & Preston 'The stakeholder theory' 65.
[383] Ibid.
[384] Ibid.
[385] Ibid.
[386] Ibid 25, also cited in AB Carroll *Business and Society: Ethics and Stakeholder Management* 3 ed (1996) 74.
[387] Section 172(1) of CA 2006, cited in Ajibo 'A critique' 51.
[388] Dodd 'For whom are corporate managers trustees?' 1147–1150.
[389] Berle 'Powers in trust' 1049.

Thus, both historically and in the present, the central theme in the stakeholder-oriented model appears to be the notion that the firm is an institution. Berle's central thesis was that corporate power is exercised for shareholder value.[390] Dodd, on the other hand, regarded corporations as 'economic institutions' with 'a social service role to play'.[391]

This study avers that in the strict corporation law sense there are no significant contradictions in the Berle–Dodd discourse, particularly because Dodd clearly acknowledged that 'firms were obliged to make profits for shareholders, but also owed responsibilities to employees, customers and the general public.'[392] In effect, the stakeholder theory only underscores the stakeholder relationship as an advancement of the firm interests from which all the other corporate stakeholders associated with the firm can benefit proportionately.

2.2.3.3 Stakeholder theory in common law

In one of the most widely quoted cases in common-law jurisdictions, *Hutton v West Cork Rly Co*,[393] Lord Bowen LJ pointed to the ad hoc stakeholder-oriented model alongside shareholder value. The brief facts of this case were as follows:

> A railway company which had no provision in its articles for paying for remuneration to directors, and had never paid any, sold its undertaking to another company at a price to be determined by an arbitrator. By the Act authorising the transfer it was provided that on the completion of the transfer the company shall be dissolved except for the purposes of regulating their internal affairs and winding up the same and of dividing the purchase money. After the completion of the transfer a general meeting of the company was held at which a resolution was passed to apply £ 1050 of the purchase money in compensating the paid officials of the company for their loss of employment, although they had no legal claim for any

[390] Ibid.
[391] Keay 'Shareholder primacy' 4.
[392] Dodd 'For whom are corporate managers trustees?' 1148.
[393] [1883] 23 Ch D 654.

> compensation, and £ 1050 in remuneration to the directors for their post services. A Holder of a debenture stock in the company who dissented from the resolution, in an action sought to restrain the company by way of injunction, from applying the £ 4000 in the manner proposed. The remedy was refused by Fry J. hence appeal to the Court of Appeal.

On a 2:1 (Baggalley LJ) dissenting held

> that a Company carrying on business has power, by the vote of general meeting, to expend a portion of its funds in gratuities to servants and directors, provided such grants are made for the purpose of advancing the interests of the company. But this does not apply to a case where the company has transferred its undertaking to another company and is being wound up.

Bowen LJ observed as follows:

> The law does not say there is to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.

Bowen's observation has been the subject of numerous scholarly interpretations. But generally, there seems to be consensus that firms can give corporate gifts and charity within reasonable limits if this benefits the firm.[394] Perhaps with a difference in approach, there is a similarity between Bowen's speech and the views of Dodd[395] in the Berle–Dodd debate, approximately 50 years later. Therefore, it is contended that legislation can provide for 'cakes and ale' within clear and reasonable parameters.

[394] Mayson et al *Company Law* 87; Gower 5 ed 169; Ajibo 'A critique' 50.
[395] Dodd 'For whom are corporate managers trustees?' 1148–1150.

2.2.3.4 Stakeholder theory in legislation

Although controversial, there are conspicuous examples of stakeholder orientation in legislation: s 172(1) of the UK's CA 2006 and the constituency statutes[396] in the US. The common feature in s 172(1) and the constituency statutes is that managers are authorised or required, in some cases, to consider non-shareholder interests when making corporate decisions.[397] Critics have cast doubt on the efficacy of this corporate model and have claimed that it presents no particular legal framework that is different from shareholder value. One common criticism is that the so-called non-shareholder constituents such as employees or creditors cannot enforce their rights under these laws – a point to which I will return.

Nonetheless, it is contended that both s 172(1) and the constituency statutes provide a legal basis for managers to consider non-shareholder constituencies in their decisions. A cursory reading of s 172(1), however, suggests no legislative intention to grant enforcement rights to constituencies named therein or to shareholders. At best, it is contended that s 172(1) and the constituency statutes are only management tools for corporate managers in given circumstances informed by the realities of modern business life. Managers have the discretion about how to enforce the provision, with no opportunity for shareholders to intervene. The terms and conditions in the business judgment rule and derivative actions, in the case of the US and the UK, respectively, would apply.

The enforcement model in s 172(1) of CA 2006 and the constituency statutes present the 'fiduciary' model of the corporation, in which the board of directors' functions as a neutral coordinator of the contributions and returns of all the firm's stakeholders.[398] Drawing on judicial precedents which have qualified shareholder

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[396] A Keay 'Moving towards stakeholderism? Constituency statutes, enlightened shareholder value, and all that: Much ado about little?' Working Paper, 4 January 2010, 1–57 at 9–26, available at https://ssrn.com/abstract=153990 (accessed 18 January 2018).
[397] Ibid 9.
[398] Hansmann & Kraakman 'The end of history' 447.

value,[399] it is contended that the fiduciary model is effective if shareholder interests are divorced from the firm's interests. This gives managers the flexibility to focus on long-term corporate objectives, driven only by what is in the interests of the company as a whole, as well as to determine when to consider stakeholder interests.

Second, it preserves the manager's contractual prerogative to make corporate decisions. Shareholder contestation of the managerial considerations of non-shareholder interests, in the absence of statistical data to the contrary, is likely to suffer major setbacks from the precedent in cases like *Foss v Harbottle*,[400] bottlenecks in derivative suits or the business judgment rule. Thus, as predicted by Dodd, managerial attitude, rather than the courts,[401] will give effect to the stakeholder-oriented model in legislation.[402]

Therefore, Keay's prediction that a contrary interpretation of s 172(1) to shareholder value would invite shareholder derivative suits to challenge managerial decisions is yet to happen.[403] The fact of the matter is that the 'early implementation experience there suggests that the anticipated flood of shareholder suits has not materialised. Rather, the primary effect of the law has been to urge companies to more carefully document their consideration of the impact of corporate decisions on stakeholders.'[404]

The second stakeholder model is German codetermination. It is a

> '[r]epresentative' model of the corporation, where two or more stakeholder constituencies appoint representatives to the board of directors, which then

[399] *BCE Inc v 1976 Debentureholders* [2008] SCC 69; *Peoples' Department Stores v Wise* [2004] SCC 68 (Canada), cited in Keay 'Towards stakeholderism' 53–54.
[400] K Idensohn 'The fate of Foss under the Companies Act 71 of 2008' (2012) 24(3) *SA Merc LJ* 355–360 at 355–358.
[401] *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306.
[402] Dodd 'For whom are corporate managers trustees?' 1153 at 1154–1161.
[403] Keay 'Corporate objective' 600; Loughrey et al 'Shaping corporate governance' 96–101.
[404] Ho 'Enlightened shareholder value' 92.

> elaborates policies that maximise the joint welfare of all stakeholders, subject to the bargaining leverage that each group brings to the boardroom table.[405]

Codetermination grants direct representation rights to employees on the upper boards of large German corporations.[406] They have the power to appoint or veto appointments to the management board.[407] The German model is prevalent in Eastern Europe.[408] The German codetermination model essentially elevates employees to shareholder status by granting them veto rights on specific corporate governance issues without any shareholder input. Indeed, if appointing the board by shareholders is a universal fundamental feature of a modern firm, as argued by Kraakman et al,[409] then the German codetermination corporate model has redefined the shareholder value concept dramatically.

Moreover, the meaning of 'stake'[410] in the firm has also been redefined. The popular view posited by shareholder value proponents is that shareholders have a greater risk and stake in the firm than all others, by virtue of their capital contribution, and are thus better placed to direct the affairs of the firm.[411] Although applicable only in large public firms, German codetermination is a significant departure from the latter position, where employee ascendancy to the supervisory board is founded on statute rather than on the traditional shareholder appointment.

The third model is the South African model. Under s 72(4) of SACA 2008, prescribed firms are required to have a social and ethics committee ('SEC') in place. The SEC is a committee of the board of directors and is mandated to report on social aspects of the firm.[412] The SEC is constituted by the Minister if this is desirable and in the public

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[405] Hansmann & Kraakman 'The end of history' 448.
[406] Hodge 'The treatment of employees as stakeholders' 116.
[407] Kraakman et al *The Anatomy of Corporate Law* 101.
[408] Hodge 'The treatment of employees as stakeholders' 97.
[409] Kraakman et al *The Anatomy of Corporate Law* 12–14.
[410] Carroll *Business and Society* 72.
[411] Hansmann & Kraakman 'The end of history' 449.
[412] Regulation 43(5) of the Companies Regulations, 2011.

interest, having regard to annual turnover, workforce size, or the nature and extent of the activities of the companies.[413]

In the discharge of its functions the SEC is guided by, among others, the ten principles set out in the United Nations Global Compact Principles.[414] Although it is a soft instrument, the UN Global Compact 'brings companies together with UN agencies, labour, civil society and governments to advance universal environmental and social principles in order to foster a more sustainable and inclusive world economy.'[415] Quite obviously, the parameters of the establishment of a SEC go far beyond shareholder value.[416]

Therefore, while shareholder value will remain dominant for the foreseeable future, the means to achieve it remains the subject of public opinion.[417] The firm can be coerced into adopting certain policy considerations completely parallel to shareholder value, regardless of the type of the firm.[418] The hypothetical 100-employee firm suggests that once a firm has attained public attributes, it easily attracts more stakeholders, most of whom it has no direct formal contracts with.

2.2.3.5 Informal stakeholder-oriented model

Outside of judicial precedent and legislation, the debate on the stakeholder-oriented model among corporates has not ceased. As already pointed out, in the US there is an ongoing ambitious project dubbed 'Project Syndicate', led by Mark Roe.[419] Project Syndicate started in August 2019 with a Business Roundtable, which comprised the CEOs of America's largest companies, with a combined annual revenue of more than

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[413] Section 72(4) of SACA 2008.
[414] Regulation 5*(a)*(i).
[415] For details on the Global Compact Principles, see http://www.unglobalcompact.org/AboutTheGC/index.html.
[416] See Esser & Delport 'Part 1' 227–230, for a critique of the SEC.
[417] Dodd 'For whom are corporate managers trustees?' 1149.
[418] Parkinson 'Corporate power' 23.
[419] Mark J Roe is David Berg Professor of Law at Harvard Law School in the US.

US$7 trillion. Remarkably, the discussion centred on ‘stakeholder capitalism’. The Major Projects Agreement (‘MPA’) for the construction of Heathrow Airport’s Terminal 5, executed by and between the employer and employees,[420] and informal employee referenda,[421] are conspicuous examples of informal stakeholder-oriented models from which policy reformers in Uganda can draw lessons.

2.2.3.6 Stakeholder-inclusion-participation approach

To adopt the definition in the Cadbury Report, which defined corporate governance as ‘the system by which companies are directed and controlled’,[422] it is apparent that the normative corporate law position is that companies are directed and controlled by managers, and other corporate stakeholders are excluded.[423] Therefore, stakeholder inclusion in the corporate governance structure is not a popular phenomenon in corporate law. However, stakeholder adherents assert that corporate intervention in the various legitimate stakeholder interests need not be uniform.[424] There are examples to support this assertion.

In South Africa, the King Code operates outside of the conventional corporate structure – outside of the board and members or any legislation. The composition of King Code committee is broad and representative. King III, for example, was supported by 13 professional bodies, which included Chartered Secretaries South Africa, the Companies and Intellectual Property Registration Office, the Compliance Institute of South Africa, the Direct Marketing Association of South Africa, the Ethics Institute of South Africa, the Independent Regulatory Board for Auditors, the Institute of Internal Auditors (SA), the JSE Limited, the Securities Regulation Panel, the South African

[420] Hodge ‘The treatment of employees as stakeholders’ 117.
[421] Bodie ‘Corporate combinations’ 878–882, 904.
[422] ‘The Report of the Committee on the Financial Aspects of Corporate Governance’ 1 December 1992 (‘the Cadbury Report’) para 2.5.
[423] TL Blackburn ‘The unification of corporate laws: The United States, the European Community and the race to laxity’ (1994) 3 *George Mason Independent L Rev* 1 at 53, cited in R Drury ‘The Delaware syndrome’ (2005) *J Bus L* 1–24 at 8.
[424] Dean *Stakeholder Society* 103.

Chamber of Commerce and Industry, the South African Institute of Chartered Accountants, the South African Institute of Professional Accountants, and the University of Pretoria: Centre for Responsible Leadership.[425]

Drawing on the composition of King Code committee, it is argued that the proper enforcement of the CoCG requires expertise beyond the Minister and the CMA. The fairly extensive provisions in the CoCG address broad issues such as: accounting, integrated sustainability reporting, social issues, ethical issues, health and safety issues, and the environment. Most of these concepts are sector-specific concepts, particularly the environment and accounting and audits, and will be better served by including other professional bodies in those areas to help refine these concepts. This is the King model.

Finally, there have been some statutory interventions with respect to access to information by creditors, which can be construed as intended to facilitate stakeholder engagement in company matters. A conspicuous case is SACA 2008. Section 26 of SACA 2008 gives a right of access to, or to inspect or copy, company records to a person who holds or has a beneficial interest in any securities issued by a profit company, or who is a member of a non-profit company on such terms under the provision. This development represents a departure from the normative corporate law position, which barred the disclosure of corporate information to 'third parties.'[426]

2.2.3.7 Selected criticisms of stakeholderism

I will not attempt to examine the criticisms of stakeholderism in their entirety. I will focus on criticisms which relate to the legal framework for stakeholder enforcement in line with the proposal for the enforcement of the CoCG outside of CA 2012. The first specific criticism arises from the assertion that companies are managed for shareholder

[425] King III 7.
[426] WJ Carney 'The production of corporate law' (1998) 71 *Southern Cal L Rev* 715 at 761, cited in Kraakman et al *The Anatomy of Corporate Law* 715.

value.[427] Non-shareholder interests, so the argument goes, can be considered only if the overall object is to promote shareholder value.[428] The second criticism is that the stakeholder manager model 'lacks precision as it fails to provide a way of balancing the conflicting interests of different stakeholders'; 'stakeholders have no way of enforcing any failure on the part of the directors to consider interests appropriately.'[429] The third criticism is that stakeholder theory creates 'too many masters and no master', leaving managers 'accountable to none'.

This latter criticism speaks to the constituency statutes in the US and the enlightened shareholder value provisions in the UK.[430] In the US, 'over half of the states have a provision allowing directors to make certain decisions based on the needs of all corporate constituencies.'[431] The same stakeholder conceptual consideration is borne out in s 172(1) of the UK's CA 2006.[432]

While shareholder value remains a core obligation for managers in terms of s 172(1), read as a whole, the provision grants managers reasonable discretion, motivated by their good faith, to consider other interests that are not the interests of members, if this is for the purpose of promoting the interests of the firm as a whole. A purposive interpretation of the provision suggests that company interests in some instances supersede shareholder value.

Moreover, the 'balancing' act under stakeholder theory is ordinarily a matter for managerial discretion informed by the prevailing circumstances.[433] The test to be applied is one of managerial good faith. Griffith has considered the challenges that shareholders

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[427] Berle 'Powers in trust' 1049.
[428] *Hutton v West Cork Rly Co* [1883] 23 Ch D 654 at 672–673 (Bowen LJ).
[429] Keay 'The corporate objective' 611; Williams 'Enlightened shareholder value in UK company law' 367.
[430] Williams ibid.
[431] Bodie 'Corporate combinations' 906.
[432] Ajibo 'A critique' 43.
[433] Ibid.

face in any attempt to impeach managerial good faith and the exercise of discretion in this regard through the courts and concludes that it is a hurdle.[434]

Contrary to the arguments which suggest that shareholders may institute derivative actions for the wrongful consideration of non-shareholder interests,[435] managers enjoy relative discretion regarding business decisions. Corporate concepts such as the business judgment rule and organic theory will require shareholders to justify such action.[436] The power and discretion to enforce the EVS provisions or a constituency statute are managerial issues, not shareholder issues. Thus, shareholder action to contest such an exercise of discretion in favour of non-shareholder interests is bound to fail.[437] Given the breadth of stakeholder interests, it appears that, by design, there is no legislative intention to grant enforcement rights to stakeholders.[438]

The challenges associated with stakeholder enforcement rights were acknowledged during the South African company law reform process. The SADTI Report noted that 'allowing enforcement rights to all legitimate stakeholders in company law would lead to multiplicity of unnecessary and avoidable litigation.'[439] There is merit to this concern. Hansmann, for example, asserts that

> [i]ndeed, it appears that codetermination [which grants participatory rights to employees] has not had a substantial impact on firm decision-making at the board level, which continues to be dominated by shareholder interests in firms outside the iron and steel industry. Rather, the worker representatives to the advisory board arguably play a largely informational role, providing a credible source of information from the firm to the workers (and vice versa) in support of the workers engaged in conducting union bargaining and in the work councils where the real workers' influence takes place.[440]

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[434] Griffith 'Good faith business judgment' 10–11.
[435] Keay 'The corporate objective' 600; Loughrey et al 'Shaping of corporate governance' 96–101.
[436] Griffith 'Good faith business judgment' 10–11.
[437] Ho 'Enlightened shareholder value' 74–75, 92.
[438] The use of the phrase 'among other matters' in s 172(1) is broad.
[439] SADTI Policy Report 26.
[440] Hansmann 'Worker participation and corporate governance' 602.

Bodie has separately made out a case for worker participation through non-binding referenda on corporate combinations so that managers get feedback on what employees feel about a corporate combination.[441] Bodie's non-binding referenda theory, as well as Hansmann's argument above,[442] emphasise the need for managers to share corporate information with employees. Shaikh surveyed employees' demands for financial and other information and established that 'an overwhelming percentage of respondents demand financial and other information from their companies.'[443]

From the foregoing discussion, it can be determined that there is no specific intention to adopt a representative model for stakeholder enforcement. The popular stakeholder enforcement model appears to be 'fiduciary', where managerial discretion to make business decisions is protected, although with a legislative managerial re-orientation to stakeholderism. This is the import of legislative provisions such as s 172(1) of the UK's CA 2006, the constituency statutes in the US, or the SEC requirements in South Africa.

By and large, the criticisms of the stakeholder manager model are based on scholarship. In the absence of a judicial decision thereon, these remain subjective. No one can be certain how the courts will interpret the EVS provisions in the UK or the constituency statutes in the US in the future. Moreover, the financial crises of 2008 to 2009[444] call for a rethink of shareholder absolutism over long-term corporate objectives.[445]

The obvious advantage of the stakeholder manager model is that, first, there is only one master – the corporation, to which all other interests are subordinated, including shareholder value.[446] This is the strict application of corporate law as espoused

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[441] Bodie 'Corporate combinations' 902.
[442] Hansmann 'Worker participation and corporate governance' 602.
[443] AH Shaikh 'Corporate employees' demand for financial information: An empirical study' (1999) 35(2) *Indian J Ind Relations* 145–159 at 148.
[444] Williams 'Enlightened shareholder value in UK company law' 360.
[445] *Hutton v West Cork Rly Co Ltd* (1883) LR 23 Ch D 654 at 673, cited in Williams ibid 365.
[446] *Percival v Wright* [1902] 2 Ch 421.

in cases such as *Salomon*.[447] Second, it is participatory and all-inclusive. The King Code model – not founded on any statutory law – supports this proposition. Thus, it is submitted that where the circumstances are such that the firm's interests require that the other corporate stakeholder interests be taken into account, managers, acting in good faith, would be perfectly entitled to do so. This must be the import of s 172(2) of CA 2006, as is the case with stakeholder participation.

Thus, with the exception of Germany, where employees through codetermination law participate directly in decision-making at board level,[448] the enforcement of corporate stakeholder interests under the stakeholder manager model in its perfect form is through managers or other informal interventions.

The reference, therefore, to the ESV provisions in CA 2006 as 'lame duck' provisions,[449] 'because there are no cases involving any breach of the provision',[450] is problematic. This is because the intention in those laws, save for a few states in the US,[451] is not to grant enforcement rights to stakeholders. Rather, the intention is to protect managers from shareholder actions when they take stakeholder interests into account. Thus, the measure of success of the ESV provisions in the UK based solely on the absence of court cases filed to enforce the ESV provisions is quite correct.

[447] [1897] AC 22.
[448] Bodie 'Corporate combinations' 879.
[449] Keay 'Corporate objective' 593.
[450] Ibid 593.
[451] Keay 'Towards stakeholderism' 9.

2.2.3.8 A rejoinder

Despite the criticisms,[452] the positive side of the stakeholder manager model is being acknowledged by even ardent proponents of shareholder value.[453] Bowen LJ once remarked:

> Directors are not to keep their pockets buttoned up and defy the world unless they are liable in a way which could be enforced at law or in equity most businesses require liberal dealings … it is for the directors to judge. The carrying on of the business of the company, and a company which always treated its employees with Draconian severity, and never allowed them a single inch more than the strict letter of the bond, would soon find itself deserted – at all events, unless labour was very much more easy to obtain in the market than it often is.[454]

Bowen's opinion is consistent with stakeholder theory.

It is contended that the growth of legislation in the US, Europe and South Africa that articulates stakeholder concepts illustrates a progressive policy shift from a predominantly shareholder value corporation law to one with a stakeholder-oriented approach. The debate as to whether these statutes mean anything can continue. But the fact of the matter is that the stakeholder debate has transcended academic discourse. The said statutes allow managers to consider non-shareholder interests without fear of possible shareholder actions. With these developments, it is suggested that, perhaps, Hansmann and Kraakman's claim that 'shareholder value has triumphed'[455] came a little too soon.

While pointing out the challenges of the managerial pluralism model, Keay acknowledges the utility of these statutes among managers. He argues that providing for

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[452] Keay 'Has it got what it takes?' 23–44; Keay 'Towards stakeholderism' 37–41; Keay 'Shareholder primacy' 3; *Re Smith & Fawcett Ltd* (1942) Ch 304, 306, cited in Ajibo 'A critique' 4; Bainbridge 'Director primacy' 1747, 1749–1750.
[453] See Keay 'Corporate objective', with respect to employees.
[454] *Hutton v West Cork Rly Co* [1883] 23 Ch D 654 at 672–673.
[455] Hansmann & Kraakman 'The end of history' 468.

a legal framework in the statute books would offer protection to directors when they deal with other stakeholders. He observes:

> [T]he advantage statutes seem to provide is that directors are able to make decisions which take into account the interests of non-shareholding stakeholders, as well as shareholders, and to do so without the same fear of being subject to legal proceedings by either the company or by the shareholders ….[456]

It is proposed that, with legislative backing, progressive managers are likely to turn around the mode of doing business to focus on long-term corporate objectives based on the stakeholder manager model in the not-too-distant future.[457]

It is acknowledged that constituency statutes, which are common in the US, apply to large public corporations. Some may therefore argue that their efficacy has not been tested in SCHCs. Such an argument is valid. However, in South Africa, the SEC requirements apply to all companies, regardless of whether they are of a private or public nature.[458] It ought to be recalled that the public character of a corporation as put forward by Dodd in the 1930s can sometimes be determined based on what the corporation does.[459]

The present discussion has shown that, even without statutory backing, there have been stakeholder model interventions outside legislation. Project Syndicate in the US,[460] which holds discussions on how businesses should respond to stakeholder interests in the pursuit of shareholder value, and the King Code are conspicuous stakeholder initiatives being conducted outside of any known legal framework. In light of the concern about the review process of the CoCG being limited to the Minister and the CMA, a broader member-based forum in which key stakeholders caucus on the CoCG

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[456] Keay 'Towards stakeholderism?' 15–16.
[457] Dodd 'For whom are corporate managers trustees?' 1153.
[458] Section 72(4) of SACA 2008.
[459] Dodd 'For whom are corporate managers trustees?' 1149.
[460] M Roe 'Why America's CEOs are talking about stakeholder capitalism: Project syndicate' reported in Daily Monitor Publication Newspaper No. 309, of Wednesday, 6 November 2019, at 28. The original text is available at www.project-syndicate (accessed 6 November 2019).

and its review is proposed. This is good for inclusivity, participation, expertise and neutrality in setting standards under the CoCG.

2.3 Judicial restraint on internal business policy

The place of the courts in corporate governance is clearly stated in judicial opinions: the courts do not manage businesses, nor do they decide business policy. A corporate governance structure enforced by the courts presents severe practical challenges. In 1812, Lord Eldon LC in *Carlin v Drury*,[461] 'when he was asked to appoint a manager of the Bankside Brewery',[462] observed thus: 'This court is not to be required on every occasion to take the management of every playhouse and brewhouse in the kingdom.'[463] The import of this decision is that the courts will not engage with the internal management issues of the firm.

In *Foss v Harbottle*,[464] a complaint was brought by a member contesting the sale by the directors of their own land to the firm, at a price which the member considered exceeded the true market price value, with the directors keeping the proceeds of the sale. The court rejected the action, setting out three very fundamental principles: first, 'if a wrong is done to a company (as a person separate from its members), only the company may sue for redress' (the proper plaintiff rule);[465] second, the court will not interfere with the internal management of companies acting within their powers (the internal management principle);[466] and third, 'a member cannot sue to rectify a mere informality or irregularity if the act when done regularly would be within the powers of the company

[461] [1812] 1 Ves & B 154 at 158.
[462] Mayson et al *Company Law* 659.
[463] [1812] 1 Ves & B 154 at 158, cited in Mayson et al *Company Law* 659.
[464] [1843] 2 Hare 461, cited in Mayson et al *Company Law* 657.
[465] Ibid.
[466] Ibid.

and if the intention of the majority of members were clear'[467] (the regularity principle).[468]

The two judicial opinions exemplify the general reaction of the courts to claims which relate to the internal business matters of the firm. Some interesting revelations emerge from the decisions. First, the courts want to control litigation. In *MacDougal v Gardiner*,[469] the court was clear, observing that 'if every dispute about internal management of a company had to be brought to court, the court would be overwhelmed with cases.'[470]

The second issue is the limitation on who brings the action. The 'proper plaintiff' rule in *Foss v Harbottle*[471] limits who can bring a suit on matters where the firm itself is deemed to have suffered a wrong. This rule is analogous to the rule in criminal law, where the Crown is deemed to be the wronged party and thus criminal proceedings can be brought only in its name. Gower argues that 'insistence on action by the company itself prevents a multiplicity of suits. If each shareholder were permitted to sue, the company might be harassed by a succession of actions started and discontinued by innumerable plaintiffs.'[472] Furthermore, 'if the irregularity complained of is one which can be effectively ratified by the general meeting it is futile to have litigation about it except with the consent of the general meeting.'[473] Gower concludes as follows on these two points: '[t]hese two reasons, and especially the second, justify the extension of the rule to internal irregularities, as well as wrongs by the directors or controllers to the company itself.'[474] These observations by Gower weaken the contractarian theory further with respect to the capacity of members to pursue any wrong committed against the firm.[475]

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[467] Ibid.
[468] Ibid.
[469] [1875] 1 Ch 13.
[470] Ibid.
[471] [1843] 2 Hare 461.
[472] Gower 4 ed 642.
[473] Ibid, citing *MacDougal v Gardiner* [1875] 1 Ch D 13.
[474] Ibid 642–643; Mayson et al *Company Law* 659.
[475] See para 2.2.

Earlier, it was argued that the statutory contract under s 21 of the 2012 Act, and its equivalent in s 15(6) of SACA 2008, is not an ordinary contract as envisaged in contractarian theory. It has no known economic bargain. Rather, it is more concerned with parties ensuring that the firm is run in accordance with the articles and memorandum of association. The two cases cited above[476] demonstrate that the enforcement of a member's right under the statutory contract has further been curtailed by judicial precedent. Thus, a decision by a party to the statutory contract to pursue his or her rights outside of the corporate structure must satisfy the conditions set out in decisions such as *Foss v Harbottle*,[477] *MacDougal v Gardiner*[478] and *Carlin v Drury*.[479]

No doubt, the rule in *Foss v Harbottle*[480] has a limited avenue for personal actions by a member under specific circumstances. Reisberg,[481] however, argues that 'shareholder litigation is neither the initial nor the primary protection for shareholders against managerial misconduct.'[482] Reisberg asserts that '[t]he academic analysis of derivative actions in English law for the most part reflects a view that derivative actions are an ineffective instrument of corporate governance.'[483] Gower observes that 'if anyone other than the company is allowed to appear as plaintiff it is an anomaly allowed only as a matter of grace to prevent a serious wrong going unremedied because the wrongdoers control the company.'[484] Therefore, the statutory contract under s 21 of the 2012 Act is rather notional in practice.

It remains to be seen, however, whether the extension of the statutory contract under SACA 2008, to cover 'each director or prescribed officer of the company or any other person serving the company as a member of a committee of the board',[485] alters

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[476] See *Foss v Harbottle* [1843] 2 Hare 461, cited in Mayson et al *Company Law* 657; *MacDougal v Gardiner* [1875] 1 Ch 13.
[477] Ibid.
[478] Ibid.
[479] [1812] 1 Ves & B 154 at 158.
[480] Mayson et al *Company Law* 657.
[481] Reisberg 'Shareholders' remedies' 229.
[482] Ibid.
[483] Ibid 235.
[484] Gower 4 ed 647.
[485] Ibid.

the position in *Foss v Harbottle.*[486] If the board itself is the subject of scrutiny, it is most unlikely that it can take a decision that opens it up to scrutiny. This study is sympathetic to the argument that '[t]he decision whether the company should embark upon litigation is a commercial decision which involves balancing risks and expenses against possible advantages, and is therefore usually one for the board of directors.'[487]

The discussion above sought to illustrate that generally courts are less inclined to decide business policy and internal corporate governance of companies. However, as will be shown later in this thesis (in chapter 4) notwithstanding the established principles in cases such as *Foss v Harbottle*[488], the courts in common law jurisdictions have been prepared to offer equitable remedies with respect to small companies to mitigate the negative effects of strict application of statutes or to fill gaps in them (statutes).[489]

2.3.1 Organic theory

Organic theory appropriates corporate power between managers and shareholders.[490] This is done through the memorandum and articles of association, which alienate company business matters (for the directors) from shareholder matters. In this regard, it is commonplace for firms to adopt default corporate constitutive documents in the Companies Acts of their respective jurisdictions.[491] Article 80 of Table A of CA 2012 supports this hypothesis.[492]

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[486] Ibid.
[487] PL Davies 'Directors' fiduciary duties and individual shareholders' in E McKendrick (ed) *Commercial Aspects of Trusts and Fiduciary Obligations* (1992) 86–87, 90–91, cited in Reisberg 'Shareholders' remedies' 231.
[488] [1843] 2 Hare 461; *MacDougal v Gardiner*.
[489] Para 4.3.2.
[490] Sullivan 'Relationship between the board and members' 572–577.
[491] Ibid 570–580.
[492] See https://www.ebiz.go.ug/wp-content/uploads/2016/01/Companies-Act-2012.pdf (accessed 22 July 2022) for art 80(1) of Table A of CA 2012; s 66(1) of SACA 2008.

In terms of art 80, managers retain power on all business matters of the firm.[493] The assumption is that managers exercise discretion freely, in good faith, and in the interests of the firm. Article 80 therefore aligns with organic theory, which is to the effect that, with limited exceptions, corporate law treats all business-related aspects of the firm as exclusively within the realm of the board's power.[494]

In applying the organic theory, the courts look at managers as a distinct organ of the firm, with no obvious obligation to a specific corporate constituency, including shareholders.[495] Thus, managers are not the subject of direction by any other firm constituency on the managerial exercise of discretion,[496] not even by majority shareholders.[497] On this point, Dodd opines that shareholder 'have indeed lost much of their *de jure* and, if the enterprise is a large one, perhaps nearly all their *de facto* control so that they may appear to be more like *cestuis que* trust than like partners.'[498]

Mayson et al share the same view.[499] Thus, the courts rarely interfere with the managerial exercise of discretion on business policy.[500] However, the corporate structure under organic theory is not watertight. Challenges usually emerge where there is a managerial abuse of power.[501] The corporate structure under organic theory is such that only shareholders, through derivative action, can constrain managerial behaviour. The derivative suits avenue has already been discounted, owing to the barriers associated with the remedy.[502]

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[493] Sullivan 'Relationship between the board and members' 572.
[494] Katsuhito 'Persons, things and corporations' 586.
[495] *Howard Smith Ltd v Ampol Petroleum Ltd* (1974) AC 821; LA Bebchuk 'Letting shareholders set the rules' (2006) 119 *Harv L Rev* 1784–1813 at 1784.
[496] TL Blackburn 'The unification of corporate laws: The United States, the European Community and the race to laxity' (1994) 3 *George Mason Independent L Rev* 1 at 53, cited in R Drury 'The Delaware syndrome' (2005) *J Bus L* 1–24 at 8.
[497] Mayson et al *Company Law* 543.
[498] Dodd 'For whom are corporate managers trustees?' 1146.
[499] Mayson et al *Company Law* 543.
[500] R Grantham 'The content of the directors' duty of loyalty' (1991) *J Bus Law* 1, cited in Dine *Corporate Groups* 186–187 and Mayson et al *Company Law* 545.
[501] *Bishopgate Investment Management Ltd (in liq) v Maxwell (No 2)* (1994) 1 All ER 261.
[502] See para 2.3.1; Reisberg 'Shareholders' remedies' 231–243.

Moreover, shareholder court actions are potentially undermined by managers' interests and the position they hold in the firm. Bebchuk describes management as 'a powerful interest group that can be expected to have substantial influence on law making in the corporate area'.[503] Under 'the house keeping rules of the corporation', shareholders cannot intervene in or initiate managerial decisions.[504] The said rules also 'limit shareholder involvement in corporate governance'.[505] The limitation is on 'intervention' and participation in 'corporate governance.' Bebchuk,[506] amidst opposition,[507] makes a case for increased shareholder power to decide the rules of the game.[508] Bebchuk's plea explains the structural deficiencies in the organic theory of corporate structure.[509]

This study, however, demonstrates that separation of ownership and management as espoused in organic theory is not applicable in all corporate forms, notably quasi-partnership companies.[510] In this category of companies, the corporate structure is founded on private treaties based on trust and the mutual understanding of the members, and they are personally involved in the day-to-day company management.[511] Moreover, it is shown that courts have disregarded the strict application of corporation rules to grant equitable relief, given the personal relationship between members; although legitimate, these rules would orchestrate minority oppression.[512] This latter argument forms the basis for arguing for a SCHC category in CA 2012 in subsequent chapters.

In the next chapter I explore the legal categories and corporate governance framework under CA 2012 to determine the appropriateness of the law for SCHCs.

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[503] LA Bebchuk 'The case for increasing shareholder power' (2005) 118 *Harv L Rev* 833–914 at 843.
[504] Ibid 843–847; cited in Bainbridge 'Director primacy' 1735; Bainbridge 'Shareholder voting rights' 601.
[505] Bebchuk 'Shareholder power' 836.
[506] Ibid 840.
[507] I Anabtawi 'Some skepticism about increasing shareholder power' (2006) 53 *UCLA L Rev* 561 at 590.
[508] LA Bebchuk 'Letting shareholders set the rules' (2006) 119 *Harv L Rev* 1784–1813 at 1784–1785.
[509] Ibid 1784.
[510] Para 4.3.2—4.3.2.2.
[511] Milman 'The quasi-partnership example' 312–313.
[512] *In re HR Harmer Ltd* (1958) 1 WLR 63 (CA) where the conduct of the founder father was found to be 'burdensome, harsh and wrongful' and 'oppressive within the meaning of s 210 CA 1948'.

CHAPTER THREE

LEGAL CATEGORIES AND CORPORATE GOVERNANCE UNDER CA 2012

3.1 Business forms and legal categories

This Chapter examines the various business forms and legal categories, the legal and corporate governance and the institutional framework under CA 2012 with focus on ss 4, 5, 14, 138, 154, and 167. The discussion seeks to determine whether CA 2012 provides an appropriate and effective legal framework for SCHCs. In going about this task, the study demonstrates the legal and corporate governance gaps in CA 2012 with respect to SCHCs. It then draws on the companies' legislation in the UK and South Africa to make some proposals to fill the gaps identified in CA 2012 with respect to SCHCs.[513]

3.1.1 Single member company

Single Member Company 'SMC'[514] is defined as a company incorporated under the Act with one person, whether natural or corporate,[515] or a private company which has only one member who is a natural person.[516] There is an apparent ambiguity about this latter feature to which I shall return later. Prior to CA 2012, SMC did not form part of companies' legislation in Uganda. Tarinyeba-Kiryabwire has opined that 'world over, a company was incorporated with at least two or more members and no company could be registered with a single shareholder owning all the shares.'[517] She is right. A review of previous companies' legislation in Uganda reveals that the minimum number of persons required to incorporate a company was two.

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[513] See Chap 5 *infra*, for the substantive discussion on best practice on the regulation of SCHCs.
[514] M Ilahi 'Legislative transplant of single member company in Islamic Republic of Pakistan: Anomalies in the Companies Ordinance, 1984' (2013) 34(1) Statute L Rev 95–100 for some commentary on SMCs.
[515] Regulation 3 of the SMC Regulations No 72 of 2006.
[516] Regulation 2 of the Companies (General) Regulations No 74 of 2023 ('Companies Regulations, 2023').
[517] Kiryabwire *Company Law* 52.

By way of illustration, s 3(1) of Companies Ordinance 1935 Cap 33 provided that [a]ny seven or more persons, or where the company to be formed will be a private company, any two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Ordinance in respect of registration, form an incorporated company with or without limited liability. Section 3(1) of Companies Act, Cap 85, which became Cap 110, replicates this position on the minimum number of shareholders who can form a company.[518]

Similarly, s 32 of the repealed Act provided that if at any time the number of members is reduced, in the case of a private company, below two, or, in the case of any other company, below seven, and it carries on business for six months, every person who is a member of the company during the time that it so carries on business after those six months and is cognisant of the fact that it is carrying on business with fewer than two members or seven members, as the case may be, is severally liable for the payment of the whole debts of the company contracted during that time, and may be severally sued for the payment of those debts.

Gower opines that '[i]n legal theory the term "company" implies an association of a number of people for some common object or objects',[519] usually economic gain. Going back in corporate history, sole proprietorships – which can be said to be predecessors in title to SMCs – have operated as unincorporated enterprises.[520] They enjoyed no benefit of corporate form and members had personal liability.[521] Arguably, an association of one member as in the case of SMC was not contemplated in company legislation but was nevertheless an evolving concept.

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[518] Para 1.5.
[519] Gower 5 ed 7, 9. The idea of an association for economic gain can be traced back to the early business forms of *societas* and *commedas* and guilds. Gower 4 ed 22–25; H Hansmann, R Kraakman & R Squire 'Law and the rise of the firm' (2006) 119(5) *Harv L Rev* 1333–1403 at 1356–1386.
[520] Mayson et al *Company Law* 10.
[521] Gower 5 ed 25–26.

Given this background, it is unsurprising that the introduction of SMC as a legal category in the Bill was opposed on the floor of the House. Fears of abuse of the corporate form – which is beyond the scope of this study – featured pre-eminently as the reason for the opposition.[522] The CLPA, which processed the Bill, at some point sought to drop the idea of SMC altogether. Hansard reads thus:

> [T]he Bill seeks to introduce a single member company. This is an exception to the general principles of company law. The committee is of the opinion that the concept of a one-man company is not desirable because it will confuse and expose the public to exploitation by unscrupulous individuals who may seek to hide under a corporate entity status that insulates their personal property/interests against the public/creditors.[523]

SMC was described as 'a very dangerous thing'[524] and a 'Western world concept.'[525] These claims were, however, rebutted by some sections of the House. One MP contended thus:

> We have other business models like sole proprietor, partnership, but these ones do not go with limited liability. Incidentally, where is the guarantee that if there are three or five people in a company, they are not capable of defrauding the public, and that defrauding the public is the monopoly of the single person?[526]

The MP added that:

> [i]t would be helpful if they were (individuals) also granted corporate personality and limited liability as individuals to facilitate enterprise by making it easy to set up and grow business to encourage the efficient allocation of capital by giving confidence to investors, by promoting long-term company performance through stakeholder engagement and effective dialogue between businessmen and investors. It would also make Uganda one of the more attractive places in the world

[522] Hansard, 21 May 2011, 13888–13895; Hansard, 21 March 2012, 3047–3053; Reid & Priest 14 n 25.
[523] Hansard, 21 May 2011, 13894.
[524] Hansard, 11 May 2011, 13890.
[525] Ibid 13891.
[526] Ibid 13894.

> to set up and run a business because this model is in place in the UK, China where we are running to buy things, South Africa and in Malaysia.[527]

Nevertheless, the Bill was passed with SMC as a label under CA 2012. Upon registration, SMC has all the known corporate benefits, including corporate personality and limited liability.[528] The motivation for SMC was to extend corporate form to sole proprietors, which, as already noted above, were hitherto unincorporated enterprises with unlimited liability. Hansard reads thus:

> In this Bill, we introduce the concept of a single member company – that individual should be in position to incorporate, form a company and enjoy the benefits of corporate personality.[529]

Further, it was submitted in the House that:

> a person who would otherwise have been a sole proprietor is complying with the law of incorporation and forming a corporate person with practically all the advantages of corporate personality.

Additionally, SMCs were being utilised elsewhere and, if adopted, would make Uganda 'one of the more attractive places in the world to set up and run a business'.[530] The House must have had in mind South Africa and the UK, which have made provision for SMC in their respective company legislation.[531] In the next section, I examine the corporate structure of SMC to determine whether it provides an appropriate and effective option for the SCHC category.

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[527] Ibid.
[528] Regulation 8 of the SMC Regulations.
[529] Hansard, 11 May 2011, 13893.
[530] Ibid 13894.
[531] Section 13(1) of SACA 2008; s 7(1) of CA 2006.

3.1.1.1 Corporate structure of SMC

Section 4(1), as amended,[532] provides that any one or more persons may incorporate a company, with or without limited liability, by filling in the particulars contained in the registration form in the Second Schedule to the Act. Prior to the amendment, s 4(1) read as follows: '[a]ny one or more persons may for a lawful purpose, form a company, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability.' In the amendment, subscribing to the memorandum of association has been substituted with the registration form. I will return to this issue later in this section.

A brief background to this provision is critical from the outset. Section 4(1) was redrafted in the second reading of the Bill. Before the redrafting, clause 4(2), which provided for SMC, was a stand-alone provision. It provided that '[n]otwithstanding subsection (1) any one person may, for a lawful purpose, form a company, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability.' This must have been to distinguish SMC from other business forms, given its novelty. In the House, clause 4(1) was amended to delete the words 'any two or more persons associated for a lawful purpose may', and to replace the deleted words with the words 'any one or more persons may for a lawful purpose, form a company.'[533] The justification was to 'provide for single-member companies.'[534] The original clause 4(2) had to be deleted as a 'consequential amendment to clause 1'.[535]

Clause 4(2) had explicitly provided for SMC. Therefore, the justification for the amendment could not have been to provide for SMC. Most probably, the drafters sought

[532] CA 2012 was amended in 2022 by the Companies (Amendment) Act 16 of 2022. The Companies (Amendment) Bill 2022 was passed on 7 September 2022 and commenced on 16 September 2022. The Companies (Amendment) Bill 2022 is available at
The Companies (Amendment) Bill, 2022 – Parliament Watch (accessed 16 September 2022).
[533] Hansard, 21 March 2022, 3054.
[534] Ibid.
[535] Ibid.

to achieve convenience.[536] Another plausible reason was to align the law to that in the UK and South Africa, whose relevant company law provision is in all fronts similar to clause 4(1) as amended.[537] Notably, in the amendment, the words 'in association' were deleted, signifying a possible end of an era for assumed association for purposes of companies which had hitherto characterised all corporate forms.[538]

The other significant fact to note is that clause 5(3) of the Bill provided that, for the purposes of this section, SMC shall be taken to be a private company. This was deleted in the Act. However, this has been clarified in the Companies Regulations, 2023,[539] which categorise SMC as a private company.[540] Under the SMC Regulations, the registrar shall, upon the registration of a company, issue to the company a certificate of incorporation in the prescribed form.[541] And, 'every single member company shall add the initials "SMC" LTD or the words "Single Member Company Limited" at the end of its name.'[542] A distinct feature of SMC is that it is a one-member company, and the member may be either a natural or a corporate person.[543] However, as noted earlier, the Companies Regulations, 2023, state that a single member for the purposes of SMC means a natural person.[544] While this clarification is to be welcomed, given the view in this thesis that membership of SCHCs be restricted to natural persons, it lacks the support of the principal Act and directly conflicts with the SMC Regulations, which state that a single member in SMC may be a natural or a corporate person.[545]

Further, SMC must nominate two individuals: one shall become a nominee director in the case of the death of the single member, and the other shall become the alternate nominee director to work as the nominee director if the nominee director is not

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[536] Hansard, 11 May 2011, 13888–13889.
[537] Section 7 of CA 2006; s 13 of SACA 2008.
[538] Gower 5 ed 1.
[539] The Companies Regulations No 74 of 2023 came into force on 1 September 2023 and repealed the Companies (General Regulations) No 7 of 2016.
[540] Regulation 2 of the Companies Regulations, 2023; Kiryabwire *Company Law* 53.
[541] Regulation 8 of the SMC Regulations.
[542] Regulation 9 of the SMC Regulations.
[543] Section 3 'Interpretation' section of reg 3 of the SMC Regulations.
[544] Sections 4 and 5 of CA 2012; reg 3 of the SMC Regulations.
[545] Regulation 3.

available.[546] This nomination must be satisfied at the registration of the SMC.[547] The appointment of a company secretary for the SMC is discretionary.[548] The nominee director shall manage the affairs of the company in the case of the death of the single member until the transfer of shares to the legal heirs of the single member; and inform the Registrar of the death of the single member, provide particulars of the legal heirs, and in case of any impediment report the circumstances, seeking directions within 15 days after the death of the single member.

The other roles are to transfer the shares to the legal heirs of the single member, and to call a general meeting of the members to elect directors. On the face of it, the SMC is a simple corporate form which avoids the traditional corporate structure of the board of directors and the shareholders. It is a one-person show with no potential for boardroom disputes or shareholder oppression claims.[549]

By and large, SMC structure offers flexibility. The registration process is simple and favourable for the unsophisticated Ugandan businessperson. All that is required is for the applicant to complete a prescribed form in the Second Schedule to the Act.[550] If the Registrar is satisfied that the applicant has complied with the provisions of the Act, he or she shall register the company and assign it a registration number.[551] Thereafter, the Registrar shall issue a signed certificate stating that the company is incorporated.[552]

That said, on further examination of the structure of SMC, its' weaknesses become apparent. Beyond the SMC label, it is not an appropriate and effective vehicle for SCHCs from the perspective of the latter's definition or the legal characteristics described in chapter 1, as demonstrated below.

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[546] Regulation 11.
[547] Regulation 6.
[548] Regulation 12.
[549] *In re HR Harmer Ltd* (1958) WLR 62; *Scottish Co-operative Wholesale Society Ltd v Meyer* (1958) WLR 404 cited and applied in *In re Harmer*; *In re American Pioneer Leather Company, Limited* (1918) CH 556. See the discussion of quasi-partnership companies in para 4.3.2.
[550] Section 4(1) of CA 2012.
[551] Section 4(1)*(a)* of CA 2012.
[552] Section 4(1)*(b)* of CA 2012, reg 8 of the SMC Regulations.

3.1.1.2 Inadequacies of the SMC structure

First, while CA 2012 makes it mandatory for a single member to appoint a nominee and alternate director at registration,[553] the law at present focuses on the fulfilment of this requirement at registration.[554] The appointment of nominee and alternate directors must be intended to avoid a vacuum in the administration of SMC upon the death of a single member.[555] Yet, the law is not clear about what happens where, subsequent to the incorporation of the SMC, both the nominee director and the alternate director are unavailable on account of death, resignation or disqualification under the Act.[556] Not only must the law require a single member to nominate both nominee and alternate directors at the registration of the SMC,[557] there must be an explicit continuous statutory requirement during the lifetime of the SMC for nominee and alternate directors to be in place. In the case of the death or disqualification of a nominee or an alternate director, whenever this occurs, the death or such disqualification must be reported to the Registrar within a prescribed time and in a prescribed form, and the positions must be filled.

A penalty must be attached to both the SMC and the single member for default. There would be severe constraints on the SMC and certainly on all the stakeholders who have contractual relations with the SMC if a single member were to die and there were no nominee or alternate directors appointed. Where, for any reason, the single member is not available to appoint the nominee and alternate directors, the interim residual power to do so should be vested in the Registrar.

Second, in terms of its' definition, SMC does not cater for SCHCs with more than one member but fewer than ten, as in the case of close corporations under CCA 84.[558] In the definition of SCHC adopted in chapter 1 for the purposes of this study,[559] the assumption is that smaller firms with more than one member exist. This category is

[553] Regulation 6 of the SMC Regulations.
[554] Regulation 6(1) of the SMC Regulations.
[555] Section 187 of CA 2012.
[556] Section 199 of CA 2012.
[557] Regulation 6 of the SMC Regulations.
[558] Para 5.2.1– 5.2.1.2.
[559] Para 1.2.

likely to find the categorisation of private companies in s 5 of CA 2012 too wide and unsuitable.[560] The capping of membership of SMC to one member suggests that the legislative intention was to confine its usage to sole proprietorship. In the First Schedule to the SMC Regulations, the membership of SMCs is limited to one member who shall wholly own the shares.[561] To avoid the problem of too many categories under CA 2012, merging SMC with other smaller companies whose members do not exceed ten to create SCHC is a suggested compromise.

Achieving this proposal will require reworking s 4(1) and s 5 to revise the number of members from one to ten to form SCHC.[562] The mandatory requirements on account reporting (s 154) and audits (s 167) will become internal and optional for SCHC under prescribed conditions in terms with an earlier recommendation by ULRC.[563]

The other challenge with the SMC structure arises from conversion from SMC to a private company, and vice versa from a private company to SMC. In terms of s 87 of CA 2012, SMC may transfer or allot shares on the death of a single member, or by operation of the law, or by a single member converting into a private company not being SMC. To give effect to the transfer or allotment or conversion, SMC requires a special resolution for the change of status from SMC to a private company; must alter its articles within 30 days of the transfer of shares or the further allotment of shares; must appoint and elect one or additional directors within 15 days of the date of passing the special resolution; and must notify the appointment to the registrar. The opportunity for SMC to convert to a private company is to be welcomed. It provides flexibility for SMC that finds the SMC legal regime to be inappropriate and wishes to opt out of it.[564]

However, in terms of s 24(7) of CA 2012, a private company that is not SMC and that has two or more members upon the commencement of the Act shall not become SMC. The import of this provision is that once SMC has converted to a private company

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[560] Kiryabwire *Company Law* 53.
[561] Regulation 2(b) of the Schedule to the SMC Regulations.
[562] See the discussion in paras 5.2.1— 5.2.1.2.
[563] ULRC Report 19.
[564] Gower 10 ed 17.

(of two or more members) it cannot revert to SMC status. No other category can re-register as SMC. Regulation 18(1) of the Companies Regulations, 2023, controversially suggests that a private company can re-register as SMC. The re-registration is by way of an application which must be accompanied by the following: *(a)* a special resolution authorising the change of status; *(b)* a transfer form showing the transfer of shares or allotted shares; *(c)* notice of change in name; *(d)* altered articles of association; and *(e)* a form appointing a nominee and an alternate nominee director.

Once the Registrar is satisfied that the company has complied with the requirements, he or she shall issue a notice of change of company status in a Gazette or any other media, as the Registrar may determine, for 30 days. Upon the expiry of the 30 days, where the Registrar is satisfied that the company has met the requirements for the conversion of a company from a private company to SMC, he or she shall issue a certificate of conversion prescribed in Form 10.

This is not supported by the principal Act nor by SMC Regulations which are specific to SMC.[565] It contravenes s 24(7), which prohibits the re-registration of a private company that is not SMC as SMC. Based on the well-established principle that subsidiary legislation must conform to principal legislation, reg 18 needs to be harmonised with ss 24(7) and 87 to allow for SMC which re-registers as a private company to re-register as SMC should it find being a private company unsuitable. While SMC is easy to form,[566] the SMC form is inflexible and excludes SCHCs, which means that CA 2012 fails to achieve the CJRP's stated objective of flexible legislation.[567]

Fourth, SMC is not an appropriate vehicle for 'asset partitioning' and 'asset shielding.'[568] These two concepts, which are the end result and benefit accruing from limited liability and corporate personality, are constrained by SMC form which

[565] Regulation 10 of the SMC Regulations.
[566] Regulation 4 of the SMC Regulations.
[567] See para 1.3 and a related discussion in para 5.2.1.2.
[568] The phrases 'separate patrimony' and 'entity shielding' are adopted from Armour et al *Anatomy of Corporate Law* 5–8. See relatedly, Hansmann et al 'Law and the rise of the firm' 1392.

undermines the purpose for which corporate form exists.[569] Some commentators have argued that with SMC, 'it is often difficult on both factual and analytic grounds to distinguish the single member from the SMLLC and, under the circumstances, to respect the asset-partitioning element of the LLC structure.'[570]

Some jurisdictions have addressed these concerns by enacting charging statutes that allow secured creditors to take charge of SMCs, including voting rights, for as long as the debt subsists.[571] This is a break with tradition where similar insolvency remedies are usually available only when companies are in financial distress and are not unique to any particular category of companies.[572] The variance in the application of the SMC form across jurisdictions suggests that its meaning is not universal. It remains an evolving concept and care ought to be taken in drafting the law. To that extent while it is clear that SMC is intended to broaden corporate personality to cover otherwise historically unlimited sole proprietorships, their operation is not straightforward.

In the fifth place, it is not immediately clear whether SMC was the most needed corporate entity at the time. The record shows that including SMC in CA 2012 had more to do with what was happening in other jurisdictions than with domestic needs. The reasoning was that SMC model was operating in the UK and South Africa. As demonstrated in chapter 1, adopting models without modification has been cited as the reason for Uganda's company legislation not addressing domestic business needs.

On the other hand, SCHCs were acknowledged to require an easy and accessible legal and corporate framework during the CJRP consultations.[573] One could argue that the local situation did not require SMC. This study proposes that 12 years after CA 2012 was passed into law, regular post-legislation reviews and studies commissioned by either

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[569] CG Bishop 'Reverse piercing: A single member LLC paradox' (2009) 54(2) *SD L Rev* 199–232 at 200–209, 228.
[570] TE Geu, TE Rutledge & JW DeBruyn 'To be or not to be exclusive: Statutory construction of the charging order in the Single Member LLC' (2010) 9 *DePaul Bus & Com LJ* 83–135 at 94, available at https://via.library.depaul.edu/bclj/vol9/iss1/4 (accessed 10 September 2022).
[571] Bishop 'Reverse piercing' 199–232; Geu et al 'Charging order' 94.
[572] See the related arguments in Hansmann & Kraakman 'The end of history' 442; Ziegel 'The quiet revolution' 516, 520–523.
[573] URLC Report 4.

the Parliament of Uganda or the Ministry of Justice and Constitutional Affairs ('MoJ&CA') on the utility of SMC in the Ugandan business space is needed.

Sixth, the deletion of the word 'association' in s 4(1) of the Act not only alters the foundational character of a company acting in association, but it fundamentally created the incompatibility of SMC with SCHCs. Drawing on the earlier definition, SCHCs have the character of 'association' because their membership is usually one or more or a few shareholders who cannot take the benefit of SMC under CA 2012 because of the latter's exclusivity to one member. Therefore, SMC is a problematic option for SCHCs.

Seventh, the SMC form ignores the various sizes or legal categories of business forms in Uganda that are not SMC. These forms can also not use the broad label of private companies because then they face the challenging compliance burden.[574] Recognising various company sizes has led to legislative interventions in other jurisdictions such as the 'elective regime',[575] which allows SCHCs to opt out of certain otherwise mandatory legal requirements, or 'exempt' and 'non-exempt private companies'[576] where companies are exempted from certain statutory requirements on account of their small size.[577] Undoubtedly, the size of a company is an important consideration when formulating legislation for SCHCs which is missing in CA 2012.

Eighth, extending the membership of SMC beyond natural persons to cover corporate persons is not consistent with best practice. First, a key motivation for SMC at the enactment of CA 2012 was to extend corporate personality to sole proprietorships.[578] These are natural persons. One can argue that allowing corporate members to form SMC was not the intention of the law. Further, best practice on the regulation of SCHCs has tended to restrict membership to natural persons. This is because of the assumption of

[574] Ferran *Company Law* 4; MTIC 2015 Policy Document 2, 31.
[575] Gower 5 ed 102–106; Reid & Priest 7.
[576] Gower 4 ed 13.
[577] Gower 10 ed 690; s 30(2A) SACA, 2008; Davis & Geach (eds) *Companies and Other Business Structures in South Africa* 21; FH Cassim et al *Contemporary Company Law* 3 ed (2021) 12–13.
[578] Hansard, 11 May 2011, 13893–13894.

the closeness of members where they operate on the basis of mutual trust and confidence.[579]

Regulation 2 of the Companies Regulations, 2023, defines 'single member' as a natural person who is a member of SMC, and SMC as a private company which has only one member. The SMC Regulations, on the other hand, define SMC as a company incorporated under the Act with one person, whether natural or corporate. CA 2012 does not define 'member' or 'shareholder', and does not classify members or shareholders as natural or juristic persons. Section 4(1), which creates SMC, applies the term 'any one or more persons', which is consistent with the SMC Regulations. Although the SMC Regulations came into force before the Companies Regulations, 2023, they are more specific to SMC. Yet, there is nothing in the Companies Regulations, 2023, to suggest that they (Companies Regulations, 2023) supersede the SMC Regulations should there be a conflict on a matter between the two sets of regulations.

Applying the principle that subsidiary legislation must conform to the principal legislation, the correct position is that CA 2012 has extended the membership of SMC to corporate persons, which is inconsistent with best practice.[580] This contradiction brought about by the Companies Regulations, 2023, needs to be cured by clarifying in CA 2012 the meaning of 'member' or 'shareholder', and indeed explicitly providing that membership of SMC or the proposed SCHC is restricted to natural persons.[581]

Ninth, a more surprising aspect of SMC is to be found in reg 6 of the First Schedule to the SMC Regulations. It provides that all meetings of the company shall be held in accordance with the provisions of the Act. The secretary, if any, shall attend all meetings of the company but shall have no vote. The import of this regulation is that SMC meetings must be conducted in accordance with ss 140–141 of CA 2012. These provisions require notice for the meetings, set out the duration of the notices, and stipulate how to vote. The requirements in reg 6 do not speak to the spirit of s 138 of CA

[579] Dunne 'The position of the quasi-partnership type' 108–109; see paras 4.3.2 –4.3.2.2.
[580] See the discussion in para 5.2.1.
[581] See the proposed amendment of ss 4 and 5 of CA 2012 in *Appendix B.*

2012, which makes AGMs optional for private companies. SMC is a one-person entity and therefore insisting on mandatory procedural requirements for company meetings does not align with the legislative intention in s 138.

Finally, to return to the changes brought about by the 2022 Companies Amendment Act. The amendment of s 4(1) has substituted a memorandum of association with a registration form for the purposes of registering a company. This amendment makes it discretionary for any person registering a company to use a memorandum of association as a form of incorporation. The rationale for the amendment is that, apparently, CA 2012 abolished the ultra vires rule rendering the memorandum of association redundant since the memorandum of association only provides for the objectives of the company.[582] The common-law doctrine of ultra vires is to the effect that a company cannot lawfully do what its constitution has not mandated in the object clause.[583] In such circumstances, the company is not bound.[584] Section 51(1) of CA 2012, which is said to have abolished the ultra vires rule, provides that the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything contained in the company's memorandum. There is some doubt if this provision has indeed abolished the vires doctrine.[585]

The amended registration form, 'Co. Form 1', has three parts. Part 'A' covers the company details: the name of the company, the type of company, the nature of the business or its objectives, the nominal capital, and the proposed address, which must include the trading centre, district or city, county or municipality, subcounty, town council or division, telephone contacts, email, and post office box. Part 'B' covers the details of subscribers: name, nationality, identification documents, address, number of shares, and amount of guarantee. Part 'C' covers the details of the directors and

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[582] See cl 3.2 to the Memorandum of the Companies (Amendment) Bill, 2022.
[583] Mayson et al *Company Law* 83.
[584] *Asbury Carriage Company v Riche* (1875) LR 7 HL 653, cited in Gower 5 ed 167.
[585] See s 51(2), which allows a member of a company to bring proceedings to restrain the doing of an act which, but for sub-s (1), would be beyond the company's capacity; but no such proceedings shall lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the company.

company secretary. The form must be accompanied by proposed articles where the standard articles under CA 2012 are not adopted.[586]

An examination of Co. Form 1 reveals some weaknesses. First, it is not correct that the memorandum of association only provides for the objectives of the company. In terms of s 7 of CA 2012, the objectives of the company (or object clause) is only one of the requirements with respect to the content of the memorandum of association. The other requirements are shares, the name of the company, the use of the suffix 'limited' unless the company is unlimited, and the amount of share capital with which the company proposes to be registered and the division of the share capital into shares of a fixed amount, among others. In any case, the object clause under s 7(1)*(c)* is optional. Therefore, it is quite controversial that a requirement which is optional could be the justification for the amendment. To be sure, Co. Form 1 is essentially a memorandum of association; it is only the form and name which have changed and not the substance.

Second, the registration form which has been substituted is much simpler than Co. Form 1. The former form only required a passport-size photograph, the names of subscribers, the address, the name of the business, the proposed share capital and the signatures of the subscribers. It was a short, straightforward form, arguably designed for the unsophisticated businessperson, compared to Co. Form 1.

Finally, Co. Form 1 requires shareholders to state their shareholding in the company. The discussion of close corporations in South Africa later in this thesis shows that shares are not an appropriate way of designating member interests in SCHCs. The negative impact of this is that it invites the strict application of corporation rules on shares.[587] Under this framework, it is difficult to achieve flexibility for SCHCs.[588] Therefore, it is doubtful if the amendment to s 4(1) has fully achieved its stated objective

[586] See Table A of CA 2012.
[587] *Trevor v Whiteworth* (1886–90) All ER Rep 46.
[588] Ibid.

of the simplified registration of companies. For these reasons, SMC is not a straight forward option for SCHCs. In the next section, I make suggestions for reforms.

3.1.1.3 Some suggestions for reforms

a. SCHC as a legal category

Drawing on the discussion above, it is suggested that s 4 of CA 2012 on SMC be reworked. The classification of private companies under s 5*(b)* should be revisited with a view to merging SMC with smaller companies that have one to ten members to create a new category of SCHC. In the result, the membership of SCHC will have to be restricted to natural persons. This intervention seeks to cater for a larger business which is not SMC but nevertheless may find the classification of private companies under the Act of 'any one … and not more than 100 members' inappropriate.

b. Conversion of SMC to SCHC

The registration and re-registration of business forms are noticeable attributes of CA 2012 and is to be welcomed. This allows for companies to register and re-register to assume different company forms or legal characteristics. In terms of s 23 of CA 2012, an unlimited company can re-register as a limited liability company and, under s 29, a limited liability company can re-register as an unlimited liability company. Under s 33, a public company can re-register as a private company and SMC can re-register as a private limited liability company. While this is to be applauded as providing flexibility in the law in terms of the stated objective of the CJRP alluded to earlier, s 24(7) of CA 2012 provides that a private company that is not SMC and that has two or more members at the commencement of the Act cannot become SMC. In the proposed amendment, SCHC should be able to register or re-register as other business forms.[589]

[589] Kiryabwire *Company Law* 75.

The other available option is conversion from an unlimited company to a limited liability company, or from a private company to a public company. In the discussion in the next section, it is argued that these options are not appropriate for SCHCs. This study therefore proposes to make provision for all existing SMCs to re-register as SCHC with a transition period of two years from the effective date of the amendment. The study also proposes a similar provision that SCHC that find the SCHC legal framework inappropriate be allowed to opt out and re-register as any other available company option, not being SCHC. However, the re-registration is to be subject to satisfying the statutory requirements and conditions under CA 2012 with respect to the option the SCHC is opting in for. This proposal is in line with the registration and re-registration provisions in CA 2012.[590]

c. Proscription of juristic persons as members of SCHC

Given that the nature of relationships by and between members in SCHC is personal and based on mutual trust, it is an anomaly to allow juristic persons to form SMC. As earlier noted, best practice on the regulation of SCHCs points to the restriction of membership of SCHCs to natural persons.[591] In the proposed amendment to s 4(1), the SMC Regulations, 2016, and the Companies General Regulations, 2023, juristic persons are explicitly proscribed from being members of SCHC. The terms 'shareholder' and 'member' will also have to be defined in CA 2012, because while under the Insolvency Act,[592] 'shareholder' is understood to mean a shareholder as defined in CA 2012 there is no such definition in CA 2012.

In the next section, I briefly explore private and public companies to illustrate the business options, if any, that each offers for SCHCs.

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[590] Sections 23, 24, 27, 28, 29, 30, 31, 32, 33, 34 and 35 of CA 2012.
[591] Section 29 of CCA 84.
[592] Section 2 of the Insolvency Act 14 of 2011, 'Interpretation section', available at insolvency-act-2011-1640091104.pdf (ursb.go.ug) (accessed 23 July 2022).

3.1.2 Private and public companies

In terms of s 4(2) of CA 2012 the company may be: *(a)* a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them in this Act referred to as 'a company limited by shares'; *(b)* a company having the liability of its members limited by the memorandum to the amount that the members undertake in the memorandum to contribute it is being wound up, in this Act referred to as 'a company limited by guarantee'; *(c)* a company not having any limit on the liability of its members, in this Act referred to as 'an unlimited company'; or *(d)* a private or public company.[593]

A private company under the Act is one which restricts the right to transfer its shares and other securities;[594] limits the number of its members to one hundred, not including persons who are employed by the company and persons who, have been formerly employed by the company;[595] and prohibits any invitation to the public to subscribe for any shares or debentures of the company.[596] Moreover, the one to one hundred-membership threshold in a private company is broad and wide for the present purposes. In SCHC, membership is generally agreed to be a 'few'[597] and, in some cases, membership limit has been capped by legislation, as is the case in South Africa.[598]

Taking the upper limit, a 100-member private company does not fit into the working definition in this study of SCHC.[599] By that definition, it is impractical to have all 100 members or a good number of them participate in the day-to-day management of the company. This is a key reason why courts in common-law jurisdictions are prepared to treat SCHCs as if they were partnerships to accord them (SCHCs) flexibility on the application of corporation law –a subject which is discussed later in this study.

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[593] The public company is beyond the scope of this study.
[594] Section 5(1)*(a)* of CA 2012.
[595] Section 5(1)*(b)* of CA 2012.
[596] Section 5(1)*(c)* of CA 2012.
[597] Ferran *Company Law* 5, 640.
[598] Section 28 of CCA 84.
[599] O'Neal & Thompson *Close Corporation* 2.

The inevitable outcome of a big membership is having dispersed members who only hold a tiny shareholding and 'who do not participate directly in the management of the company.'[600] Once the fusion of members and managers is negatived, the argument for SCHC is altogether problematic since there will be a corporate structure with members distinct from the managers.[601] In consequence, further classification of a private company under CA 2012 is needed to accommodate the description of SCHC beyond SMC.

ULRC's recommendation on this matter was that when the number of persons in a private company exceeds 50, that company should not be permitted to opt out of certain provisions applicable to private companies.[602] A schedule of proposed mandatory provisions would have been useful and offered guidance to the legislature. Nevertheless, the interpretation of this recommendation is that companies with fewer than 50 members would be entitled to either optional or flexible regulatory provisions. It can be argued that the discussion of SCHCs in chapter 1 suggests that 50 members is a higher number for purposes of SCHCs which are structured as quasi-partnerships.

Finally, this recommendation was not adopted in CA 2012. Section 4(1) which provides for the number of members who can register a private company does not provide for such categorisation along the lines of the recommendation. The membership requirement under s 4(1) read together with s 5(1)*(b)* is that 1 to 100 members may form a private company. The proposal in this study to redraft s 4(1) of CA 2012 to merge SMC and other smaller companies whose members do not exceed ten and are limited to natural persons to form SCHC is a modification of the ULRC recommendation above and achieves the CJRP stated objective of a simpler, flexible and accessible law.[603]

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[600] Ferran *Company Law* 4.
[601] Armour et al *The Anatomy of Corporate Law* 1–14.
[602] ULRC Report 19, recommendation 5(b).
[603] Ibid 4.

3.1.3 Unlimited companies

CA 2012 establishes a company of any one or more persons not having any limit on the liability of its members as 'an unlimited company'.[604] In this category, the liability of members is unlimited. This means that the liability of the company is wholly inseparable from the liability of its members. There is no 'asset shielding' and 'asset partitioning'.[605] Upon the company's registration the 'members become fully liable for the company's debts if its assets are not sufficient to pay off the creditors.'[606]

The apparent weakness with this company form is that the members do not enjoy limited liability.[607] Tarinyeba-Kiryabwire has suggested that '[u]nlimited liability companies are very rare due to the risks of insolvency associated with it.'[608] So, while a company may convert from a limited liability company to an unlimited company or register as an unlimited company, from a legal and corporate law perspective, its members are disadvantaged because of the lack of distinction between the members and the company.[609] This is because it is a widely held view that '[l]imited liability is the advantage which is often said to drive entrepreneurs' decisions to incorporate'.[610] This argument is also true of the CJRP reforms leading to the enactment of CA 2012.[611]

The limited number of companies which registered as unlimited companies corroborates the claim in this study that unlimited companies are not popular business models. In the UK, for example, Gower asserts that only between 100 and 200 hundred unlimited companies over the period 1996-2001 were formed.[612] A survey done in 2015 revealed that '[t]here were fewer than 5,000 unlimited companies on the register.'[613]

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[604] Section 4(2)*(c)* of CA 2012.
[605] Armour et al *Anatomy of Corporate Law* 5–9.
[606] Musisi *Company Law* 98.
[607] Gower 10 ed 16.
[608] Kiryabwire *Company Law* 49–50.
[609] See Gower 4 ed 14 for some insights from the UK perspective.
[610] Gower 10 ed 16, 29.
[611] Hansard, 11 May 2011, 13888–13890; 21 March 2012, 3044–3045.
[612] Gower 7 ed 16.
[613] Gower 10 ed 16.

To return to CA 2012, a company initially registered as a limited liability company can re-register as an unlimited company, except that where an unlimited company becomes a limited company by virtue of re-registration, it cannot re-register to revert to an unlimited company.[614] The ability of the company to register and re-register as an unlimited company offers regulatory flexibility, which is good for business. This tool (of registration and re-registration) did not exist in the repealed law. Nevertheless, it is contended that under CA 2012 SCHCs have limited options for registering or re-registering.[615]

Limited liability cushions members from personal liability beyond the value of the shares they hold. It partitions the assets of the firm from those of the individual members, and vice versa.[616] Armour, Enriques et al have described limited liability as 'a contracting tool and financing device'.[617] This benefit outweighs 'the flexibility (particularly as regards withdrawal of their capital) and privacy of their financial affairs as a partnership'[618] which is said to exist in unlimited companies. There is no denying that making limited liability easily available to a broad spectrum of businesses in Uganda was central to the enactment of CA 2012.[619]

To be sure, the privilege of 'the [f]lexibility and privacy of financial affairs' alluded to above has negative consequences. The assumption seems to be that there shall be no disclosure at all of the accounts of unlimited companies. If this were to be the case, unlimited liability curtails credit or increases the cost of borrowing and offers less protection to creditors brought about by a lack of differentiation between company property on the one hand and the personal property of members on the other.[620] The fusion of company property and that of members denies creditors a clear picture of the

[614] Section 29(1) and (2) read together with s 23 of CA 2012.
[615] Sections 23, 24, 28 and 29 of CA 2012.
[616] Armour *Anatomy of Corporate Law* 5–9; *Salomon v Salomon & Co* (1897) AC 22 (HL).
[617] Armour ibid 9.
[618] Gower 10 ed 97–98.
[619] Hansard, 11 May 2011, 3894.
[620] Kiryabwire *Company Law* 49–50.

ability of the company to pay its debts. Yet, beyond their capital contribution, companies will find commercial borrowing a useful financing alternative.

On the above point, Ferran suggests that 'the great advantage that corporate form has over firms which are sole traders or partnerships with regard to financing: the corporate form is best suited to raising large amounts of business finance and to limiting, or diversifying, financial risk.'[621] Drawing on this argument, the law should provide a flexible but progressive legal framework to allow for growth, but not to perpetually 'conscript' SCHCs to that status, which was a concern that the CLRSG raised about separate legislation for SCHCs.[622]

Gower has opined that 'the recent tendency has been to reduce the reporting requirements of small companies.'[623] This proposition is consistent with the 'small companies regime' under the UK's CA 2006 or close corporations in South Africa. In consequence, it may well be that regulatory intervention with regard to small companies seeks to achieve a flexible legal regime as opposed to erasing the basic aspects of company law such as disclosure.[624]

Despite its availability and the stated advantages, the unlimited company presents several weaknesses, as pointed above; the main weakness is the absence of limited liability, which hinders its growth as elaborated above. Therefore, the unlimited company is not a popular business form across jurisdictions, with Mayson et al suggesting that it has '[o]nly specialised uses.'[625] Below, I make some proposals for how CA 2012 can be improved upon with respect to SCHCs.

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[621] Ferran *Company Law* 1.
[622] Ibid 5; Gower 10 ed 17.
[623] Gower 10 ed 690.
[624] Ibid 689.
[625] Mayson et al *Company Law* 53–54.

3.1.4 Suggestions for reforms

3.1.4.1 Statutory modifications

There are provisions under CA 2012 which can be viewed as a compromise to lessen the compliance burden of small private companies. The conspicuous one is optional company meetings or Annual General Meeting ('AGM') for private companies; however, as the discussion below shows, some jurisdictions have extended this flexibility to accounting and audit requirements, which are mandatory in CA 2012.

a. Annual General Meeting

In terms of s 138 of CA 2012, the AGM is optional for private companies. This is a departure from the repealed Act, where the AGM was mandatory.[626] Section 138(2) of CA 2012 provides that a private company may, at the requisition of a member, hold an AGM. The company meeting is traditionally considered a tool by which shareholders check management.[627] This presupposes that there is a distinct board separate from the members.[628] Conversely, where there is no such a distinction because of 'a small number of shareholders, all of whom have ready access to information about the business and homogeneous preferences',[629] making the AGM optional is justifiable.

Indeed, in SCHCs where the members and the directors are the same, it would be inappropriate and futile to insist on company meetings when in fact none will be had at all.[630] Bainbridge has suggested that '[i]n such a corporation, voting is effectively an exercise of managerial power.'[631] As pointed out above, CA 2012 has tended to reflect

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[626] Section 131(1) of the repealed Act made AGMs obligatory for all companies.
[627] Sullivan 'Relationship between the board and members' 572–573 where the author asserts that 'Article 80 [of Table A of the UK's CA 48] was not intended to give directors a free hand in matters of management.' See also *Marshall's Valve Gear Co Ltd v Manning, Wardle & Co Ltd* (1909) 1 Ch 267.
[628] Armour et al *Anatomy of Corporate Law* 11; LA Bebchuk 'The case for increasing shareholder power' (2005) 118 *Harv L Rev* 833–914 parts II and III.
[629] SM Bainbridge 'The case for limited shareholder voting rights' (2006) 53 *UCLA L Rev* 601 at 602.
[630] Naude 'The South African close corporation' 117–119, cited by Henning 'Close corporation law reform in Southern Africa' 922–923.
[631] Bainbridge 'The case for limited shareholder voting rights' 602.

this reality by making company meetings optional for private companies.[632] However, there are weaknesses in CA 2012 on this aspect.

One clear exception to the strict application of rules on company meetings, such as the notice of meetings, the quorum and voting procedure, is that the company is a quasi-partnership company where most if not all the members are in day-to-day management.[633] They meet regularly and can easily hold informal meetings, and so the law allows them to opt of company meetings.[634] It is not that there will be no company meeting. Rather, quasi-partnership companies are absolved of the formalities of calling and holding meetings because of the small numbers and the fact that the members are in regular contact.

The ULRC noted that 'our experience shows that the majority of Ugandan private companies do not hold annual general meetings. The majority of companies in Uganda are small family-based establishments. Their membership allows for easy access to information on the affairs of the company even without the annual general meeting.'[635]

Surprisingly, having come to the above realisation about SCHCs, the ULRC recommended that the AGM is a forum in which all shareholders meet and are updated and give their opinions regarding the management of a company. Therefore, it is a very important aspect of corporate management and should not be dispensed with easily.[636] While this recommendation is correct about the purpose of meetings, this is not applicable to SCHCs for the reasons I have advanced above.

Recommendation 5(b)[637] is more useful at this point. There, and as already noted, ULRC recommended that a private company whose members are 50 are above should not be permitted to opt out of certain provisions applicable to private companies. This

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[632] See the related discussion by Kiryabwire *Company Law* 132–140.
[633] WS Hochstetler & MD Svejda 'Statutory needs of close corporations – an empirical study: Special close corporation legislation or flexible general corporation law' (1985) *J Corp Law* 849–1049 at 853. Sections 139–140 of CA 2012 contain an elaborate procedure on the calling of company meetings.
[634] O'Neal para 1.07, cited by Hochstetler & Svejda 'Statutory needs of close corporations' 853.
[635] ULRC Report 36.
[636] Ibid, recommendation 23.
[637] Ibid 19.

recommendation recognises the number of members as the basis for giving special treatment to some categories of companies. The only problem with this recommendation is that the threshold of 50 is high and leaves no body in the loop. A more realistic approach is the SCHC route, where there can be one to ten members. Therefore, my proposal is to redraft s 138 to reclassify companies for the purposes of company meetings. In the redrafted s 138(2), only private companies with one to ten members will be entitled to opt out of the mandatory formalities of a meeting. Private companies with more than ten members will be required to comply with all the meeting requirements.[638]

b. Accounts and reporting

Section 154(1) provides that every company shall cause to be kept in the English language proper books of account with respect to *(a)* all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place; *(b)* all sales and purchases of goods by the company; and *(c)* the assets and liabilities of the company, except that in respect of an existing company the requirement that the books of account shall be kept in the English language shall not have effect until after the expiration of a period of two years from the date of the commencement of the Act.

Under s 154(4), where any person being a director of a company fails to take all reasonable steps to secure compliance by the company with the requirements or has by his or her own wilful act been the cause of any default by the company of any provision of this, he or she commits an offence and is liable on conviction to imprisonment not exceeding twelve months or a fine not exceeding one currency point, or both.[639]

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[638] Section 140 of CA 2012; Kiryabwire *Company Law* 135–140.
[639] Under s 2 and the First Schedule to CA 2012, one currency point is Uganda shillings 20,000 (approximately USD 540.00 or ZAR 9,523.00).

Section 154(5) provides that, subject to sub-s (4), *(a)* in any proceedings against a person in respect of an offence under this section consisting of a failure to take reasonable steps to secure compliance by the company with the requirements of this section, it shall be a defence to prove that he or she had reasonable grounds to believe and did believe that a competent and reliable person was charged with the duty of seeing that those requirements were complied with and was in a position to discharge that duty; and *(b)* a person shall not be sentenced to imprisonment for an offence under sub-s (4) unless in the opinion of the court, the offence was committed wilfully.

The other aspects of accounting and auditing which are elaborated upon are the profit and loss account and balance sheet (s 155); general provisions as to the contents and form of accounts (s 156); the obligation to lay group accounts before the holding company (s 157); the form of group accounts (s 158); the contents of group accounts (s 159); and the financial year of the holding company and subsidiary (s 160).[640]

It obviously benefits the company to keep proper books of accounts to 'give true and fair view of the state of the company's affairs and to explain its transactions'.[641] However, an analysis of the accounting and auditing provisions above shows that, first, preparing and keeping books of accounts is a mandatory annual obligation for all companies irrespective of their type, size or membership. The accounts must be in a prescribed format.[642] The company's balance sheet and profit and loss account must comply with the requirements of the Fifth Schedule to this Act, so far as applicable.[643]

The Fourth and Fifth Schedules to CA 2012 contain elaborate principles of accounts with a combined total of 56 clauses. This is an overlay of legislation as alluded to earlier of companies legislation generally. The provisions on holding or group companies do not apply to SCHCs. This study proposes that a simple accounts structure for SCHCs should be worked out. If the principles are to be maintained as one single set

[640] See s 161 for the meaning of 'holding company'.
[641] Section 154(2) of CA 2012.
[642] Section 156 of CA 2012.
[643] Section 156(2) of CA 2012.

of principles, I propose that a schedule with only principles on audit and accounts that are relevant to SCHCs be inserted in the Fourth and Fifth Schedules.

This study has established that accounts and reports is one area where corporation statutes have provided for flexible provisions or less mandatory disclosure.[644] Therefore, in so far as s 154 applies to all companies, it needs to be redrafted in line with best practice to reflect the reality that SCHCs cannot be regulated in the same way as other companies. One route is to develop simplified accounts for SCHCs, which requires redrafting the Fourth and Fifth Schedules. This task can be achieved in consultation with professional bodies such as the Institute of Certified Public Accountants of Uganda ('ICPAU'), which is a body corporate established under the Accountants Act.[645] Its mandate is to regulate and maintain the standard of accountancy in Uganda, and to prescribe and regulate the conduct of accountants and practising accounts in Uganda.[646]

Second, best practice has been to de-criminalise companies legislation and to prefer fines because company wrongs are considered technical.[647] Fines are a sufficient deterrent because shareholders in SCHCs regard their firms as their employment base.[648] If fines are construed as a threat to the capital base of the SCHCs, this will elicit the desired compliance from shareholders. Therefore, in keeping with international best practice, I propose that the offence created under s 154(4) for non-compliance with the provision be removed and replaced with a fine for non-compliance. In any case, when considered as a whole, s 154(5)*(a)* and *(b)* offers a strong defence of the lack of knowledge or the belief that someone else was performing the compliance role. For that reason, it is suggested that prosecutors will find it difficult to successfully prosecute culprits for non-compliance with s 154(4).

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[644] Gower 10 ed 17, 689; s 30(2A) of SACA, 2008.
[645] Act 19 of 2013, available at Accountants Act, 2013.pdf (icpau.co.ug).
[646] Section 4*(a)* and *(b)* of the Accountants Act, 2013.
[647] Naude 'The South African close corporation' 128.
[648] RA Ragazzo 'Toward a Delaware common law of closely held corporations' (1999) 77 *Wash UCQ* 1099–1151 at 1102.

The redrafted CA 2012 proposed in this study is one where there is less use of penal sanctions for breaches of the Act save for serious breaches such as falsification of records, false declarations or false accounting. Rather, in accordance with international best practices, the use of fines is preferred for any breaches of duty under the Act. For the reasons that are advanced in this section, the UGX 2 million penalty is sufficient deterrence to ensure compliance with audit and reporting obligations.

c. Audit

The requirement for the appointment of auditors under ss 167–171 is mandatory for all companies. Section 167(1) provides that every company shall at each annual general meeting appoint an auditor to hold office from the conclusion of that annual general meeting until the conclusion of the next annual general meeting. The appointment of the auditor is by special resolution.[649] Where at an annual general meeting no auditors are appointed or re-appointed, the registrar may appoint a person to fill the vacancy.[650]

The import of s 167 is that, first, it is mandatory for all companies to appoint an auditor. Second, the same rules apply to all companies. Subjecting SCHCs to the same rules as other companies is inappropriate and elicits sham or no compliance at all.[651] Drawing on the South African example, 'the close corporation is not required to have an annual audit as with a company unless this is a requirement of any association agreement.'[652] In any case, it is still open to third parties who deal with SCHCs who are not obliged to keep audited books of accounts to demand under contract that they provide these on a case-by-case basis. The best approach is to make such provisions optional for small private companies.[653]

[649] Section 168 of CA 2012.
[650] Section 167(4) of CA 2012.
[651] Naude 'The South African close corporation' 117–118.
[652] Spisto & Samujh 'Close corporations in South Africa' 163.
[653] Reid & Priest 12.

Moreover, the mandatory audit requirements also ignore the CJRP recommendation. On audits, the ULRC recommendation 22 was *(a)* to the effect that the preparation of audited accounts by private companies should be a matter of the internal management and constitution of the company and should not be imposed by law; and *(b)* accounts prepared should be done in accordance with generally accepted accounting principles.[654] This recommendation ought to be revisited in the light of best practice.[655]

Generally, the ULRC had contemplated 'opting out provisions for private companies.'[656] This however was not clear in CA 2012. In my proposed amendments to CA 2012, one of the interventions is to provide a schedule of provisions from which SCHCs can opt out. The purpose of this schedule is to make the Act user-friendly so that SCHCs do not have to work through the entire Act to look for provisions which apply to them.[657] That way, reading of the law is simplified for the unsophisticated Ugandan businessperson. Further, Reid & Priest draft report had, in fact included a regulatory scheme pursuant to which the members of small private companies could dispense with the appointment of an auditor.[658] This recommendation was not adopted in CA 2012.

To the extent that CA 2012 subjects all forms and sizes of companies to the same audit requirements, it is doubtful whether the CJRP's stated objective of a simple accessible companies' law for SCHCs has been achieved. It is proposed that the provisions for auditor appointment and rotation are made optional for SCHCs. This proposal accords with the general policy in the law of de-regulation except for 'matters of grave importance so far as the public or state are concerned'.[659] It also accords with the ULRC recommendations above.

In the next section, the study explores basic corporate governance structure before delving into the specific corporate governance framework under CA 2012.

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[654] ULRC Report 35.
[655] See the discussion in para 5.2.1.2.
[656] ULRC Report 32.
[657] Gower 5 ed 106.
[658] Reid & Priest 12.
[659] Article 33 of the Bill.

3.2 Basic corporate *g*overnance *s*tructure

3.2.1 Definitions

Baums and Scott understand corporate governance 'broadly' as

> encompass[ing] every force that bears on the decision-making of the firm. That would include not only the control rights of the stockholders, but also the contractual covenants and insolvency powers of debt holders, the commitments entered into with employees and customers and suppliers, the regulations issued by governmental agencies, and the statutes enacted by parliamentary bodies. And in a still more comprehensive sense, the firm's decisions are powerfully affected by competitive conditions in the various markets in which it transacts, and indeed by the social and cultural norms of the society in which it operates.[660]

In the ULRC Report,[661] corporate governance is understood to mean

> the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission.

3.2.2 General principles

As shown in chapter 2, legal and corporate governance structure generally has two foundational preoccupations. The first is the internal corporate structure and business policy which regards managers as the custodians of corporate power.[662] This means that business policy and the managerial exercise of corporate power are protected from

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[660] Baums & Scott 'Taking shareholder protection seriously?' 34.
[661] ULRC Report 41.
[662] *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* (1906) 2 Ch 34 (CA); see the related argument in S Cools 'The real differences in corporate law between the United States and Continental Europe: Distribution of powers' (2005) 30 *Del J Corp L* 697–766 at 739.

intervention by all other different parties associated with the firm.[663] Business policy should rarely be a subject of regulation.

This resonates with Tudway's description of the firm as 'a black box',[664] 'a network of comprehensive commercial contracts'[665] or 'a private institution governable only by rules of commercial law and not an appropriate vehicle for regulation'.[666] Apparently, 'management is constrained in its actions through contractual discipline and by market forces.'[667] This corporate structure is very prevalent in liberal economies.[668]

Second, and in its modern form, is the manager–stakeholder relationship. There is little controversy that the corporate governance of the firm contemplates a relationship between managers and various stakeholder actors in the firm. The debate usually concerns how that relationship should be achieved and whether it has an impact on the corporate governance of firms. The discussion of stakeholder management in chapter 6 has been undertaken in this study only to the extent of the alternative enforcement of the CoCG, modelled on the King Code.

3.2.3 Regulation of corporate governance

In general terms, not much regulation is directed at the corporate governance and business policy of private enterprises.[669] Nonetheless, the regulation of corporate governance can be seen in a number of areas. The first is routine publicity.[670]

Publicity, in this context, places an obligation on the firm or its directors to file its corporate documents, such as the particulars of managers, the registered place of

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[663] Bainbridge 'Director primacy' 1735; Griffith 'Good faith business judgment' 10–12.
[664] Tudway 'The juridical paradox of the corporation' 66.
[665] Ibid.
[666] Ibid 66, 84.
[667] Ibid 79. The market forces control ('MFC') of managerial power is beyond the scope of this study.
[668] Hansmann & Kraakman 'The end of history' 447; MB Fox & MA Heller 'Corporate governance lessons from Russian enterprise fiascos' (2000) 75 *NYU L Rev* 1720–1780 at 1721.
[669] See para 2.5.1.
[670] Gower 4 ed 41.

business, annual returns, audited accounts and similar information, with the regulator, usually the registrar of companies.[671] While some of these publications are routine and have minimal cost implications, such as notifying the place of business and providing particulars of managers, others, such as providing annual audited accounts, as argued above, can be burdensome. As a result, there has been some form of legislative intervention to recognise the fact that SCHCs may find some of these compliance requirements onerous over time and hence made them optional for this category of companies.[672]

In these publications, there is a presumption of regularity: all is well until otherwise put on notice, which is the rule in *Turquand*.[673] The rule limits enquiries about the internal corporate governance matters of the firm by outsiders who deal with the firm. The *Turquand* rule presupposes the regularity of everything which comes from the firm. A further presumption is that an outsider who deals with a firm is deemed to know the nature and extent of the firm's mandate on the basis of the information published for the general public. CA 2012 has, however, modified this position, and there is 'no duty to enquire as to capacity of a company or authority of directors.'[674]

The endemic problem with these publications is the insufficient capacity of the regulator to inquire into, and independently verify, their accuracy. To illustrate this point, s 132 of CA 2012 requires a company having a share capital to file annual returns every year, in the manner prescribed. The annual return should contain the registered office of the firm, registers of members and debenture holders, shares and debenture indebtedness, past and present members and directors and secretary, the matters specified in Part 1 of the Fourth Schedule to the Act; the return shall be in the form and shall be made up to the date set out in Part II of that Schedule or as near to it as

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[671] See s 51 of CA 2012, which provides that '[a] company's capacity is not limited by its memorandum.' This provision has effectively modified the *ultra vires* doctrine as espoused in cases such as *Ashbury Rly Carriage & Iron Co Ltd v Riche* (1875) LR 7 HL 663.
[672] Section 30(2)*(b)* of SACA 2008.
[673] (1856) 6 E & B 327, cited in Gower & Davies 17 ed 144, 157–165; JL Yeats 'The drafters' dilemma: Some comments on the Corporate Laws Amendment Bill' (2006) 4 *SALJ* 601–614 at 612.
[674] Section 51 of CA 2012.

circumstances admit. Part 1 of the Fourth Schedule referred to in the section is in respect of the balance sheet, which covers aspects of authorised share capital, issued share capital, liabilities and assets, reserves, provisions, liabilities, and fixed and current assets. In effect, most if not all of these publications have become standard and routine. The only comfort on their fairness, correctness, and honesty is certification by directors and auditors. In terms of s 135 of CA 2012 the annual returns must be accompanied by a balance sheet certified by a director and a secretary, and auditors' reports.

The certifications although good because an action can be founded on false or fraudulent declarations are no obvious guarantee of the fair representation of the affairs of the firm.[675] This is because in the corporate structure managers are largely the source of information that is used in these publications. If material corporate information is withheld or false declarations are made, the final publication would not be a fair representation of the affairs of the firm. In the circumstances, given the associated costs burden with no guarantee of indemnification, it takes an over-vigilant 'outsider' with an interest in the affairs of the firm and much less, the regulatory institutions, to carry out independent verifications and audits of these publications.

Second, the discussion of the CoCG shows that the penalty for non-compliance with the law is in most cases a fine for the firm, which is undesirable.[676] Attaching personal liability to the individual wrongdoer is proposed for purposes of the CoCG in particular.

The third issue is de-regulation. The general view is that 'over-regulation' and the 'immorality' of it is harmful to investment. In the ULRC Report,[677] the Clare Manuel Report,[678] and the Reid and Priest Report,[679] the call to deregulate companies' internal operations was dominant. However, the question usually is how to strike a balance. It

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[675] *Kingston Cotton Mill Co (No 2)* (1896) 2 Ch 279*; Formento (Sterling Area) Ltd v Selsdon Fountain Pen Co Ltd* (1958) 1 WLR 45*; Barings Plc v Coopers and Lybrand* (1997) 1 BCLC 427; and *Berg and Co Ltd v Adams* (1993) BCLC 1045.
[676] See para 3.2.2.
[677] ULRC Report 1–2.
[678] Ibid 9.
[679] Reid & Priest 1–3.

follows that, in the public interest, determining certain specific corporate governance issues should not be left exclusively to the articles of association for the purpose of 'taming' the 'harsher aspects of capitalism'.[680]

Finally, regulation is enforced by institutions such as courts and regulators – in the present case, the Registrar of companies.[681] This enforcement model suffers from institutional inadequacies. The success of CA 2012 requires a demonstrable effort to respond to the regulatory enforcement deficiencies.[682] In the next section, the study explores specific corporate governance concerns that existed before CA 2012.

3.3 Corporate governance concerns before CA 2012

The idea of the Code of Corporate Governance ('CoCG') did not explicitly emerge from the Reid and Priest and Clare Manuel Reports nor is there a specific recommendation on it. However, the position of the Reid and Priest Report was that the deregulation of private companies should be balanced to avoid corporate abuses.[683] However, the ULRC Report contains a significant discussion of the subject. The conceptual thinking about corporate governance in the ULRC Report is materially replicated in the CLPA Report at the committee stage of the Bill and ultimately in s 14 of the Act.[684]

The ULRC Report, besides defining corporate governance, emphasised the promotion of 'transparency and accountability by and within companies'[685] and 'integrity and fairness'.[686] The ULRC Report is clear that this 'does not mean that the law should merely facilitate and secure freedom for management and controllers of business entities.'[687] The Report adds that '[t]here is a trade-off between freedom and

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[680] J Plender *The Stakeholding Solution* (1997), cited by Dean *The Stakeholder Society* 117.
[681] Para 3.5.2.
[682] Hansard, 21 March 2012, 3045, 3048; Hansard, 11 May 2011, 13890.
[683] Reid & Priest 3, 8.
[684] Para 3.3; ULRC Report 41.
[685] ULRC Report 41.
[686] Ibid.
[687] Ibid 2.

abuse and between freedom and efficiency.'[688] The ULRC Report further notes that 'in its reforms [i]t seeks to ensure that appropriate high standards of conduct are maintained. Such standards are important components in promoting competitiveness and efficiency.'[689]

The ULRC Report adds that '[s]uch standards give rise to demands on management which must be recognized both internal from shareholders, partners and others external, ensuring business activity responds also, to the maximum extent it efficiently can, to wider economic, environmental and social needs.'[690] The Report contains a draft CoCG, the text of which is replicated in the CoCG.[691] The recommendation was that the CoCG should be incorporated in the Act and that the provisions should be optional.[692]

Notably, the ULRC Report makes no specific recommendation on how the proposed high standards of conduct of managers are to be achieved in the law given the fact that, unlike the conceptual framework in the CLPA Report where the CoCG would be mandatory for publicly held firms and optional for closely held firms,[693] the CoCG in the ULRC Report was to be optional for all firms.[694] However, it is evident from the above passages that the idea of high standards for managers informed the CoCG both at the initial stages of the CJRP and during the final enactment of the law. In its definition of corporate governance above, the ULRC Report envisaged an expanded duty for managers: to look at the business holistically to cover both the social and economic needs of society.[695]

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[688] Ibid.
[689] Ibid.
[690] Ibid.
[691] Ibid 217–227.
[692] Ibid 41.
[693] Hansard, 21 March 2012, 3058–3059.
[694] ULRC Report 41.
[695] Ibid.

At the second reading of the Bill, concerns about managers in SCHCs were described thus:

> [I] do not know what article we shall enforce so that we have real good governance. The reason companies are collapsing is because their owners are involved in the day-to-day management and even fraud. In some cases when they are asked a question by the internal auditors, they sack them. The purpose of the audit committee is to promote accountability both within and without and make the board members and the owners of the business accountable.[696]

The above passages suggest that corporate governance in SCHCs in Uganda was an important topic when CA 2012 was enacted. The legislature was alive to the fact that companies that are owner-managed had to be taken into account when enacting the law. Thus, the regulatory response to these concerns is critical if the economic role that is 'assigned' to SCHCs in the CJRP is to be achieved.[697] In the next section the study explores the legal and corporate governance structure under CA 2012 to establish whether it promotes simple operations for SCHCs.[698]

3.4 Corporate governance structure under CA 2012

In this section, I argue that the legal and corporate governance structure under the CoCG is complex for and inapplicable to SCHCs. Moreover, its enforcement model is not aligned to best practices. I then make some proposals on how the CoCG can be redesigned to cater for SCHCs.

[696] Hansard, 21 March 2012, 3048. Fraud is beyond the scope of this study.
[697] ULRC Report 4.
[698] Ibid para 1.2.10.

3.4.1 Section 14: Adoption and application of Table F

3.4.1.1 Principles and perspectives

The CoCG is provided for in s 14 and Table F. Section 14(1), as amended, provides that the CoCG specified in Table F shall apply to every public company that does not comply with any corporate governance provisions or code prescribed under any other law. This amendment absolves public companies that are bound by sector-specific codes of corporate governance, such as those in financial services, from complying with the CoCG.

Section 4(2) provides that '[a] private company may, at the time of registration of its articles, or subsequently, adopt and incorporate into its articles the provisions of the code of corporate governance contained in Table F. Section 4(3) provides that where a company adopts all or any part of the Codes [sic] in Table F, a printed copy of that table shall be annexed to or incorporated in each copy of its articles of association.[699] Section 4(4) provides that a company that has adopted the code of corporate governance shall annually file a statement of compliance with the Registrar and the Capital Market Authority. Section 4(5), as amended in 2022, provides that a *company that fails to comply with subsection (4) shall be liable to a fine of five hundred currency points*.[700] I will return to this amendment later in this section. Finally, section 4(6) provides that the Minister shall, in consultation with the Capital Markets Authority, by statutory instrument amend Table F. The 'Minister' means the Minister of Justice.[701]

The final text of s 14 as cited above is slightly different from the original cl 14 in the Bill. Clause 14 initially had only three sub-clauses: (1), (2) and (3). However, at the second reading of the Bill, sub-clauses (4), (5) and (6) were introduced and they

[699] The word 'Codes' instead of 'Code' appears in the original text; see *Appendix A.*
[700] Emphasis added.
[701] Section 2.

became subsections (4), (5) and (6). Undoubtedly, these provisions were intended to strengthen the enforcement mechanism of the CoCG.[702]

The CoCG is optional for private companies – which include SCHCs – while mandatory for public companies, which are not the subject of this study. In terms of s 14(3) a private company may adopt all or any part of the CoCG, in which case it must annex it to the memorandum and articles of association. Adopting the CoCG comes with a dual obligation to file an annual statement of compliance with the Registrar and the CMA,[703] failing which the company in default is liable to pay a fine of 500 currency points.[704]

The option of the private company adopting only part of the CoCG gives private companies the flexibility to adopt the CoCG in portions. This addresses the problem of the compliance burden since private companies can adopt only those parts of the CoCG which they find are either necessary or less burdensome and this is to be welcomed. However, the optional nature of the CoCG does not tell the whole story. The CoCG suffers from some weaknesses, as explained in the next section.

3.4.1.2 Weaknesses in the CoCG

First, the CoCG is a single document presumably intended for both public and private companies, small and large companies. This is all well and good and it is in line with the overall objective of the CoCG to achieve good corporate governance in the entire business sector.[705] However, it is not immediately clear which aspects of the CoCG are intended for SCHCs. In the CoCG's current form, SCHCs have to search the entire Code for provisions that are appropriate for them. Moreover, some of the principles are complex and inapplicable to SCHCs. For example, the CoCG contains detailed

[702] Hansard, 21 March 2012, 3058.
[703] Section 14(4).
[704] Section 14(5).
[705] Hansard, 11 May 2011, 13890; Hansard, 21 March 2012, 3058–3059.

accounting reporting requirements that are burdensome for SCHCs.[706] As demonstrated earlier, best practice has generally tended towards less reporting obligations for SCHCs.[707] To that end the format of the CoCG should be reworked to delineate aspects of the CoCG that are specific to the different legal categories. This can be achieved by way of inserting a schedule of principles in the CoCG that are simplified, flexible and consistent with a quasi-partnership form, and aimed at the SCHC category.[708]

Second, s 5*(b)* of the Companies Amendment Act, 2022 ('CAA 22'), amended s 14(5) in respect of the penalty for default on the statutory declaration in s 14(4) by substituting a fine of 50 currency points with a heavier fine of 500 currency points. This equals UGX 10 million, which is approximately USD 3,000. If one uses the classification of companies by the MTIC Policy Document,[709] this fine is equivalent of the capital of a macro company, which is stated to be UGX 10 million. This is a ten-fold increment and therefore disproportionately prohibitive. This study proposes that this fine should be reviewed with the capital base of SCHCs in mind. If a fine equals the entire capital base of an SCHC, this may deter SCHCs from adopting the CoCG.

Third, the dual reporting by private companies to the Registrar and the CMA on the CoCG is burdensome. Besides, in terms of s 5 of the Capital Markets Authority Act ('CMAA'),[710] the principal mandate of the CMA is exclusively public listed companies. Thus, requiring a private company to report to the Registrar and the CMA on the same matter but without clarity on what each of them is expected to do is undesirable, financially onerous for SCHCs, and not sustainable in the long term. In any case, the CMA has little, if anything, to do with private companies.

Fourth, it is not clear what should be declared in the statement of compliance.[711] The content and form of this declaration remains a matter of speculation. Statutory

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[706] Articles 12, 15 and 17.
[707] Gower 10 ed 17, 689.
[708] See the related discussion in para 5.2.1.1.
[709] MTIC Policy Document 10.
[710] Cap 84 (as amended).
[711] J Katto, S Wanyama & ME Musaali *Corporate Governance in Uganda: An Introduction to Concepts and Principles* (2014) 71.

declarations of a kind contemplated under the CoCG ought to be clear in text and form to ensure uniformity in enforcement. This lacuna can be cured by redrafting the CoCG to provide for the mode of declaration with residual power to the Registrar to prescribe the form of declaration.

The fifth weakness is that under the CoCG the penalty attaches to the firm and not to the individual officers in the case of default. This is a contradiction given the overall duty of the board and the individual directors to ensure that the principles contained in the CoCG are observed.[712]

Sixth, s 14(6), as noted above, is intended to provide a mechanism for regular updating and revision to bring the CoCG into line with the ever-changing business world. This claim is supported by Hansard. On amending clause 14 to include the new sub-clauses (4), (5) and (6), Hansard reads as follows:

> Madam Chairperson, the justification is to ensure that companies that have adopted the code of corporate governance comply with it. And secondly, the code is *a living document* that contains principles that change from time to time. Therefore, it is necessary to keep updating it.[713]

Regular revision of the CoCG is critical for three reasons. First, it will provide a predictable line of course with mechanisms for measuring progress in adopting and enforcing the CoCG. Second, it will allow for the assessment of the contribution of the CoCG to the growth of the private sector in keeping with the overall objective of the CJRP.[714] The performance of the CoCG can be assessed through research, led by the government.[715] The outcome of the research can inform the reform of the CoCG to achieve flexibility within the broader CJRP objectives.[716] Finally, revision allows for the CoCG to be updated in line with international best practice.

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[712] Article 22 of the CoCG.
[713] Hansard, 21 March 2012, 3058 (emphasis added).
[714] See para 1.3.
[715] Section 185 of SACA 2008 establishes the CIPC. One of its mandates under s 188 is to ensure that the Act is up-to-date with international best practice through reporting, research, etc; see para 3.6.1ff.
[716] Para 1.3.

However, restricting the amendment of the CoCG to the Minister and the CMA excludes major stakeholders and potential end-users of the CoCG such as traders, business groups and other professional bodies. This limitation is perhaps the reason why there is no record of review of the CoCG since the Act's enactment in 2012. Therefore, I propose that the CoCG review mechanism be broadened beyond the Minister and CMA to include, among others, traders' associations, the ICGU, FESMEs and the MTIC – the line Ministry.[717] As noted earlier, to achieve a broad-based stakeholder-inclusive review of the CoCG requires either *(a*) amending s 14 to accommodate other stakeholders; or *(b)* decommissioning it from the principal Act. The latter subject is explored further in chapter 6.[718]

Moreover, while private companies can adopt the CoCG in whole or in part, the legislature did not give them the privilege to amend any part of the CoCG – this role is reserved for the Minister and the CMA. They must adopt it on an 'as is' basis. This denies the CoCG the crucial element of flexibility, which was a key consideration in the CJRP, and hence defeats its purpose, particularly for SCHCs.

Seventh, having benchmarked South Africa and the UK, and applying the most minimalist compliance approach, requiring an annual explanation from private companies which do not adopt the CoCG is necessary and uncontroversial. In the King III Report, it was remarked that requiring an explanation in itself results in compliance.[719] The explanations give the regulator an opportunity to ascertain the reasons for not adopting the CoCG. Ultimately, these explanations become a source of primary data on how to improve and broaden the utility of the CoCG, thereby giving it an outlook similar to that of the King Code. To give effect to this proposition, however, requires further classification of companies in terms of the earlier suggestions so that SCHCs are not obliged to make these explanations.

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[717] MTIC 2015 Policy Document 31.
[718] See para 6.6.
[719] King III 7.

Eighth, the CoCG sets out a wide range of responsibilities of the board.[720] It contains 22 broad articles with sub-clauses and is extensive in terms of principles and structure. The CoCG provides for Board Composition,[721] Risk Management,[722] Application and Reporting,[723] Scope of Internal Audit,[724] Integrated Sustainability Reporting,[725] Organisational Integrity or Code of Ethics with a stakeholder-inclusive approach;[726] detailed provisions on Accounting and Auditing,[727] Reporting of Financial and Non-Financial Information,[728] Relations with Shareholders,[729] Communication,[730] and, lastly, Implementation of the Code.[731]

These principles are wide in scope and elaborate. On the basis of the working definition of SCHCs adopted in chapter 1, it is contended that these principles undesirably set the compliance bar far too high for the SCHC category. To put this matter in perspective, art 17(1) on accounting provides that '[f]inancial statements shall be presented in line with applicable national laws and in accordance with International Financial Reporting Standards unless otherwise allowed by the Institute of Certified Public Account [of] Uganda.' This article sets an international standard for prudent financial management and accounting and it is not clear what these principles are. Further, the applicable national laws on accounting are equally wide and extend to tax laws.[732] The net effect of this provision is that besides having to read through CA 2012, SCHCs must familiarise themselves with all laws relevant to accounting, tax and finance. The main law is the Income Tax Act; there is no doubt that this requires resources for training and compliance.

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[720] Article 1(4).
[721] Article 2.
[722] Article 11.
[723] Article 12.
[724] Article 14.
[725] Article 15.
[726] Article 16.
[727] Article 17.
[728] Article 18.
[729] Article 20.
[730] Article 21.
[731] Article 22.
[732] E.g. the Income Tax Act Cap 340 and the Value Added Tax Act Cap 349.

Finally, as demonstrated earlier,[733] company legislation has accorded SCHCs flexibility in compliance in accounting and audits. SCHCs can either opt out of certain obligations for accounting purposes or they are presented with much simpler accounting formats. This is not the case with CA 2012, which obliges every company to appoint an auditor.[734] For relations with shareholders, this is not significant. As illustrated earlier,[735] shareholders and managers in SCHCs are the same. This aspect of the CoCG works best in companies where there is a distinction between shareholders and the board. Similarly, on the requirement for Organisational Integrity or a Code of Ethics with a stakeholder-inclusive approach – a subject explored in detail later in this thesis[736] – it has been shown that stakeholding in company management in SCHCs is inapplicable. This tool has been employed in large corporations with various stakeholder interests.[737] The application of this part of the CoCG to SCHCs is fallacious.

3.4.1.3 Enforcement models of codes of corporate governance

Codes of corporate governance are essentially private soft law instruments.[738] They are usually best practices designed for and enforced by individual firms.[739] They are usually voluntary in nature, lacking in external monitoring mechanisms, and usually suffer from issues of credibility.[740] The inherent weaknesses in the individual codes of corporate firms is a probable explanation for the latest attempts to standardise corporate best practices by incorporating them into legislation, as has been done with the CoCG.[741]

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[733] Para 3.1.4.2(b).
[734] Section 167 of CA 2012.
[735] Para 1.2.
[736] Para 6.2.
[737] Para 2.2.3.
[738] SD Murphy 'Taking multinational corporate codes of conduct to the next level' (2004–05) 43 *Colum J Int Law* 389–433 at 430–431; A Harry 'Reinventing labour law for the global economy' (2001) 22(2) *Berkeley J Employment and Labour Law* 274–294 at 289.
[739] Ibid.
[740] Ibid.
[741] P Redmond 'Transnational enterprise and human rights: Options for standard setting and compliance' (2003) 37(1) *The International Lawyer* 69–102 at 87–90.

The UK's approach to corporate codes, although for listed companies[742] – which are not the subject of this study – is worth mentioning and can be traced back to the Cadbury Report.[743] The Cadbury Committee noted that while the boards of companies 'must be free to drive their companies forward, [they] must exercise that freedom within the framework of an effective accountability'.[744] The issue of accountability is applicable to all firms, regardless of whether they are listed or private. The Cadbury Report led to several other Reports, which culminated into the Combined Code.[745] The significance of the Combined Code in the present study is its enforcement model of 'comply or explain' which is credited for its flexibility.[746] In terms of the Code, listed companies are required to disclose the extent of their compliance with the Code in the previous 12 months and, if they have not complied, they must provide reasons for their failure to comply.[747] Disclosure is a form of enforcing codes of corporate governance that can be used to improve the enforcement of the CoCG.

Gower remarks that 'the possibility of not complying fully with the Code gives the companies in question flexibility in adapting the provisions of the Combined Code to their particular circumstances, whilst the need to "explain" gives the Code a somewhat greater force than a recommendation which companies are free to accept or reject.'[748] Similarly, Black et al have noted that flexibility in the law speaks to particular needs across jurisdictions[749] or in different contexts. The flexibility potentially addresses two other practical challenges: imperfections arising from 'transplanted' legislation, and compliance burdens in terms of time and actual financial considerations.[750]

In South Africa, the King Code is independent of SACA 2008. Its compliance model has evolved from 'apply or explain' in King I in 1994, to 'apply and explain' in

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[742] Ibid 323.
[743] Cadbury Report paras 2.1–2.8.
[744] Ibid 9.
[745] Greenbury, Hampel, Turnbull, Smith and Higgs Reports; Gower 17 ed 321–326; King III 6–7.
[746] Gower 17 ed ibid.
[747] Ibid 322.
[748] Ibid.
[749] Black et al 'Corporate law from scratch' 245–246.
[750] Reid & Priest 3.

King IV in 2017.[751] The legitimacy of the King Code lies in the broad composition of its executive committee, which spearheads its regular reviews.[752] In this composition lies support for the claim that the King Code is 'an internationally recognised brand'.[753] Moreover, the King Code is increasingly receiving judicial approval.[754] The utility of the CoCG for SCHCs ought to be reconsidered using the King Code model because of the latter's stakeholder inclusion and participation, its enforcement model. However, this may require the separation of the CoCG from CA 2012 to allow for more stakeholder participation.[755]

Having benchmarked South Africa and the UK, and applying a minimalist compliance standard, a requirement under CA 2012 for an annual explanation by prescribed private companies is proposed. The term 'prescribed companies' means that there has to be further classification of a private company to create the SCHC label whose members are between 1-10 that are not subject of the explain requirement. On the other hand, 'prescribed companies' are those private companies with 11 to 50 members, which must apply or explain the CoCG. Those with 50 to 100 members must comply alongside public companies. This latter proposal accords with the ULRC recommendation made during the CJRP consultations, that companies with more than 50 members should not be allowed to opt out of the provisions of the Act.[756]

King III remarked that to require explanation in itself results in compliance.[757] Notwithstanding the legislative intention to keep the CoCG optional for SCHCs,[758] reviewing this position with respect to some material aspects of the CoCG is justifiable. Reviewing the CoCG is a policy matter which cannot be left to private instruments or the discretion of SCHCs.

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[751] King IV 7.
[752] King III 136.
[753] Ibid 5.
[754] *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Company Ltd and Others* 2006 (5) SA 333 (W) 337, where the court explicitly referred to paras 16.3 to 16.7 of King II.
[755] See paras 3.2.2 and 6.6.
[756] ULRC Report 18–19.
[757] King III 7.
[758] Hansard, 21 March 2012, 3058.

Further, companies that fall outside the SCHC category and that have not adopted the CoCG would be required, without the threat of sanctions, to render annual explanations on what they have done about the CoCG.[759] These explanations give the regulator an opportunity to ascertain the reasons for not adopting the CoCG. In addition, these explanations become a source of primary data upon which to improve and broaden the utility of the CoCG, thereby giving it an outlook similar to the King Code.

3.5 Institutional framework under CA 2012

Under CA 2012, the key institution is the Registrar. Section 14 only assigns a nominal role to the CMA with respect to the enforcement of the CoCG, as discussed above. However, the Uganda Registration Services Bureau ('URSB'), although outside the CA 2012, plays a role in the operations of the companies' registry. I will return to the URSB.

3.5.1 The Registrar

Under CA 2012, and indeed in the repealed Act,[760] the Registrar of Companies is the regulator and custodian of records of corporate firms in Uganda. He or she also plays a quasi-judicial role.[761] He or she enjoys general powers over registered corporate entities and can have access to, or require the production of, any corporate document for inspection.[762] He or she may seek explanations from the company on any particular matter of interest, or make an order accordingly.[763]

Furthermore, the Registrar's power extends to calling for or causing the holding of firm meetings and closing firms.[764] His or her quasi-judicial function allows the

[759] Section 14(4) of CA 2012.
[760] Cap 110.
[761] Sections 172 and 173 of CA 2012.
[762] Section 172 of CA 2012.
[763] Ibid.
[764] Ibid; reg 3 of the Companies (Powers of the Registrar) Regulations, SI No 71 of 2016.

Registrar to issue such directions as are just and necessary with respect to firm management.[765] The decisions of the Registrar on some matters are appealable to the High Court.[766] In terms of reg 4(1) of the Companies Regulations 71 of 2016, the registrar shall not hear any matter or application pending before court which has been brought to his or her notice. There are areas that can be improved.

An important issue is the power to make regulations. Reid and Priest observed that, under the repealed Act, 'the registrar of companies lacks the authority to operate effectively as a regulatory institution.'[767] They further noted that 'the registrar has authority to reject filings that do not comply with certain formalities',[768] 'but it has no authority to promulgate regulations or rules to effectuate the purposes of the Uganda Companies Act.'[769] While the appointment of inspectors, which was done by the court in the repealed Act,[770] has been transferred to the Registrar under CA 2012,[771] the power to make regulations – which had been proposed by Reid and Priest – was not granted. That power lies with the Minister.[1] Under s 294(1) of CA 2012, '[t]he Minister may by Statutory Instrument, make regulations for giving full effect to this Act and in particular for making provision for any matter required to be prescribed or provided for by the Minister.' However, Reid and Priest's preference was for the CMA to enforce CA 2012.[772]

The role of the Minister in the administration of CA 2012 needs to be reconsidered. It is proposed that the Registrar becomes an autonomous institution to minimise political interference in its operations. The Minister can retain general policy oversight over the Registrar, while the latter retains operational autonomy, including the power to make practice notes or practice directions to give further effect to CA 2012. As shown below, the distinctive feature in institutions under SACA 2008 is their relative

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[765] Section 173 of CA 2012 on inspection.
[766] Section 173(3) of CA 2012.
[767] Reid & Priest 30.
[768] Section 44(3) of the repealed Act, cited in Reid & Priest.
[769] Reid & Priest 30.
[770] Ibid.
[771] Section 172 of CA 2012.
[772] Reid & Priest 30.

autonomy, protected by the law, with clear parameters about when the line minister can direct their operations. I explore this argument late in this section.

3.5.2 Uganda Registration Services Bureau

The Uganda Registration Services Bureau ('URSB') is established by the Uganda Registration Services Bureau Act.[773] The URSB enjoys relative autonomy with respect to registration services, which include the maintenance of registers, data and records.[774] The URSB houses the companies registry, and other registries under the Registrar General.[775] Despite being established under a different legal regime and not the 2012 Act, the URSB's autonomy suggests that the legislative intention was that the body would develop capacity and operate efficiently on matters of registration, the storage of data, and searches.

One critical area in which the URSB must be assisted to develop capacity relates to the verification of information that is filed by different companies and held by it. This helps to detect or minimise the falsification of records by corporate officials. The power to prosecute those who file false or fraudulent documents with any of its registries is necessary to improve the integrity and reliability of the data held by the URSB. Currently, this occurs in terms of general penal laws[776] under the exclusive control of the Office of the Director of Public Prosecutions.[777] During the debate on the Bill, there was concern about the capacity of the URSB to extend its reach to the rural areas.[778] This latter problem is logistical in character and is not pursued further here. In the next section I draw some inspiration from SACA 2008.

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[773] Cap 210.
[774] Sections 3 and 4 of CA 2012.
[775] Sections 4 and 14 of the URSB Act. Under s 262(1) of the 2012 Act, the Registrar General appointed under the URSB Act is the Registrar under CA 2012.
[776] See ss 323 and 324 of the Penal Code Act, Cap 120, Laws of Uganda (as amended).
[777] Article 120 of the 1995 Constitution establishes the office of the Director of Public Prosecutions ('ODPP').
[778] Hansard, 21 March 2012, 3049.

3.6 Some comparisons with SACA 2008

SACA 2008 has two comparative advantages over the 2012 Act. The first is the institutional set-up, as shown below. The second advantage is the extensive guiding principles on the interpretation and enforcement of the Act, as provided in ss 5 and 7. SACA 2008 presents a significant institutional presence with clear roles. Chapter 8 of SACA 2008 created regulatory agencies for the purposes of compliance with and administration of the Act to include the following: the Companies and Intellectual Property Commission,[779] a Takeover Regulation Panel,[780] the Companies Tribunal[781] and the Financial Reporting Standards Council.[782] Each of these regulatory agencies plays a specific and complementary role to the other.

These agencies enjoy relative statutory immunity and protection from any kind of influence exerted by anybody or any person, with the exception of the Constitution and any policy statement or directive issued by the Minister under the Act.[783] They collectively achieve compliance with the Act through monitoring, referring cases to court, seeking declarations, issuing practice directions, and making recommendations to the appropriate agency of government. They also do research in order to align the administration of the Act with international best practice.[784]

The institutional set-up under SACA 2008 is such that the agencies are obliged to carry out routine reviews of their tasks and performance to reflect new developments in business. If funded well, with the requisite personnel, the SACA 2008 institutional set-up significantly addresses areas of criticisms on the use of 'indirect participants'[785] to manage corporate businesses. The challenge though is the possibility of executive interference with the operations of these agencies – an occurrence not unique to South

[779] Section 185 of SACA 2008.
[780] Section 196 of SACA 2008.
[781] Section 193 of SACA 2008.
[782] Section 203 of SACA 2008; the long title to SACA 2008.
[783] Sections 185(2)*(b)*, 193(1), 196(1), 203(1) and 204 of SACA 2008.
[784] Section 188(1)*(a)* and (2)*(a)* and *(b)* of SACA 2008.
[785] Black et al 'Corporate law from scratch' 246–249.

Africa. In terms of SACA 2008 the Minister may give directions to the agency in accordance with the terms of the Act.[786]

3.6.1 Companies and Intellectual Property Commission

The Companies and Intellectual Property Commission ('CIPC') is established under s 185 of the Act as 'an organ of state within the public administration, but … an institution outside public service.'[787] The CIPC enjoys considerable statutory independence and is subject only to the Constitution, the law, and any policy statement, directive or request issued to it by the Minister in terms of SACA 2008.[788]

The CIPC also has a research mandate[789] and, most remarkably, issues explanatory notices on the interpretation of the Act,[790] including applying to the court for declaratory orders on the interpretation of the Act.[791] The explanatory notes and declaratory orders with respect to obscure provisions of the Act make the Act user-friendly and therefore broaden its acceptability and understanding among the ordinary businesspeople of South Africa. Moreover, the CIPC can liaise with other regulatory agencies for the purposes of sharing information on 'matters of common interest'.[792] This coordination helps to strengthen systems through the constant reviews of strategy facilitated by the sharing of information. Similarly, what can be conveniently done in CA 2012 is to grant the registrar powers to either make practice directions or issue enforceable guidelines.[793]

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[786] Sections 185(2)*(b)*(ii) and 196(2)*(b)*(ii) of SACA 2008.
[787] Section 185(1).
[788] Section 185(1)*(a)*(i) and (ii).
[789] Section 188(1) and (2)*(c)*.
[790] Section 188(2)*(b)*(i).
[791] Section 188(2)*(b)*(ii).
[792] Section 188(3)*(a)*.
[793] Reid & Priest 30, for related proposals with respect to CMA.

3.6.2 Companies Tribunal

The Companies Tribunal is established as 'juristic person'[794] under s 193. It has jurisdiction throughout South Africa and is independent, subject only to the Constitution and the law.[795] The Tribunal is clothed with quasi-judicial powers over disputes relating to the Act.[796]

In the exercise of its mandate, the Tribunal is guided by the principles of mediation, conciliation and arbitration.[797] The Tribunal is an alternative dispute resolution mechanism outside of the mainstream courts.[798] This study proposes that these principles be incorporated in CA 2012, by way of amendment, to introduce a provision which provides guiding principles on the interpretation and enforcement of the Act, similar to ss 5 and 7 of SACA 2008.

3.6.3 Financial Reporting Standards Council

The Financial and Reporting Standards Council ('FRSC') is established under s 203(1) of SACA 2008. It is constituted by the Minister responsible for trade, and has a minimum of 16 members.[799] From its name, and as provided for in s 204,[800] it is clear that the FRSC is concerned with the standards of reporting on financial statements and with the clear objective of making such financial statements reliable. The composition of the FRSC is worth noting: registered and practising auditors,[801] managers in public and private companies, who are responsible for preparing financial statements,[802] and,

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[794] Section 193(1).
[795] Section 193(1)*(a)* and *(b)*.
[796] Section 195(1) of the Act; SADTI Policy Report paras 4.7.1.4 and 4.7.2.
[797] Section 195(1)*(b)* and s 166(2) of the Act. Mediation, conciliation or arbitration are beyond the scope of this study.
[798] Section 166(1).
[799] Section 203(1).
[800] Ibid.
[801] Section 203(1)*(a)*.
[802] Section 203(1)*(b)* and *(c)*.

remarkably, creditors.[803] The other members are a person knowledgeable in company law,[804] a nominee of the executive officer of the Financial Services Board,[805] a nominee of the Governor of the South African Reserve Bank,[806] and such number of persons, nominated one each by any exchange that imposes adherence to financial reporting standards as a listing requirement, each of whom must be appointed by the Minister to serve for a term of three years.[807]

This thesis is aware of the dangers of relying on regulatory agencies and courts for firm management.[808] However, the composition and establishment of the regulatory agencies under Chapter 8, and particularly the FRSC, to include creditors underscores the importance of having in place a mechanism that ensures the fair and true disclosure of the financial status of the firm to address the interests of other corporate stakeholders.[809] This is because it is on the basis of these financial statements that those who deal with the firm make decisions on the extent to which they should deal with the firm, or take risks without having to participate directly in the corporate governance of the firm or sit on its board.[810]

The allied observation to the foresaid proposition is inclusivity in policy formulation. This is seen in the composition of the FRSC, which comprises both public and private players. This underscores the argument made in this thesis that having a broad-based platform – particularly for purposes of the CoCG – which brings together key stakeholders on matters of business is one way of broadening and increasing policy acceptability.[811]

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[803] Section 203(1)*(d)*.
[804] Section 203(1)*(e)*.
[805] Section 203(1)*(f)* of the Act; s 1 of the Financial Services Board Act 97 of 1990.
[806] Section 203(1)*(g)*.
[807] Section 203(1)*(h)*.
[808] Black et al 'Corporate law from scratch' 249; SADTI Policy Report para 4.7.
[809] SADTI Policy Report para 3.2.3.
[810] Ziegel 'The quiet revolution' 511–513.
[811] See Para 6.5.

3.6.4 Takeover Regulation Panel

The mandate of the Takeover Regulation Panel ('TRP') is specific to offers, amalgamations or mergers, acquisitions, or affected transactions.[812] The TRP's mandate covers public companies, state-owned companies and private companies. The TRP can investigate and examine transactions, and, in some cases, its approval is required prior to the conclusion of a transaction. The mandate of the TRP provides an opportunity for the public to scrutinise managerial decisions on offers, mergers, the dispositions of corporate firms, amalgamation, or affected transactions which are suspect.

This is one clear instance where SACA 2008 has curtailed the managerial exercise of power in specific transactions. The requirement for disclosure with respect to certain share transactions is such a limitation. The TRP can investigate complaints with respect to affected transactions. Drawing on the institutional set-up in SACA 2008, it is proposed that the Registrar's mandate under CA 2012 be broadened to address the inefficiencies and institutional challenges identified above.

This chapter has demonstrated that CA 2012 is not an appropriate law and fails in its stated objective of simplicity, flexibility and accessibility for SCHCs for the following reasons: (1) the business forms established under CA 2012 of SMC, private company, public company and unlimited company are not suitable business vehicles for SCHCs because their legal characteristics do not match the definition of SCHCs; (2) the CoCG is wide in scope and presents an obvious compliance burden for SCHCs – with some principles inapplicable to SCHCs; and (3) mandatory accounts, reports and audits for all companies, regardless of their size, are not consistent with best practice.

The discussion has drawn on the experiences of the UK and South Africa to argue for: (1) broadening participation on the review of the CoCG beyond the Minister and the CMA, (2) post-legislation reviews of CA 2012, in general, and particularly the CoCG, to

[812] Sections 112, 113, 114, 115 and 117 of CA 2006.

assess its relevance and impact; (3) simplified or optional accounts for SCHCs; and (4) optional audit requirements, to remedy the gaps in CA 2012 with respect to SCHCs.

In the next chapter I explore using the common law to fill the gaps in CA 2012 within the broader question of the appropriateness and efficacy of CA 2012 for the legal and corporate governance needs of SCHCs in Uganda.

CHAPTER FOUR

THE APPLICATION OF THE COMMON LAW IN CA 2012

4.1 Application of the common law in CA 2012

In Chapter 3 the study pointed out the weaknesses in the Ugandan Companies Act, 2012, 'CA 2012' with respect to the legal needs of small and closely-held companies 'SCHCS.' It demonstrated that subjecting SCHCs to mandatory accounts and reporting and audit, in terms of ss 154 and 167 respectively, as other the companies, is burdensome and not consistent with best practice. I contended that this means that CA 2012 does not provide the promised legal flexibility.[813] Further, the available business forms are not aligned to the legal needs of SCHCs. In particular, I averred that the threshold of membership in private companies of one to 100, in terms of ss 4(1) and 5(1)*(b)*, is broad and fails to consider SCHCs. Finally, the CoCG (provided for by s 14 and Table F) contains complex principles that do not apply to SCHCs. Consequently, I proposed that some of these challenges could be remedied by using the common law.

In this Chapter, I explore using the common law to fill the gaps in company legislation generally and in CA 2012 in particular. I show why the strict application of statutory rules on the internal corporate governance of companies – especially SCHCs – has been deemed inequitable; therefore, recourse must be had to the common law.[814] The discussion of the common law has two aspects.

First, I examine the common law as applied by the courts to found equitable remedies outside of corporation statutes. I explore the common law concept of quasi-partnership companies, which has been applied by the courts in common-law jurisdictions, notably the UK, to offer flexible corporate governance rules for SCHCs. Despite the associated challenges, I contend that SCHCs can structure their internal

[813] See para 1.3.
[814] Mayson et al *Company Law* 556.

corporate governance using shareholder agreements, apart from memoranda and articles of association.[815]

I show how the courts have construed SCHCs as if they were partnerships to afford them equitable and flexible internal corporate governance rules 'on the basis of a personal relationship between members involving mutual confidence and the understanding that certain members will be directors.'[816] I argue that, despite the concessionary nature of the corporate form,[817] the advent of quasi-partnership companies suggests that (the law of) contract remains an integral part of corporation law.[818]

Second, the common law as restated ('codified') in company legislation, is a growing drafting style. Here, the discussion draws on some experiences from the UK and South Africa. The two comparable jurisdictions have each codified some common-law principles in their respective company legislation, apparently, for certainty and simplification of the law, or to inform its interpretation.[819] In enacting CA 2012 there were indications that the CLPA was moving in that direction on certain provisions.[820] I contend that a restatement of common law in CA 2012, as opposed to strict codification, gives the law flexibility and adaptability which is consistent with the overall CJRP objective of simplicity and certainty of the law.[821]

Finally, I will show that on account of the evolving nature of society and to avoid absurdity which sometimes comes with strict application of statutes, the courts' interpretation of statutes with equity lenses becomes critical in shaping the law to the specific needs of society.[822] The end result is a just and progressive society. This aligns

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[815] Henning 'Identifying the structure envisioned for closely held incorporated business entities' 22 n 21; Hochstetler & Svejda 'Statutory needs of close corporations' 985 n 1190.
[816] Mayson et al *Company Law* 68.
[817] See para 2.2.1.
[818] Gower 7 ed 66 on 'private ordering' into the rules governing the company.
[819] Section 77(2)*(a)* and *(b)* of SACA 2008 and s 170(3), (4) and (5) of CA 2006 apply the common law in the interpretation of directors' duties or the breach of these duties.
[820] Hansard, 11 May 2011, 13888–13889.
[821] See para 1.3.
[822] D Tallon 'Codification and consolidation of the law at present time' (1979) 14 *Israel L Rev* 1–12 at 9; GA Weiss 'The enchantment of codification in the common law world' (2000) 25 *Yale J Int'l L* 435–532 at 452, 515.

to the constitutional dictates of art 77(1) to make laws for the peace, order, development and good governance of Uganda.

I approach this task well aware that the common law is a broad subject, which cannot be exhaustively examined in the present study. In this discussion I briefly state the origin of the common law before examining its application and how it fills gaps in company legislation in Uganda. The discussion is divided into three parts: the common law as applied by the courts in Uganda; the possibility of codifying some of the principles relevant to SCHCs in CA 2012, to remedy the inadequacies identified in the law on SCHCs; and the relevance of quasi-partnership companies in the SCHC discourse.

Before embarking on the discussion, it is necessary to consider the rules of statutory interpretation applied by the courts in Uganda, in order to provide an appropriate context for statutory interpretation in Uganda and to lay a foundation for assessing the application of the common law to company legislation.

Generally, the rules on the interpretation of constitutions apply in the interpretation of statutes.[823] These principles have attained some notoriety and are therefore of wide application. In the Ugandan case of *Charles Onyango Obbo and Anor v AG*, for example, Twinomujuni JA (as he then was) cited and applied a case from South Africa and a case from the US: *De Klerk and Another v Du Plessis and Others*[824] and *Trop v Dulles.*[825] This suggests that the courts in Uganda are prepared to draw from the experiences of other jurisdictions which have a persuasive effect on Ugandan courts. In the next section, I outline the key rules on the interpretation of statutes: the literal rule, the golden rule, the mischief rule, public policy and the purposive rule.

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[823] *Charles Onyango Obbo and Anor v AG* Constitutional Petition No 15 of 1997 (Constitutional Court of Uganda) 11; *AG of Uganda v Kabaka's Government* (1965) EA 393.
[824] (1994) 6 BCLR 124 (T) at 128–129.
[825] 356 US 86 (1956).

4.2 Principles of statutory interpretation

4.2.1 The literal rule

The foundation of the literal rule is that 'the judges regard themselves as bound by the words of a statute when the words clearly govern the situation before court.'[826] A number of cases have dealt with this subject. In the Ugandan case of *Prof Syed Huq v The Islamic University in Uganda*,[827] on the issue of whether pleadings drafted by an advocate without a valid practising certificate were illegal or invalid, the Supreme Court, in construing the Advocates Act of 1970, held that 'if parliament intended to declare illegal or invalid, pleadings signed by advocates without valid practising certificates the legislature would have said so.'[828]

The relevant provisions were ss 10 and 14, particularly s 14(1), which provided that any advocate not in possession of a valid practising certificate, whose practising certificate has been suspended or cancelled, and who practises as an advocate shall be guilty of an offence. The Supreme Court found that nothing in that provision states that documents prepared by such an advocate are illegal or invalid. The court chose to accept the documents prepared by the advocate by invoking art 126(2)*(e)* of the Constitution, which provides that in adjudicating cases of both a civil and criminal nature, the courts shall, subject to the law, apply the following principle: substantive justice shall be administered without undue regard to technicalities.

Under this rule the language and substance of the provisions are key.[829] Where the words of the statute are clear and unambiguous for the 'situation before court',[830] they should be given their ordinary and natural sense, irrespective of the consequences.[831] The

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[826] Williams *Learning the Law* 102–103.
[827] SCCA No 47 of 1995 (unreported) (Tsekooko JSC) 17.
[828] Ibid (Tsekooko JSC).
[829] *Centre for Health, Human Rights and Development (CEHURD) and Anor v AG* Constitutional Petition No 64 of 2011 (unreported) 7 (Ugandan Constitutional Court) available at constitutional-petition-64.pdf (cehurd.org) (accessed 22 March 2022).
[830] Williams *Learning the Law* 102; Twinomujuni JA in *Charles Onyango Obbo and Anor v AG* 11.
[831] Okello J (as he then was) in *Maj Gen David Tinyefuza v AG* Constitutional Petition No 1 of 1996 at 11; *Pinner v Everett* (1969) 3 All ER 257; *McCormick v Horsepower Ltd* (1981) 2 All ER 746, 751.

courts can go beyond the provision only where giving the statute its ordinary and literal meaning will not resolve the matter before the court.

In the US case of *Lafarge Midwest, Inc v City of Detroit State of Michigan*[832] a provision of the statute was said to be ambiguous 'only if it "irreconcilably conflicts[s]" with another provision or when it is equally susceptible to more than one meaning'.[833] Generally, the intention of the legislature must be sought to determine whether the words are plain and ordinary and should be enforced as such if not.[834]

In *Magor and St Mellons v Newport Corpn*,[835] the House of Lords held that 'in the construction of a statute the duty of the court is limited to interpreting the words used by the legislature and it has no power to fill in any gaps disclosed. To do so would be to usurp the function of the legislature.'[836] This criticism addressed the dissenting speech of Denning MR in the court below on what courts should do when they discover gaps in a statute; he opined that 'we should fill them'.[837] The House of Lords took the view that 'if a gap is disclosed, the remedy lies in amending [the] Act.'[838] The gist of the literal rule, as offered in *Magor*'s case, is that the courts are confined to the words used in the Act and the intention of Parliament, otherwise they risk 'being accused of making political judgments at variance with the purpose of Parliament when it passed the Act'.[839]

It should be noted, however, that the assertion that if the court fills the gaps in a statute, it is 'usurping the powers of the legislature' is a controversial one. Harvey suggests that '[j]udges do apply pre-existing law but they also create and reshape legal

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[832] Court of Appeals No 289292, cited by Kiryabwire J (as he then was) in *Crane Bank v Uganda Revenue Authority* CA No 18 of 2010 (unreported) 7, available at https://ulii.org/ug/judgment/commercial-court-uganda/2012/42 (accessed 7 March 2023).
[833] Ibid.
[834] See Lord Diplock in *Duport Steels Ltd v Sirs* (1980) 1 WLR at 157, cited by Williams *Learning the Law* 103; Craies on Statute 6 ed 66.
[835] (1952) AC 189.
[836] Ibid.
[837] Ibid 190–191.
[838] Ibid 191.
[839] Williams *Learning the Law* 105. The subject of courts engaging in politics is beyond the scope of this study. However, for a recent exposition of this subject, see J Oloka Onyango *When Courts do Politics: Public Interest Law and Litigation in East Africa* (2017).

rules.'[840] This exercise involves going beyond interpreting the law in the ordinary and literal way. It can be said that in the interpretation of statutes, there is a thin line between making the law (which is generally considered an absolute power of the legislature) and applying the law (which is considered the function of the court when interpreting statutes).

Tallon has remarked on this matter thus:

> On one hand, it may happen that a code limits the effective power of the judge more than an ordinary statute. When a statute or a code is enacted, the courts are at first full of respect for the intentions of Parliament as expressed in the Act. But, with the passing of time and with the need to adapt the legal provisions to changing economic and social conditions, the courts take more and more liberties with the literal meaning of the text and refer more and more to its spirit. *They adopt a teleological interpretation, that is to say they endeavour to look for the general policy of the Act and to adapt this policy to the needs of the present time.*[841]

Clearly, the role of the courts in shaping legislation cannot be overlooked. Indeed, as Chalmers, put it, '[w]e cannot escape from the common law, and we should not try to do so.'[842] In terms of art 79(2) of the Ugandan Constitution, 'except as provided in this Constitution, no person or body other than Parliament shall have power to make provisions having the force of law in Uganda except under authority conferred by an Act of Parliament.' Applying this provision, the argument against courts making the law should be understood in the context of making statutory enactments, which courts do not do when interpreting statutes. However, if ultimately Parliament's intention must be given effect to, the courts should be able to 'reshape'[843] the law to achieve that purpose.

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[840] Harvey *An Introduction* 527.
[841] D Tallon 'Codification and consolidation of the law in the present time' (1979) 14 *Israel L Rev* 9.
[842] MD Chalmers 'Codification of mercantile law' (1903) 19 *LQR* 10, also cited in Ahern 'Codification of company law' 242 n 63.
[843] Harvey *An Introduction* 527.

The need for interpreting statutes is the result of ambiguities in the final enactments. Harvey lists some of the causes of uncertainty in statutes: imperfect words, unforeseen situations, and uncertainties arising in the course of enactment.[844] He also underscores the 'differentiation of statutes for purposes of interpretation'.[845] All these factors contribute to judges' differences in opinion when interpreting statutes. Nevertheless, as the discussion in the next section shows, in appropriate situations, the courts modify or wholly depart from the literal rule in order to avoid absurdity or to achieve reasonableness.[846] They do this solely to ascertain the intention of the legislature.

4.2.2 The golden rule

Under the golden rule, the courts will consider and adopt the interpretation of a statute that achieves equity, reasonableness and justice.[847] To conclude that there is an absurdity in a statute, one must look at the statute as a whole. The application of the golden rule may sometimes require that a judge wholly departs from the plain language of the statute to avoid absurdity. However, Williams argues that, to do so, 'the argument must be very strong to induce the court to meddle with a statute.'[848]

Two other considerations support Williams' proposition above. First, the legislature does not legislate to bring about absurdity. Legislation is promulgated for good order, peace and the development of society. Article 79(1) of the Ugandan Constitution provides that '[s]ubject to the provisions of this Constitution, Parliament shall have power to make laws on any matter for the peace, order, development and good governance of Uganda.' By this provision it is clear that the legislative function of Parliament does not contemplate absurdity.

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[844] Ibid 750–753.
[845] Ibid 830–837.
[846] Lord Mackey of Clashfern in *Pepper v Hart* [1993]1 All ER 42 at 48.
[847] *Fender v St John Mildmay* (1938) AC 38.
[848] Williams *Learning the Law* 108.

Under the 'National Objectives and Directive Principles of State Policy' of the Ugandan Constitution, objective 1(i) on the 'Implementation of objectives' provides that

> [t]he following objectives and principles shall guide all organs and agencies of the State, all citizens, organisations and other bodies and persons in applying or interpreting the Constitution or any other law and in taking and implementing any policy decisions for the establishment and promotion of a just, free and democratic society.[849]

Undoubtedly, there is good reason for courts to adopt the interpretation of a statute that avoids or supresses absurdity.

Second, enactments have been struck down by the courts on the grounds of unconstitutionality. Article 137(1) of the Constitution provides that '[a]ny question as to the interpretation of this Constitution shall be determined by the Court of Appeal as the constitutional court.' Specifically, art 137(3) is to the effect that '[a] person who alleges that—an Act of Parliament or any other law or anything in or done under the authority of any law; or (b) any act or omission by any person or authority, is inconsistent with or in contravention of a provision of this Constitution, may petition the constitutional court for a declaration to that effect, and for redress where appropriate.

According to art 137, through interpretation, the courts can strike down legislation for being unconstitutional. Therefore, a theory that restricts the courts to 'applying the law' in the strict sense is erroneous. In terms of the golden rule, the courts can remedy shortfalls which arise during the enactment of the law.[850] The discussion on quasi-partnership companies later in this section speaks to this rule.

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[849] This objective was cited and applied in *Maj Gen David Tinyefuza v AG* (FMS Egonda-Ntende J) 12 and 13, and most recently in *Foundation for Human Rights Initiative ('FHRI') v AG* Constitutional Petition No 53 of 2011 (unreported) available at https://ulii.org/ug/judgment/constitutional-court-uganda/2020/7 (accessed 7 March 2023).

[850] *Lafarge Midwest, In v City of Detroit State of Michigan* CA N 289292.

4.2.3 The mischief rule

Under the mischief rule, '[t]he interpretation is such as to suppress the mischief and advance the remedy.'[851] To the extent that the rule allows the courts to look at the circumstances obtaining before the Act, it follows that, in interpreting statutes, the courts look beyond the words in the enactment. In the present case, the CJRP Reports, the reports of the CLPA and Hansard are useful legal materials for interpreting CA 2012 under the mischief rule.

4.2.4 Public policy

The assumption is that, in construing any statute, the courts are informed by some policy considerations. In *Fender v St John Mildmay*[852] Lord Wright observed that:

> In one sense every rule of law, either common law or equity, which has been laid down by the courts, in that course of judicial legislation which has evolved the law of this country, has been based on considerations of public policy.

The public policy approach to construction of statutes keeps the law relevant to changing circumstances. On this point Tallon has argued that

> when a statute or a code is enacted, the courts are at first full of respect for the intentions of Parliament as expressed in the Act. But, with the passing of time and with the need to adapt the legal provisions to changing economic and social conditions, the courts take more and more liberties with the literal meaning of the text and refer more and more to its spirit. *They adopt a teleological interpretation, that is to say to endeavour to look to the general policy of the Act and to adapt this policy to the needs of the present time*.[853]

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[851] Williams *Learning the Law* 101.
[852] (1938) AC 38; *Kainamura Patrick v Lt Ben Kachope and 4 Ors* HCCS No l59 of 2017 (unreported) available at https://ulii.org/ug/judgment/hc-civil-division-uganda/2022/259 (accessed 7 March 2023); *Day v Womble Bond Dickson (UK) LLP* (2020) EWCA 447 at 457 para 5.2ff.
[853] Tallon 'Codification and consolidation' (emphasis in original).

The discussion of *Mathew Rukikaire*[854] and *Mawogola Farmers*[855] later in this section shows how the courts in Uganda (and other common-law jurisdictions)[856] have attempted to preserve corporate form, and its advantages or purpose, across different companies including the SCHC category, without undue regard to technicalities, as a matter of public policy.[857]

In the present discussion making corporate form easily available for the benefit of various business forms is a public policy consideration that should be upheld when interpreting CA 2012. This is particularly so where matters of internal corporate governance or compliance with routine statutory obligations on formalities are concerned.[858] This objective can be integrated into the Act by adopting guiding principles in its interpretation formulated around the core objectives of the CJRP.[859] South Africa realised this need and provided guiding principles in ss 5 and 7 of SACA 2008, to inform its interpretation and enforcement by restating its purpose. I will return to this point later in this section.

4.2.5 Purposive rule

When interpreting statutes, courts should strive to establish the purpose for which the law was enacted. In *Pepper v Hart*[860] Lord Bridge of Harwich observed that:

> The courts now adopt the purposive approach which seeks to give effect to the true purpose of legislation and are prepared to look at much extraneous material that bears on the background against which the legislation was enacted.[861]

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[854] Civil Appeal No 3 of 2015 (Supreme Court) (unreported).
[855] (1971) EA 272.
[856] See the discussion on quasi-partnership companies in para 4.3.2.
[857] Lord Mackey of Clashfern in *Pepper v Hart* [1993] 1 All ER 42 at 48.
[858] *Rukikaire*.
[859] See para 1.3.
[860] (1993) 1 All ER 42.
[861] Ibid 50.

In terms of this rule the courts search for the purpose of the law.

These rules may be applied alone or in combination, depending on the facts of the case before court. With these rules in mind, I explore common law and its relevance to SCHCs in the next section.

4.3 Application of the common law in Uganda

The common law in Uganda has its roots in the 1902 Order -In-Council '1902 O-I-C'[862] By the 1902 O-I-C, the laws that were applicable at the time in the UK, India or any other colony became applicable in Uganda. The common law has been understood and applied in two major ways. The common law '[o]riginally meant the law that was not local law, that is, the law that was common to the whole of England.'[863] '[T]his may still be its meaning in a particular context, but it is not the usual meaning.'[864] Williams opines that 'more usually [the common law is] the law that is not the result of legislation, that is, the law created by the custom of the people and decision of the judges.'[865] I will adopt the latter meaning (decisions of the judges or precedent[866]) for present purposes.

The common law was applied in Uganda in two ways. Prior to the O-I-C, a widely held view was that 'those decisions which were given by the English courts prior to the reception dates are binding on the East African courts. Any English decisions after such dates are, at best, merely of persuasive authority.'[867] This view is supported by *Kiriri Cotton Co Ltd v Dewani*[868] where O'Connor, President of the Court of Appeal for East Africa, opined as follows:

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[862] Section 12 of the O-I-C.
[863] Williams *Learning the Law* 25.
[864] Ibid.
[865] Ibid.
[866] Ibid.
[867] Sawyer & Hiller *The Doctrine of Precedent in the Court of Appeal for East Africa* (1971) 16, cited by Musisi *Company Law* 86.
[868] (1958) EA 239.

> And, in my opinion, established decisions on the common law or doctrines of equity of the superior courts in England, given before the date of reception of the common law and doctrines of equity into the relevant colony or Protectorate within the courts' Jurisdiction are binding on this court as well as the Supreme court or High Court of that territory. By established decisions, I mean decisions which must be taken to have correctly declared the common law or the doctrines of equity at the date of reception because such decisions are either unreversed decisions of an appellate court; or being decisions of a superior court other than an appellate court, stand unreversed and have either been affirmed as correct in principle by other superior courts in England.[869]

Drawing on the above authorities, it is clear that the common law is applied in Uganda, initially with binding force and, after the reception date, with persuasive authority. The above position was codified in the Judicature Act of 1967,[870] which provided that:

> 3(1) Pursuant to the provisions of clause 3 of article 91 of the Constitution, the High Court shall be a superior court of record and shall have full jurisdiction, civil and criminal, over all causes and all matters in Uganda; (2) Subject to the provisions of the Constitution and of this Act, the jurisdiction of the High Court shall be exercised, *(a)* in conformity with the written law including any lawin force immediately before the commencement of this Act; *(b)* subject to any written law and in so far as the same does not extend or apply, in conformity with, (i) the common law and doctrines of equity; (ii) any established and current custom or usage; and (iii) the powers vested in, and the procedure and practice observed by, the High Court immediately before the commencement of this Act in so far as any such jurisdiction is consistent with the provisions of this Act; and *(c)* where no express law or rule is applicable to any matter in issue before the High Court, in conformity with the principles of justice, equity and good conscience.

In terms of s 3(3) the applied law, the common law and the doctrine of equity shall be in force only in so far as the circumstances of Uganda and of its people permit, and subject

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[869] Ibid 246; also cited in Musisi *Company Law* 87.
[870] Act 11 of 1967. Section 3(1), (2), (3), (4) and (5) also reproduced in Harvey *An Introduction* 537–538.

to such qualifications as the circumstances may render necessary. Section 3(4) provided that, subject to the provisions of sub-s (3) of this section, in every cause or matter before the High Court, the rules of equity and the rules of common law shall be administered concurrently; if there is a conflict or variance between the rules of equity and the rules of the common law with reference to the same subject, the rules of equity shall prevail. Finally, s 3(5) provided that, for the purposes of this section, the expressions 'common law' and 'doctrines of equity' mean those parts of the law of Uganda, other than the written law, the applied law or customary law, observed and administered by the High Court as the common law and the doctrines of equity respectively, immediately before the commencement of this Act.

The above position is replicated in the Judicature Act, Cap 13. Section 14(1) and (2) of this Act provides that the High Court shall, subject to the Constitution, have unlimited original jurisdiction in all matters and such appellate and other jurisdiction as may be conferred on it by the Constitution or the Judicature Act or any other law, and subject to the Constitution shall be in conformity with the written law and subject to the written law in so far as the written law does not extend or apply in conformity to the common law and the doctrines of equity.[871]

The interpretation of the above provision in a recent decision by the Court of Appeal in *Hashim Sulaiman v Onega Robert*[872] suggests two outcomes: (1) the courts in Uganda will apply the common law where the statute is ambiguous; and (2) case law is ordinarily part of the common law since it is not the statute itself.[873] It is clear from statute law that the common law is applicable in Uganda subject to the following conditions: (1) it is of persuasive force, as opposed to binding on the courts in Uganda; and (2) it is applicable in situations where there is no local authority and the facts must be similar to the local situation.[874] Given the importance of the common law in filling the gaps in company legislation, the position in *Hashim Sulaiman v Onega Robert* of

[871] Available at akn-ug-act-statute-1996-13-eng-2020-06-19.pdf (ulii.org) (accessed 30 September 2022).
[872] Election Appeal No 1 of 2021 at 22 (Madrama JA).
[873] Ibid.
[874] Section 3(3) of the Judicature Act, 1967.

subordinating the common law to statute can be remedied by codifying some of the well-established principles in the Act. I deal with this issue later in this chapter.[875]

It is also critical to point out that the reception clause in the 1902 O-I-C from its inception was drafted in such a way as to give the courts flexibility to take into account local circumstances, or to depart from, distinguish or not apply a decision of the UK courts. The courts were not to pay undue regard to technicalities, which is a very critical aspect in formulating a law for SCHCs. Section 20 of the O-I-C provided that:

> [i]n all cases, civil and criminal, to which natives are parties, every Court *(a)* shall be guided by native law so far as it is applicable and is not repugnant to justice and morality or inconsistent with any Order in Council or Ordinance, or any regulation or rule made under any Order in Council or Ordinance; and *(b) shall decide all such cases according to substantial justice without undue regard to technicalities of procedure* and without under delay.[876]

Arguably, with the above principles in mind the court in *Mawogola Farmers and Growers Ltd*[877] disregarded technicalities and upheld the substantive law. The above qualifications notwithstanding, the courts in Uganda can draw from the body of judicial precedent in the UK and other common-law jurisdictions on any matter before them to clarify or refine the law. While later I propose the codification of the common law in CA 2012 by way of a substantive provision, in the absence of an explicit statutory enactment, the courts can advance the cause of justice by applying the common law, as I will demonstrate later in this chapter.[878]

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[875] See para 4.3.3.
[876] Emphasis added. There is a similarity with art 126(2)*(e)* of the Constitution. It should be noted that s 20 of the 1902 O-I-C introduced what has come to be known as the 'repugnancy clause' which is viewed by scholars as a tool used by the colonial masters to unduly 'refine' African customs. This is a subject beyond the scope of this study. But, for a quick reference, see Kanyeihamba *Constitutional and Political History* 12; RK Mayambala 'The impact of the repugnance doctrine on the concept of human rights in traditional Africa during the colonial era: The Ugandan situation' (2006) 1(1) *Makerere LJ* 134–144 at 137–139.
[877] (1971) EA 272.
[878] See para 4.3.2.

An equally important aspect of the common law as understood through the prism of judge-made law is the doctrine of precedent and *stare decisis*.[879] Precedent means that the lower courts are bound to follow the decisions of the superior courts of record.[880] *Stare decisis* (the shortened form of the Latin maxim *stare decisis et non quieta movere*[881]), on the other hand, means 'to stand firmly by things that have been decided (and not to rouse, disturb or move things at rest)'.[882] 'In a behavorial sense, therefore, stare decisis means that a judge must decide a case at bar in accordance with any *applicable* precedent that cannot be distinguished on valid grounds.'[883]

Furthermore,

> the doctrine of *stare decisis*, in addition to whatever it may enjoin upon intellect, certainly evokes an atmosphere and a mood to bide by ancient decisions, to follow the old ways, and conform to existing precedents. It suggests a condition of rest, even of stasis, a system of law whose content is more or less settled, the past content by past decisions, and the present and future content because they too are controlled by past decisions. It implies the stability of the legal system along the stream of time, that despite all the vast social, economic and technological changes of the last eight or nine hundred years, society remains nevertheless in some meaningful sense under the governance of the same system of law.[884]

This is, however, the ideal position. In Uganda *stare decisis* and adherence to precedent is not applied strictly. For example, by law, the Supreme Court can depart from its earlier decisions. In terms of art 132(4) of the Constitution the Supreme Court may, while treating its own previous decision as normally binding, depart from a previous decision when it appears to it right to do so, and all other courts shall be bound to follow

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[879] See Harvey *An Introduction* 597–748 for an exposition of the subject; R Bhala 'The myth about stare decisis and international trade law (Part one of the trilogy)' (1999) 14(4) *American UL Rev* 845–956.
[880] Allot 'Judicial precedent in Africa revisited' (1968) 3 *J African Law* 26–27 at 26, cited by Harvey *An Introduction* 598.
[881] Bhala 'The myth about stare decisis' 849.
[882] R Versteeg *Essential Latin for Lawyers* (1990) 159, cited by Bhala 'The myth about stare decisis' 849.
[883] Bhala 'The myth about stare decisis' 849 (emphasis added).
[884] Anonymous 'The ratio of the ratio decidendi' (1959) 22(6) *ML Rev* 597–620 at 598.

the decisions of the Supreme Court on questions of law. The import of this provision is that, in given situations, the courts can depart from, distinguish or not apply precedent.

The doctrine of *stare decisis* in Uganda therefore enjoins the courts of superior record to depart from their own precious decisions when it is right to do so. This is significant because it gives the courts some latitude to discard bad precedent or modify precedent to suit the prevailing circumstances. In the ever-changing world of business, this flexibility is a critical judicial tool in adjudication.[885] In the next section I briefly explore the application of common law in CA 2012 and its impact for SCHCs.

4.3.1 Application of the common law in CA 2012

The application of the common law in CA 2012 can be looked at in two ways. First, common-law principles, though not directly related to SCHCs, have been codified in CA 2012 in the form of substantive provisions.[886] This is to be welcomed. Second, although CA 2012 does not directly refer to the application of common law in its interpretation – a question I will return to later in this section – the common law remains an integral part of CA 2012 in terms of the Judicature Act. It has been applied by the courts either to ease internal processes where the strict application of the law would lead to injustice or to fill existing gaps in the legislation.

4.3.1.1 The courts

In terms of s 14(2)*(b)* of the Judicature Act the High Court is enjoined, subject to any written law and insofar as the written law does not extend or apply, to apply the common law and doctrines of equity. As noted earlier, the courts do this either to fill existing or

[885] See the discussion in para 4.3.3ff.
[886] See s 51 (*ultra vires* doctrine), s 53 (the rule in *Turquand*) and s 54 (pre-incorporation contracts).

identified gaps or to offer equitable relief which would otherwise not be available upon the strict application of company law statutes, as illustrated below.

In *Mawogola*'s case the Court of Appeal of East Africa disregarded formalism and applied substantive justice and equity principles. Had the court only looked to the register and applied the rule strictly, it may well have been that none of the respondents would have had a remedy of specific performance against the appellant company to allot shares to them.

In *Rukikaire*'s case the Supreme Court of Uganda looked beyond the members' register to find that, despite the absence of the appellant's name from the members' register, he was still a member. The court took the view that it was not the appellant's duty (even if that duty is couched in mandatory terms) to keep an updated members' register. Both the *Mawogola* and *Rukikaire* cases dealt with formalities of corporate law which, if applied strictly, would have been inequitable.

Common law has also played a role in shaping Uganda's company law in the application of precedents from other jurisdictions, notably the UK, as can be seen in a number of cases.[887] In *Allied Bank International Ltd v Sadru Kara and Abdul Kara*[888] while dealing with derivative actions, Ogoola J drew inspiration from the famous case of *Foss v Harbottle*[889] to reiterate the proper plaintiff rule, which is to the effect that the proper plaintiff in an action to redress an alleged wrong to a company is the company

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[887] *Abbo Samuel v Cimeel Engineering Ltd* Misc Appl No 29 of 2013 (unreported) (Commercial Court of Uganda); *Stanbic Bank Uganda Ltd v Ducat Lubricants (U) Ltd and 3 Ors* Misc Appl No 845 of 2013 (unreported) (Commercial Court of Uganda); *Nile Energy Limited v Phoenix Petroleum Limited and 2 Ors* (unreported) (Commercial Court); *Ms Fang Min v Uganda HuiNeng Mining Ltd (Nominal Defendant) and 5 Ors* HCCS No 318 of 2016 (unreported); *Wavenets Communication Ltd v Zimwe Enterprises Hard Ware & Construction Ltd and 2 Ors* (unreported) (Commercial Court); *Lubega Matovu v Mikwano Investment Ltd* Misc Appl No 156 of 2012 (unreported) (Commercial Court); *MKM Trading Company Ltd and Anor v Commodity International Ltd and Anor* HCCS No 0496 of 2001 (unreported) (Commercial Court); *Salim Jamal and 2 Ors v Uganda Oxygen Ltd and 2 Ors* SCCA No 64 of 1995 (unreported) (Supreme Court of Uganda); *Fam International Limited and Anor v Mohamed Hamid El Fatih* SCCA No 16 of 1993 (unreported) (Supreme Court of Uganda); and *National Enterprises Corporation and 2 Ors v Nile Bank Limited* SCCA No 17 of 1994 (unreported) (Supreme Court of Uganda). All these cases, though dealing with different issues not relevant to the present discussion, have variously applied the common law.

[888] HCCS Civil Suit No 191 of 2002 (Commercial Court) (unreported).

[889] (1843) 2 Hare 461.

itself. The judge went on to quote from Gower's *Principles of Modern Company Law* (2 edn. At 528) to deal with the exceptions to the proper plaintiff rule.

In light of the discussion above, and as I will show later in this chapter on best practice in comparable jurisdictions, what can be easily done in CA 2012 is the codification of common law by way of a substantive provision to the effect that in interpreting the Act, the common law shall apply. South Africa and the UK adopted this approach in their company law statutes, clearly stating whether the common law applies generally, specifically or concurrently with statutory law.[890] This directly integrates common law into CA 2012.

In the next section, I explore the concept of quasi-partnership companies – a creature of common law – and its application to the SCHC category.

4.3.2 Quasi-partnership companies

Quasi-Partnership Companies or domestic companies are not recognised entities under (companies) legislation.[891] They are a creature of common law, and therefore there is no universally accepted legal definition of quasi-partnership companies.[892] However, it is well-established that courts in common-law jurisdictions – led by the UK courts – have been ready to enforce mutual agreements between members of companies that usually have two or fewer members, or companies which are registered with the background of a partnership.[893]

Mayson et al define quasi-partnership companies as:

> companies formed on the basis of a personal relationship between members involving mutual confidence and understanding that certain members will be

[890] See s 158*(a)* of SACA 2008.
[891] Ferran *Company Law* 5; Milman 'The quasi-partnership example' 313.
[892] Milman 'The quasi-partnership example' 314, citing Brightman J in *Re Leadenhall General Hardware Stores Ltd* (1971) 115 *Sol Jo* 202 n 12; Milman 'Towards a more formal recognition' 28.
[893] Dunne 'The position of the quasi-partnership type' 119–121.

> directors …. And the courts are willing to take into consideration the mutual understandings between members of quasi-partnership companies even if they have not stated so in the company's memorandum and articles of association or in separate contracts between the members.[894]

Usually, shareholder agreements are entered into outside of the company memorandum and articles of association.[895] The courts enforce these agreements with the sole purpose of granting members of such companies the flexibility or latitude to arrange their internal corporate governance issues, to fill the gaps in statute law, to avoid subjecting them to onerous statutory compliance, and to protect shareholders from minority oppression. Quasi-partnership companies have led to the development of a body of jurisprudence in which the courts have either departed from traditional corporation rules or created flexible rules where there is no explicit prohibition in statute.[896] Next I examine selected common-law cases to expound on the definitions and principles underlying quasi-partnership companies, and their application to SCHCs.

4.3.2.1 Definitions and principles

As one commentator has argued, '[a]ny attempt to define a quasi-partnership with more precision inevitably must confront the judgment of Lord Wilberforce in *Ebrahimi v Westbourne Galleries Ltd & Ors.*'[897] The facts of this case were as follows: from about 1945 the appellant and N were partners in a business. In 1958 a private company was formed to take the business over. The appellant and N were its first directors. In terms of the articles of association, the company in general meeting had an express power to remove a director by ordinary resolution. Soon afterwards, N's son G was made a director. By virtue of their shareholding, N and G had a majority of the votes in general meeting. The company made good profits, all of which were distributed as directors'

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[894] Mayson et al *Company Law* 68.
[895] Dunne 'The position of the quasi-partnership type' 119.
[896] *CVC/Opportunity Equity Partners Ltd v Almeida* (2002) UKPC 16 para 32; *Re BC & G Care Homes Ltd* (2015) EWHC 1518; *Quinian v Essex Hinge Co Ltd* (1996) 2 BCLC 417.
[897] (1973) AC 360.

remuneration. No dividends were ever paid. In 1969, after a disagreement between the appellant and N and G, an ordinary resolution was passed by the company in general meeting, with the votes of N and G removing the appellant as director. The appellant petitioned for an order under s 210 of the Companies Act of 1948 that N and G should purchase his shares in the company, or sell their shares to him on such terms as the court should think fit, alternatively for an order under s 222*(f)* that the company be wound up. At the hearing, an assurance was given in evidence that the practice of not paying dividends would not be continued. Plowman J refused to make an order under s 210 but held that N and G had done the appellant a wrong because it was an abuse of power and a breach of the good faith which partners owed each other to exclude one of them from all participation in the business on which they had embarked; all members should participate in the management of the business, and the appellant had made a case for a winding-up order under s 222*(f)*.[898] The Court of Appeal allowed the respondents to appeal. The court held that in the case of a quasi-partnership company the exercise by a majority in general meeting of the power under the articles or s 184 of the Act of 1948 to remove a director from office, and consequently to exclude him from participation in the management and conduct of the business, did not constitute a ground for holding that it was just and equitable that the company should be wound up, unless it was shown that the power had not been exercised *bona fide* in the interests of the company or that the grounds for exercising the power were such that no reasonable man could think that the removal was in the company's interests. On the facts, the appellant had failed to show that his removal had not been justified and in the best interests of the company, or that no man could have thought so.

The appellant appealed to the House of Lords, which allowed the appeal. The court held that a limited company was more than a mere legal entity and the rights, expectations and obligations of the individuals involved *inter se* were not necessarily merged in its structure. While the 'just and equitable' provision did not entitle a party to

[898] Section 222 provided that 'a company may be wound up by the court if ... *(f)* the court is of the opinion that it is just and equitable that the company should be wound up.'

disregard the obligation which he assumed by entering a company, it enabled the court to subject the exercise of legal rights to equitable considerations of a personal character arising between individuals which make it inequitable to insist on legal rights or to exercise them in a particular way. In the present case, the appellant and N had joined in the formation of the company on the basis that the character of the association, namely that the appellant was entitled to participate in the management, would, as a matter of personal relation and good faith, remain the same. Since N had in effect repudiated that relationship, the appellant had lost his right to a share in the profits, was at the mercy of N and G and was unable to dispose of his interest without their consent; therefore, the proper course was to dissolve the association by winding up the company.

This case is significant in many respects. First, it disregarded the so-called majority rule in corporation law according to which decisions are made where there is no consensus.[899] The court instead held the parties (N and the appellant) to their personal relationship with each other when they started the association. Second, the case widened the scope of remedies available to an aggrieved member to equitable considerations on the grounds of the good faith principle.[900] Third, it protected members' participation in small companies. Finally, it paid less attention to technicalities in favour of substance.

The decision in *Ebrahimi* set forth the following principles as attributes of quasi-partnership companies: (1) the existence of a previous partnership relationship;[901] (2) the expectation that all members would participate in the management of the company, as is the case in a traditional partnership;[902] and (3) that there would also be share transfer restrictions, as in partnerships.[903] Milman has suggested that '[i]t is not necessary for all

[899] See *Foss v Harbottle* (1843) 2 Hare 461, particularly the 'internal management principle' which is to the effect that 'the court will not interfere with the internal management of companies acting within their powers.' See the discussion in Mayson et al *Company Law* 657.
[900] *Scottish Co-operative Wholesale Society Ltd v Meyer and Another* (1958) 3 WLR 404 at 405.
[901] Milman 'Towards a more formal recognition?' 1.
[902] Ibid.
[903] Ibid 2.

three indicia (above) to be present to create a quasi-partnership, but, as they are interlinked, it is common to find these three characteristics working in unison.'[904]

4.3.2.2 Weaknesses of quasi-partnership companies

Despite the flexibility that quasi-partnership companies offer to members of small companies to structure their internal corporate governance through agreements (among members *inter se*) there may be some weaknesses with this business form. First, all the disputes for which quasi-partnership companies were considered involved personal agreements between shareholders. The companies all existed under company legislation, which means that the use of the phrase 'quasi-partnership companies' must be restricted to personal members' rights against each other. It has little, in the strict corporation sense, on the existence of a company as a legal entity. The companies remain subject to any mandatory statutory requirements.

Drawing on the arguments in chapter 2 on the limitations of the contract theory in corporation law and the concessionary nature of companies, members' right to contract to achieve quasi-partnership status may be limited by express statutory provisions. By way of illustration, it is inconceivable that members in a company can contract out of the mandatory accounts and reporting obligations or audits in terms of ss 154 and 167 of CA 2012 respectively, or in any way vary any conditions set out therein. It is trite that where the statute is clear and unambiguous, it should be enforced as such.[905]

In the *Ibrahimi* case the company had been properly registered as a company under the 1948 Companies Act. The issue at hand was the personal rights of Shokrollah Ibrahimi. Had the company not been properly registered, the case would probably not have progressed to the House of Lords. This speaks to the propositions made in chapter

[904] Ibid. See also Milman 'The quasi-partnership example' 3–8 in which he cites *Re Yenidje Tobacco Ltd* (1916) 2 Ch 426, among others; *In Re American Pioneer Leather Company, Limited* (1918) 1 Ch 556 at 561–562 (Neville J).
[905] See para 4.1.1.

2 that incorporated companies are a concession from the state. The net result of my submission is that the exceptions to the accounts and reporting requirements under CA 2012 can only be made by legislation. The courts cannot grant a remedy that is explicitly contrary to statute.

Second, it is almost certain that all personal agreements for the purposes of determining whether companies should be accorded quasi-partnership status are subject to interpretation. When designing a legal framework for SCHCs, recourse to courts should be minimal. Using the courts as a corporate governance tool comes with costs.[906] There is no denying that where a member seeks to exclude the strict application of corporation law to their relationship with other members or in running the affairs of the company, they must petition the court, as a matter of course, for that declaration.

Ebrahimi's case offers a direct illustration of this point. The dispute started in the High Court of England. It went to the Court of Appeal and eventually to the House of Lords. The decision by Plowman J is dated 14 July 1970 and the House of Lords decision is dated May 1973; it took three years for the case to be finally decided. At the Court of Appeal, Shokrollah Ebrahimi had to seek leave before a full bench (Russell, Megaw and Buckley LJJ) to lodge the final appeal to the House of Lords – however aggrieved he was, he had no automatic right of appeal. The application for leave could have gone either way. Two courts ruled in his favour – the House of Lords and Plowman J – while the Court of Appeal reversed Plowman's decision in favour of the respondents. Using the courts is very uncertain, and involves much time and resources. From a business perspective, this is a constraint.

Similar protracted proceedings can be seen in other cases. *Scottish Co-operative Whole Society, Ltd* involved a parent company's conduct in a subsidiary of which the respondents were both shareholders and directors. While the appellant parent company was found to have acted unfairly and oppressively against the respondents, the matter ended in the House of Lords. The petition was filed by the respondents in the High Court

[906] Mayson et al *Company Law* 21.

on 14 July 1953. It went on appeal and was decided by that court on 20 March 1957, and by the House of Lords on 24 July 1958. This legal dispute continued for about five years.

Re HR Harmer, Ltd[907] probably took the shortest time, from the decision of Roxburgh J on 12 May 1958 to the decision of the Court of Appeal (Jenkins, Romer and Willmer LJJ) in November 1958. But nonetheless, it was a contested matter in the court. In *In Re Yenidje Tobacco Company, Limited*[908] the decision of Astbury J was appealed against to the Court of Appeal.

Drawing on the above decisions the aspect of time and resources cannot be over-looked. While the judicial concept of quasi-partnership companies is to be welcomed because it mitigates the harshness of statutes, its application may be subject to full-blown litigation partly because of its lack of statutory backing. The oppressors will want to enforce strict corporation law – particularly the majority rule – while the oppressed will seek to enforce equity. The remedy may well lie in giving some critical aspects of quasi-partnership companies what it lacks – a statutory basis in company legislation.

The third weakness of quasi-partnership companies is the assumption that all members of quasi-partnership companies are literate and have the necessary competencies to negotiate and draft shareholder agreements to achieve the desired results of the quasi-partnership corporate structure. Company law commentators have generally expressed concerns about the problems that lay businesspersons face in grasping company law, which is an admittedly complex branch of the law.[909] It is contended that drafting shareholder agreements to achieve the purposes of quasi-partnership companies is a sophisticated matter requiring the skills of an attorney. This involves in legal fees. One way to cure this weakness is for the legislature to develop a

[907] (1958) 3 All ER 689.
[908] (1916) 2 Ch 426.
[909] Ahern 'Codification of company law' 239.

default framework agreement by way of a schedule in CA 2012 that can be modified to suit the individual circumstances of a given SCHC.

Fourth, it is an established fact that quasi partnership companies are not recognised labels under companies' legislation.[910] On the available literature it is clear that legislation on quasi-partnerships is yet to be realised.[911] They do not have a universally accepted definition, and they remain a creation of the common law. The result is that there has to be recourse to the courts. Milman has opined that '[t]he alarming truth is that a particular company may be classed as a quasi-**partnership** at one point in its history, but not at other times.'[912] Undoubtedly, there is a level of uncertainty about the application of the quasi-partnership concept. It is proposed that one solution to this challenge is to codify (re-state) some of the well-established principles of quasi-partnerships in CA 2012.[913]

These limitations speak to recourse to legislation for all matters for which contract may not offer ready interventions. This needs to be done using an explicit elective legal regime or less burdensome legal provisions in statute. One wonders why some of the positive attributes of quasi-partnership companies as espoused in various decisions were not codified in CA 2006. This study argues that there is a possibility that in the near future some of the well-established principles of quasi-partnership companies will be codified; the recognition of quasi-partnership companies as a category in company legislation would be even better.

While recourse to court is a legitimate process in dispute resolution, it involves time and money, and an objective of the CJRP was an easy corporate form for SCHCs. Therefore, this study proposes that well-established principles of quasi-partnership

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[910] Ferran *Company Law* 5; Gower 10 ed 5.
[911] Ibid.
[912] Milman 'The quasi-partnership example' 6. The bold is in the original text.
[913] See para 3.1.4.1; WE Ross 'History of Virginia codification' (1905) 1 *Virginia L Rev* 79–101 at 99.

companies should be codified in CA 2012. In any case, the codification of 'scattered decisions' on common-law principles was considered when CA 2012 was enacted.[914]

Finally, in some jurisdictions, courts have not given automatic effect to private shareholder agreements, citing public policy. In the US, a court in the state of Illinois in *Somers v AAA Temporary Services Inc*[915] rejected an agreement by the two sole shareholders in which they had agreed to amend the by-laws of the company to reduce the number of directors from three to two, when in fact, under the Business Corporation Act, that power could only be exercised by the board of directors – unless reserved to the shareholders by the articles of incorporation, which was not the case here. The court distinguished the earlier case of *Galler v Galler*[916] which, according to Elfin,[917] has been cited for the proposition that 'there is no reason for preventing those in control of a close corporation from reaching an agreement concerning the management of the corporation that is agreeable to all though such an agreement is not within the letter of the state's Business Corporation Act',[918] to hold that 'such agreements among shareholders should be permitted only when no fraud or apparent injury would be worked upon the public, minority interest or creditors.'[919] The court interpreted the statute strictly, holding that 'the Business Corporation Act is clearly mandatory regarding the amendment of the corporate byelaws, and that the two sole shareholders could not disregard the language of the Act.'[920]

The two decisions are significant for three reasons. First, contracts will remain the subject of interpretation. As shown in the discussion about the rules of statutory interpretation, the courts consider various factors when construing a statute. The *Galler* case was decided in 1964. Eight years later, *Somer*'s case had a completely different outcome, in terms of the same law. Second, is the limitation of a legal framework

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[914] Hansard, 11 May 2011, 13888–13889.
[915] 5 Ill App 3d 931, 2E 2d 462 (1972), cited in Elfin 'A critique' 446.
[916] See *Galler v Galler* 32 Ill 2d 16, 203 NE 2d 577 (1964), cited in Elfin 'A critique' 445.
[917] Elfin 'A critique' 446.
[918] Ibid.
[919] Ibid 447.
[920] Ibid.

founded on contract. In chapter 2,[921] it was noted that the contract theory presents some weaknesses where there is express statutory provision. Therefore, the codification of some of the principles of quasi-partnership companies is proposed in this study. Third, and on a positive note, there is consistency in the argument that close corporations regard shareholder relationships as essential. *Somer*'s case demonstrates that shareholders in close corporations who are in control cannot exclude the minority shareholder under the guise of majority rule.[922] The gist of the majority rule is that members of any kind of association are obliged to abide by majority decisions.[923]

Despite the above weaknesses, quasi-partnership companies are recognised in common-law jurisdictions, and in different form in South Africa and the US, and have been enforced as such if one of the following legal characteristics is present: (1) the existence of a previous partnership relationship; (2) an expectation that all members will participate in the management of the company, as is the case in a traditional partnership; and (3) the existence of share transfer restrictions, as in a partnership. It follows that company legislation involving these three principles speaks to the needs of SCHCs.

No judicial precedent in Uganda has dealt directly with quasi-partnership companies. However, since common law is applicable in Uganda to the extent demonstrated in chapter 1 and this chapter, cases like *Ebrahimi v Westbourne Galleries Ltd and Ors*[924] can be cited and enforced by the courts in Uganda to support a claim for quasi-partnership companies which upholds the two key principles of trust and good faith[925] in SCHCs, despite their absence in CA 2012. The cases of *Mathew Rukikaire* and *Mawogola* discussed in this chapter and in chapter 1 support this claim.

Next, I explore codification as a possible remedy to the weaknesses discussed above.

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[921] See para 2.2.2.
[922] Mayson et al *Company Law* 659.
[923] Ibid.
[924] (1973) AC 360 (HL); see the full discussion of this case in para 5.4.1.
[925] Ibid.

4.3.3 Codification of the common law in companies' legislation

There is a growing trend to codify the common law in company legislation. Away from fashion,[926] codification of common law is viewed as positive for ease of reference and for improving the accessibility of the law by providing clarity on the text of the law.[927] This philosophy runs through the DTIs in the UK[928] and South Africa,[929] as well as CJRP in Uganda,[930] at the time of reform of their respective companies' legislation.

In the House, at the second reading of the Bill, the House heard that:

> [t]here are some aspects of the Company Law which have not been written and we have been reading about them in the court cases, but they have been difficult to access by practitioners and business people. These have also been given statutory bases.[931] The laws, which have been scattered in court cases, being difficult to ascertain, have been brought within this Bill.[932]

While the question whether codification of common law necessarily leads to the accessibility and simplicity of the law is controversial,[933] a general statement in a statute about the application of the common law in interpreting that statute is straightforward. The former presents the following challenges. The first challenge is the possibility of different meanings as a result of ambiguities or the poor drafting of legislation. This is coupled with the fact that some concepts and principles are simply too complex to be satisfactorily codified in legislation.

Mayson et al have opined that:

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[926] Bakibinga *Company Law in East Africa* 4.
[927] J Loughrey, A Keay & L Cerioni 'Legal practitioners, enlightened shareholder value and the shaping of corporate governance' (2008) 8 *J Corp L Stud* 79–111 at 82–83.
[928] Ibid.
[929] L Coetzee & JL van Tonder 'Advantages and disadvantages of partial codification of directors' duties in the South African Companies Act 71 of 2008' (2006) 41(2) *J Juridical Science* 3.
[930] Hansard, 11 May 2011, 13888–13889.
[931] Ibid.
[932] Ibid.
[933] Ahern 'Codification of company law' 239.

> within the limits allowed by the rules of precedent, courts can develop and adjust common law rules and equitable principles in a way which they are not normally allowed to do with the words of statute …. *The codification risks losing this adaptability in exchange for the certainty and accessibility of fixed statutory wording*.[934]

Drawing on Mayson et al's viewpoint, it is argued that the inflexibility which sometimes accompanies codification of substantive provisions can be minimised by adopting a more general statement in the law to the effect that the common law will apply. This approach grants the courts relative flexibility to make the necessary adjustments to the law to suit the needs of the time while retaining the overall objective of the statute. Moreover, for purposes of CA 2012, this approach accords with the overall objective of the CJRP to enact a law which is flexible and accommodates various business interests.[935]

Whether codification in fact results in ease of reference and the accessibility of the law, one thing is certain. Codification applied in civil-law countries.[936] Codification in common-law jurisdictions remains a matter of considerable debate and cannot be addressed exhaustively in this study.[937] So, what is codification of the common law for the present discussion?

According to Weiss,[938] the following are the elements of codification: (1) a conception of law that is centred on a code; (2) the code is authoritative rather than merely persuasive; (3) it is complete in the sense that it is the primary source of the law

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[934] Mayson et al *Company Law* 556 (emphasis added). While directors' duties are beyond the scope of this study, the point that some principles of common law are incapable of being exhaustively legislated upon is relevant to the current discussion.
[935] See para 1.3.
[936] GA Weiss 'The enchantment of codification in the common-law world' (2000) 25 *Yale J Int'l L* 435–532. Codification in the context of civil law is beyond the scope of this study.
[937] Mayson et al *Company Law* 556; T Meyer 'Codifying custom' (2012) 160(4) *Uni Pennsyl L Rev* 995–1069 at 1054; generally, Tallon 'Codification and consolidation' 7; Ahern 'Codification of company law' 238–240; Weiss 'The enchantment of codification' 449ff.
[938] Weiss 'The enchantment of codification' 470, also cited in M Luney 'Common law codification: Lessons and warnings from twenty first century Australia' (2019) 10(3) *J European Tort Law* 183–206 at 188 n 22.

with respect to the exclusive of other sources in the field of law that it covers; (4) it requires a theory of adjudication that binds the judge to the code, yet gives the judge the power to fill in gaps and develop the law; (5) it presents a clearly structured and consistent whole of legal rules and principles, promoting the internal coherence of the law, and provides a conceptual framework for further doctrinal, judicial or legislative development; and (6) it often serves to promote both legal and political unification.[939]

It is not clear whether all the features must be present in legislation to pass the test of codification. Considered as a whole, however, it appears that codification entails 'completeness' of the legal rules, and some level of exclusion of other sources of law for purposes of the subject matter. This is problematic to achieve in a single piece of legislation – particularly the third feature – given that usually one branch of the law may be neatly connected with others. Weiss refers to this the pluralism of legal sources.[940] This may result in a voluminous statute, which is characteristic of most company legislation, and which makes the law unfriendly to users.[941]

According to Tallon,[942] '[i]n general terms, codification may have three functions: 1) formal simplification of the law, 2) systematisation of the law, and 3) reform of the law.'[943] Additionally, he contends that 'formal simplification of the law, tidying of the law, is the primary aim of all codification.'[944] It is sometimes called 'consolidation' of the law.[945] This view is supported by other commentators.[946] In systematisation, codification is applied in 'a scientific way, with formulation of concepts and general principles and the use of logical classifications'.[947] If this function is applied

[939] Weiss ibid 470.
[940] Ibid 456.
[941] See para 5.3.1ff.
[942] Tallon 'Codification and consolidation' 3.
[943] Ibid; Weiss 'The enchantment of codification' 449.
[944] Tallon ibid.
[945] Ibid 4.
[946] Ahern 'Codification of company law' 233.
[947] Ibid.

to the present discourse, codification allows for general common-law principles on SCHCs to be incorporated into CA 2012 by way of a restatement of the law.[948]

The third and final function is the reform of the law function. This function ties in with the reform agenda of the CJRP, already alluded in chapter 1.[949] Here, the law seeks to achieve 'a new slate'; '[t]he former rules have to be abolished; there is a complete liquidation of the past, … a *table rase*.'[950] Therefore, the codification of the common law in CA 2012 has three advantages: (1) simplifying the law; (2) developing new principles for SCHCs; and (3) reforming the law completely. Despite these advantages, codification was not well utilised by the drafters of CA 2012 with respect to SCHCs.

In the present discussion, 'codification' means, in the words of Ahern,[951] 'putting common law principles on a statutory footing.'[952] With this context in mind I briefly consider codification in CA 2012.

4.3.3.1 Codification of the common law in CA 2012

No provision in CA 2012 has codified any principle of the common law on SCHCs.[953] However, as noted above, some of the common-law positions that were enacted in CA 2012 were not codification in the strict sense of word. Rather, they were a restatement of the law, including the 'scattered decisions of courts' in the Act,[954] apparently to ensure simplification, ease of reference, and accessibility of the law.[955]

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[948] Tallon used the term 'codification' 'in its wider meaning of compilation of existing rules, whether law or case law'; Tallon 'Codification and consolidation' 3 n 3.
[949] Para 1.3.
[950] Tallon 'Codification and consolidation' 5.
[951] Ahern 'Codification of company law' 234. For related meanings of codification, see Weiss 'The enchantment of codification' 449; Tallon 'Codification and consolidation' 2–3.
[952] Ibid; Meyer 'Codifying custom' 1003–1004.
[953] Sections 20, 51, 53, 54 and 198 are conspicuous examples of a restatement of common law but the subject matter in those sections is beyond the scope of this study.
[954] Hansard, 21 May 2011, 13888–13890.
[955] Ibid.

The move by the CLPA in that respect is not surprising. There is a growing shift toward the codification of the law (as a drafting tool) in common-law jurisdictions, which has traditionally been a practice of civil-law countries.[956] Thus, in the present discussion the codification of the two principles of trust and good faith[957] that have characterised quasi-partnership companies would give the concept of quasi-partnership companies a statutory basis and would integrate it in CA 2012. Below, I briefly explore best practice on the codification of the common law in company legislation.

4.3.4 Best practice on the codification of the common law

The discussion below briefly explores best practice on codification of common law in South Africa and the UK. I show that the approach has been one of partial codification of the common law in company legislation. This is a restatement of the common law in statute, while leaving room for the courts to fill in the gaps. Complete codification has been noted to be 'more difficult in matters which lack a doctrinal consensus.'[958]

4.3.4.1 South Africa

The SACA 2008 provisions have codified specific common-law positions as well as the provisions on the application of the common law in the interpretation of the Act.[959] The way in which South Africa has dealt with the question of common law in SACA 2008 is similar to that of the UK in CA 2006. In some cases it has enacted specific provisions by

[956] Tallon 'Codification and consolidation' 2–3; MW Hesselink 'The ideal of codification and the dynamics of Europeanisation: The Dutch experience (2006) 12(3) *European L J* 179–288 at 287–289; Weiss 'The enchantment of codification' 439–442.
[957] *Scottish Co-operative Wholesale Society, Ltd* 67; *Geaney v Portion Kalkheuwel Properties CC* 1998 (1) SA 622 (T), cited by Davis & Geach *Companies and Other Business Structures* 415.
[958] Tallon 'Codification and consolidation' 7.
[959] In codifying directors' duties, SACA 2008 adopted the common-law position as the test of measure of directors' duties. See s 77(2)*(a)* and *(b)* of SACA 2008.

restating the common law, while in others it has adopted common law as the guiding law on the interpretation of the law. This is called partial codification.

Sir Courtenay Ilbert has opined that 'partial codification means an orderly and authoritative statement of the *leading rules of law on a given subject*, whether the rules are found in statute or in common law.'[960] He adds that 'partial codification entails adopting the general principles of law in the form of a statutory statement, while allowing some room for the development of the common law by the application of legal principles'[961] and that 'partial codification is a means of attaining uniformity in an area of the law'.[962] Let me illustrate this point further.

In terms of s 20(8) of SACA 2008, the common law is applied concurrently with the Act on matters pertaining to s 20(7). This takes away the subordination of the common law, which I referred to earlier in respect of the Ugandan position. On the other hand, s 158 provides that when determining a matter brought before it in terms of this Act, or making an order contemplated in this Act, '*(a)* a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act.' Additionally, specific provisions in SACA 2008 adopt the common law. These are ss 49, 71, 77(2) and 161 of SACA 2008.

The advantage of partial codification is that it is considered flexible. It 'leaves room for the judiciary to fill in the gaps, with which the statutory statement does not expressly deal.'[963] Drawing on these principles, I propose that CA 2012 can be improved upon in two ways: first, by adopting a general statement of purpose to the effect that in interpreting CA 2012, the common law shall apply; second, by restating the common

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[960] D Lyman 'A commercial code' (1903) 37(3) *American L Rev* 348, cited by L Coetzee & JL van Tonder 'Advantages and disadvantages of partial codification of directors' duties in the South African Companies Act 71 of 2008' (2006) 41(2) *J Juridical Science* 3.
[961] Ibid.
[962] Ibid.
[963] EN Veasey 'On corporate codification: A historical peek at the Model Business Corporation Act and the American Law Institute principles through the Delaware lens' (2011) 74 *Law and Cont Problems* 95–106 at 95, cited by Coetzee & Tonder 'Advantages and disadvantages' 4 n 26.

law by way of a substantive provision in CA 2012, where practical, on specific issues relating to SCHCs.[964]

4.3.4.2 United Kingdom

During the lengthy process leading to the enactment of CA 2006, some favoured the codification of the common law.[965] Indeed, CA 2006 has codified the common law in certain respects by way of general statements to the effect that, for the purposes of those provisions, the common law shall apply.[966] The approach adopted in CA 2006 is more less the same as in SACA 2008.

The only controversy about codification of common law in CA 2006 has arisen in relation to an apparent lack of clarity on whether 'prior common law principles will continue to apply'.[967] However, a number of suggestions have been made to resolve this question. First, codification of common law, at its inception, as already alluded to, was only intended to clarify the law.[968] Second, codification of common law in CA 2006 is a 'restatement', leaving room for the courts to shape the law. With these suggestions, the cloud around the question whether common law prior to CA 2006 must lift–namely that codification of common law in CA 2006 did not put a bar to application of legal positions prior to the Act.

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[964] See s 198 (directors' duties), s 20 (lifting the corporate veil), s 51 (*ultra vires* doctrine) and s 53 (the application of the rule in *Turquand*). The rule in *Turquand* is to the effect that outsiders dealing with the company need not go beyond the company's constitutive documents. The subject is, however, beyond the scope of this study.

[965] Loughrey et al 'Legal practitioners' 82–83.

[966] Sections 170(3), (4) and (5); 178(1); 180(1)*(b).* Section 170(3) provides that the general duties (of directors) shall be interpreted and applied in the same way as common-law rules or equitable principles, and regard shall be had to the corresponding common-law rules and equitable principles in interpreting and applying the general duties.

[967] Ahern 'Codification of company law' 241.

[968] Loughrey et al 'Legal practitioners' 82–83.

4.3.5 Suggestions for codifying the common law in CA 2012

Arising from the discussion in this Chapter, the following suggestions are made. First, giving common law a statutory basis in terms of a substantive provision in CA 2012 directly integrates the application of the common law into the Act.[969] As shown earlier, while the common law remains applicable in Uganda, it is qualified. It remains subject to certain 'ifs', 'buts' and classification, as seen in the Court of Appeal's decision in *Hashim Sulaiman v Onega Robert*.[970] The enactment of a general statement of purpose to the effect that, in interpreting CA 2012, the common-law principles shall apply would remove the qualifications with which the common law is currently applied in Uganda.[971]

Second, quasi-partnership companies are not a category in company legislation – not even in the UK, the jurisdiction where they are arguably most employed[972] – but rather a judicial concept. They are a remedy in the law of contract.[973] It is proposed that codifying some aspects of quasi-partnership companies in CA 2012 will give the law clarity in terms of definitions of concepts.[974] This would remove the burden of always having to seek a judicial declaration regarding whether a company is a quasi-partnership company or not. The courts would only have to expound on those defined concepts using the rules of statutory interpretation explored earlier in this chapter.

A provision can be inserted in CA 2012 – possibly by amending ss 4 and 5 – to the effect that members of a private company may, outside of a memorandum and articles of association (which is now an optional document following the 2022 amendment of CA 2012),[975] in addition to or in place of the memorandum and articles, register with the Registrar of companies at incorporation such shareholder agreement as they deem fit for

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[969] See s 20(8) of SACA 2008, cited above.
[970] Election Appeal No 1 of 2021 at 22 (Madrama JA).
[971] Hesselink 'The ideal of codification' 288–289; also s 158 of SACA 2008.
[972] Milman 'The quasi-partnership example' 3–4; Dunne 'The position of the quasi-partnership type' 109–113.
[973] *Ebrahimi v Westbourne Galleries Ltd* (1972) 2 All ER 492, cited by Dunne ibid 110–111.
[974] Meyer 'Codifying custom' 1010. Although Meyer's setting is international customary law, his 'clarification thesis' has significance for the present discussion in terms of codification being a tool to clarify a legal concept and give it a statutory basis; see Tallon 'Codification and consolidation' 3.
[975] Section 4(1) of CA 2012, as amended.

the purposes of their internal corporate governance. The legislature could formulate a default agreement which SCHCs can modify to suit their circumstances. The agreement should contain the features of a partnership to accord with the core aspects of quasi-partnership companies.

The discussion in this chapter sought to demonstrate the relevance of the common law to the broader question of whether CA 2012 provides an appropriate, effective and flexible legal framework for SCHCs in Uganda. It was shown that the common law has played a significant role in easing processes and formalities for small companies, and has crucially provided equitable remedies where there would have been none if strict corporation law had been applied.[976] While it has been applied by the courts, there is also evidence that common law is being integrated into company legislation by way of partial codification. The assertion in this chapter is that codification was not well utilised in the drafting of CA 2012, particularly with respect to SCHCs, to deal with the gaps in CA 2012.

[976] See the discussion in para 4.3.2.

CHAPTER FIVE

BEST PRACTICE ON THE REGULATION OF SMALL COMPANIES

5.1 Best practice on the regulation of SCHCs

This Chapter seeks to answer the Research Question, with focus on the UK and South Africa as comparable jurisdictions, what is best practice on regulation of Small and Closely-Held Companies ('SCHCs')?[977] The discussion draws on the experiences from the two jurisdictions on the regulation of SCHCs to further suggest possible interventions to address the challenges in CA 2012 with respect to SCHCs.[978] The presentation is in four parts. First, it examines the salient features of South African close corporations 'CCs' under Close Corporations Act 'CAA 84' alongside the changes that were brought about by South African *Companies Act*, 2008, 'SACA, 2008' on CCs.[979]

Second, the chapter then explores the 'small companies regime' under the UK's CA 2006 to demonstrate its potential to address the legal needs of SCHCs. The discussion of CCA 84 and CA 2006 shows, in direct answer to the inadequacies of CA 2012,[980] how the two jurisdictions – although employing different models – have attained relative flexibility and lessened the compliance burden for SCHCs by fusing corporation law with partnership law.[981]

Third, I briefly explore limited liability partnerships, under the Partnership Act, 2010. Finally, I make suggestions on how an appropriate and effective legal regime for SCHCs can be developed by amending some provisions of CA 2012. Given that the corporate structure of SCHCs is one '[w]here all, or most, of the shareholders participate

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[977] See para 1.11 bullet 3.
[978] See para 3.1.1.3; 3.1.4; 3.4.1.3; 3.6.
[979] Cassim et al *Contemporary Company Law* 13, 65, 132–136.
[980] See paras 3.1.1.2 and 3.4.1.2.
[981] Ferran *Company Law* 5; Hansmann et al 'Law and the rise of the firm' 1392 – especially the discussion on limited liability partnerships ('LLPs') and the application of the 'entity shielding' concept to partnerships, making LPPs a viable business form, also cited in Armour et al *Anatomy of Corporate Law* 6; 15 (n 13); 56; Mayson et al *Company Law* 68–70; Gower 10 ed 4–6, 16–18, 689–693.

in management reflecting the fact that the management structure is akin to that of a partnership',[982] the strict application of corporate rules embodied in the statute – such as the rules on company meetings, mandatory accounts and audit requirements, among others – is 'wholly inappropriate'.[983] The UK's 'small companies regime' and South Africa's CCA 84 on CCs address this reality.

5.2 South Africa's close corporations

Until the enactment of SACA 2008, South Africa had a distinct corporate form under a distinct legal framework for small businesses with one member or a few members – the close corporation or 'CC'. This legal framework existed for close to 24 years until the effective date of the new law – 1 May 2011. For this period CCA 84 existed alongside the 1973 Companies Act ('CA 73'). CA 73 was enacted in 1973 and remained in force until 2008, when it was repealed by s 224(1) of SACA 2008.

CCA 84 was passed and assented to on 19 June 1984, and commenced on 1 January 1985. It remains in force to date, except that it has been amended by SACA 2008; this presents some uncertainties on the future of CCs in South Africa. Section 13 of SACA 2008 proscribes the registration of new CCs or the conversion of a company registered under SACA 2008 to a CC, once s 13 is operationalised. Section 13 took effect on 1 May 2011, effectively bringing an end to the registration of new CCs.[984] In this section, I deal first with CCA 84 and then with the amendments under SACA 2008, and their implications for CCs.

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[982] Ferran *Company Law* 5; see para 1.2.
[983] J Freedman 'Small businesses and the corporate form: Burden or privilege?' (1994) 57(4) *Modern Law Rev* 555, 578–579, cited by Spisto & Samujh 'Close corporations in South Africa' 154.
[984] Henning suggests that since 1 May 2011 was a public holiday that fell on a Sunday, the Act could only have taken effect on 3 May 2011 – the first official day after the public holiday; JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) 40(1) *J Juri Sci* 19–34 at 20.

5.2.1 South Africa's Close Corporations Act, 1984: the history

The history and concept underlying the legal framework of CCA 84 is well-documented,[985] and will not be discussed in any detail here. However, any discussion of CCA 84 must encounter the work of Naude. His most cited article, 'The South African close corporation',[986] clarifies that it all started with Naude's memorandum to the Standing Advisory Committee on Company Law in South Africa, entitled 'The need for a new legal form for small business.'[987]

The memorandum '[i]dentified a definite need for a new legal form of business enterprise that would provide entrepreneurs with the advantages of incorporation without subjecting them to the complex company law regime.'[988] To state the problem that existed before CCA 84 more succinctly:

> The first is the ever increasing complexity of the massive Companies Act, 1973. Despite its 443 sections and four schedules to this Act, like the English Companies Act of which it is a now rather emancipated offspring, it is by no means a codification of company law. It is simply impossible for the unsophisticated businessman with limited access to professional assistance to master the plethora of legal complexities that surround him. In practice he survives only because his infractions of statutory and uncodified company law are not visited by the criminal and civil sanctions which in theory ought to follow. The fact that he nevertheless retains the benefits of the system is a cause of concern from a policy point of view. [S]econdly, the one or few businessmen have to comply with a system which in many ways is obviously inappropriate for his or their needs and circumstances. The requirement to have a board of director, the numerous provisions applying to various aspects of meetings and voting thereat and the extensive accounting and disclosure

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[985] Delport & Pretorius *Introduction to the Close Corporations Act* 1–5; Henning 'Closely held incorporated business entities under the new statutory dispensation' 20 and 21.
[986] Naude 'The South African close corporation' 117–131, cited in Henning 'Close corporation law reform' 921; Henning 'The impact of South African company law reform on close corporations' 457; C Jaehne 'Legal framework of the close corporation' (2008) 42 *Transactions of the Centre for Bus Law* 43–78 at 47 n 15.
[987] Naude, publ.in M.B., (5), 1882, at 5, cited in Naude 'The South African close corporation' 117.
[988] Henning 'Close corporation law reform' 921.

> provisions are merely the most obvious instances. It is known that sham compliance with formalities, like the drafting of notices and minutes of meetings that never took place, is common practice …. Moreover, the fact that this sham compliance has not given rise to serious prejudice does not prove that the 'system works.' It rather shows that the formalities concerned are meaningless. Sham compliance also fosters disrespect for the law.[989]

This passage demonstrates that the problem at the time of conception of CCA 84 was the overlay and complexities of companies' legislation for the unsophisticated businessperson and sham compliance. As noted earlier, Uganda's company legislation presents similar problems.[990] This similarity is part of the reason why this study sought to draw some inspiration from South Africa.

In 1981, '[t]he Standing Advisory Committee on Company Law ("SAC") in principle accepted the proposal in the above memorandum',[991] and the author of the memorandum was instructed by the SAC to prepare a draft Bill.[992] This historic assignment must be the reason why Naude is variously referred to as the 'father' or 'architect' of the CC.[993] On 16 September 1983, a proposed Bill was recommended by the SAC to the Minister of Industries, Trade and Tourism for enactment.[994] The Close Corporations Act 69 of 1984 was assented to on 19 June 1984. It was published in the *Government Gazette* on 4 July 1984 and became operative on 1 January 1985.[995]

Distinct legislation for CCs was motivated by the fact that '[t]he SAC concluded that it was undesirable – if not impossible – to meet the problem of small businesses by adjustments to the Companies Act.'[996] '[I]n fact, while one important aim was to achieve the greatest possible simplicity, an attempt to build the required flexibility into the Companies Act could only exacerbate the problem by an inevitable overall increase

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[989] Naude 'The South African close corporation' 117–118; Henning 'Close corporation law' 922.
[990] Mayson et al *Company Law* 17–18.
[991] Ibid.
[992] Naude 'The South African close corporation' 117; Henning 'Close corporation law reform' 921.
[993] Jaehne 'Legal framework of the close corporation' 47 n 15.
[994] Ibid.
[995] Ibid 43; Henning 'The impact of South African company law reform on close corporations' 457.
[996] Naude 'The South African close corporation' 118.

in complexity.'[997] Further, '[a]t the root of the new development is the conviction that a single Act can no longer present a satisfactory legal form for the giant as well as the small man'.[998]

It is not surprising that CCA 84 was 'met with wide approval'.[999] Its '[a]dvent has been described as an event of very significant historical importance in the development of South African entrepreneurial law.'[1000] It has been asserted that '[t]he Close Corporations Act has proved to be one of the most remarkable innovations in South African company law.'[1001] This must be for the simple, inexpensive and flexible form of incorporation that CCA 84 introduced.[1002] As Ramsden has suggested, the close corporation was introduced to enable small undertakings to acquire the advantages of incorporation without having to comply with all the complex requirements of the present company law.[1003] CCA 84 is viewed as a dramatic departure from traditional company legislation because it integrated elements of partnership and contract.[1004] The discussion below explores the principles in CCA 84.

5.2.1.1 Principles and objectives of CCA 84

CCA 84 is founded on simplicity of legislation in the formation of the corporation (easy legal personality) and 'flexibility in internal relations' among members *inter se*; shareholder limits–in which all or most participants have a chance to be actively involved in company management. The other characteristics are no separation of ownership from

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[997] Ibid.
[998] Ibid.
[999] Henning 'The impact of South African company law reform on close corporations' 456.
[1000] HS Cilliers et al *Entrepreneurial Law* 2 ed (2000) 228, cited by Henning 'Close corporation law reform' 918.
[1001] C Jordan *Reviewing the Hong Kong Companies Ordinance – Consultancy Report* (1997) 2–18, cited by Henning 'Close corporation law reform' 918.
[1002] See Naude 'The South African close corporation' 118–119; Delport & Pretorius *Introduction to the Close Corporations Act* 1; Henning 'Close corporation law reform' 918–919.
[1003] See Ramsden 'Close corporations – Their character and creation' (1988) *Businessman's Law,* cited by Jaehne *Legal Framework of the Close Corporation* 46; Spisto & Samujh 'Close corporations in South Africa' 155.
[1004] Jaehne *Legal Framework of the Close Corporation* 46 n 13.

control and restriction of members to natural persons; these attributes characterise partnerships and also fit the definition of SCHCs adopted in chapter 1.[1005] A final characteristic is the existence of members' interests as opposed to shareholding. These principles stem from CCA 84's stated policy objective of promoting small businesses in South Africa.[1006] The long title of CCA 84 states that its object is to provide for the formation, registration, incorporation, management, control and liquidation of close corporations, and for matters connected therewith.

CCA 84 defines 'corporation' to mean a close corporation referred to in s 2(1) which has been registered under Part III of the Act. Section 2(1) provides that '[a]t any time before s 13 of the Companies Act comes into operation, any one or more persons, not exceeding ten, who qualify for membership of a close corporation in terms of this Act, may form a close corporation and secure its incorporation by complying with the requirements of this Act in respect of the registration of its founding statement referred to in section 12.'[1007]

Naude expounds on the concept of 'close' corporation to suggest that in principle a '[c]lose corporation is one where in which all or most participants are more or less actively involved'.[1008] There is 'no separation between ownership and control'.[1009] The number of members is restricted to a particular number and to natural persons.[1010] SADTI was opposed to the restriction of members to natural persons on the grounds that it 'precludes certain categories of equity financiers from investing in these business entities'.[1011] I return to this complaint later in this section.

In other accounts, the term 'close corporation' is derived from the expression 'closely held corporation'. This refers to the limited number of members of the

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[1005] See para 1.2.
[1006] Delport & Pretorius *Introduction to the Close Corporations Act* 1–2. These principles are not unique to South Africa: see Bradley 'An analysis of the model Close Corporation Act' 817, 827; Hochstetler & Svejda 'Statutory needs of close corporations' 865, whose setting is the US.
[1007] See s 1 of CCA 84 (as amended).
[1008] Naude 'The South African close corporation' 125.
[1009] Ibid.
[1010] Ibid.
[1011] SADTI Report 16.

corporation and the closeness of their relationship. The use of this term by company lawyers can be traced back to at least the previous century, and it is a widely accepted concept worldwide.[1012] It is noteworthy that '[a] close corporation frequently arises out of the incorporation of an existing or family owned business.'[1013] Further, '[t]hese entities seek corporate status because of the benefits of limited liability'[1014] and possible corporate tax advantages.[1015]

Second, a corporation formed in accordance with the provisions of CCA 84 becomes a juristic person and continues, subject to the provisions of this Act, to exist as a juristic person notwithstanding changes in its membership, or its conversion to a company in terms of Schedule 2 of the Companies Act, until it is deregistered or dissolved *(a)* in terms of this Act; or *(b)* in terms of the Companies Act, in the case of a juristic person that has been converted to a company. Subsection (3) provides that, subject to the provisions of the Act, the members of a corporation shall not merely by reason of their membership be liable for the liabilities or obligations of the corporation. Subsection (4) provides that '[a] corporation shall have the capacity and powers of a natural person of full capacity in so far as a juristic person is capable of having such capacity or of exercising such powers.'

Drawing on the above provisions, the following observations can be made about CCA 84. First, although a CC is not a company,[1016] it is a category that results from registration.[1017] Once the registration process has been complied with, the CC enjoys juristic status with all the associated benefits of incorporation; the conspicuous benefits are corporate personality and limited liability, signifying the certainty of its legal

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[1012] JJ Henning, HS Cilliers, ML Benade & L du Plessis 'The close corporation' in *The Law of South Africa* vol 4 (1996) (first reissue) 497, cited in Henning 'Closely held incorporated business entities under the new statutory dispensation' 21.
[1013] F O'Neal *Close Corporations* 2 ed (1971) § 1.08, cited by Hochstetler & Svejda 'Statutory needs of close corporations' 853.
[1014] Hochstetler & Svejda 'Statutory needs of close corporations' 853.
[1015] H Henn & J Alexander *Laws of Corporations* 3 ed (1983) § 257 at 694, cited by Hochstetler & Svejda 'Statutory needs of close corporations' 853.
[1016] Davis & Geach (eds) *Companies and Other Business Structures* 408.
[1017] Section 2(2) of CCA 84, cited in Davis & Geach ibid.

existence.[1018] The process entails registration of the 'founding statement', which Naude has suggested to be 'containing simple, factual information under seven headings, are required for registration (ss 2 and 13).'[1019] The 'seven headings' contained in s 12 include: (1) the full name of the corporation; (2) the principal business to be carried on by the corporation; (3) a postal address for the corporation, and the address (not being the number of a post office box) of the office of the corporation.

The other headings are (4) the full name of each member, his or her identity number, or, if he or she has no such number, the date of his or her birth, and his or her residential address;[1020] (5) The size, expressed as a percentage, of each member's interest in the corporation; (6) particulars of the contribution of each member to the corporation, including (i) any amounts of money; and (ii) a description and statement of the fair value of any property (whether corporal or incorporeal) or any service referred to in s 24; and (7) the name and postal address of a qualified person who or firm which has consented in writing to his or her or its appointment as accounting officer of the corporation and the date of the end of the financial year of the corporation.

The registration process and its requirements are generally agreed to be simple and procedurally less cumbersome; 'the managerial and administrative requirements for close corporations are less formal than for companies'.[1021] As already pointed out, one only has to deal with one document, the founding statement; '[t]he typical small entrepreneur will be able to complete the constituting documentation and register the corporation on his own without expensive professional advice'.[1022] The registration process under CCA 84 is a significant departure from the canonical corporation law rules on the incorporation of companies of reserving a name and filing the company

[1018] See ss 1 and 14 of CCA 84; Henning 'The impact of South African company law reform on close corporations' 457.
[1019] Naude 'The South African close corporation' 125.
[1020] This requirement has since been substituted by s 1 of Act 81 of 1992.
[1021] Henning 'The impact of South African company law reform on close corporations' 458.
[1022] Ibid.

constitutive documents: a memorandum and articles of association, which are usually detailed documents.

SACA 2008 has made significant attempts to simplify the registration of companies in line with the SADTI pledge of simple legislation by, for example, requiring registration of only a memorandum of incorporation.[1023] In 2022, Uganda amended s 4 of CA 2012 by substituting the memorandum of association with a prescribed form in Schedule 2 to the Act for the purposes of incorporation.[1024] Given the precise nature of the form and the objective of the Companies (Amendment) Bill, the amendment can be viewed as an attempt to simplify the incorporation process under the Act. This is consistent with the CJRP's objective of a simplified law.[1025]

With regard to volume and length,[1026] CCA 84 contains only ten parts (parts I to X) with 83 provisions and no schedules (a very rare occurrence), which is a clear departure from the tradition of very lengthy and complex legislation. To put this into perspective, CA 2006, for example, contains 47 parts, 16 schedules and 1,300 provisions – by all means *sui generis*.[1027] The only distinction is that, unlike previous legislation, it has explicitly made provision for small companies.[1028] SACA 2008 contains nine chapters with a total of 225 provisions and five schedules, which should be read together with the Companies Regulations 2011, which is equally extensive with 179 provisions.

CCA 84 avoids an overlay which is characteristic of most company legislation across jurisdictions, as noted in chapter 1. Additionally, SACA 2008 has repealed a number of provisions. Section 4(1)*(b)* was substituted with s 224(2) of SACA 2008, which repealed ss 4(2) and 16(3) of CCA 84. Numerous sections have been repealed or

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[1023] See s 13*(a)* of SACA 2008, and para 5.2.1.2 for a full discussion.
[1024] See para 3.1.1.2.
[1025] See para 1.3; ULRC Report 3.
[1026] Naude 'The South African close corporation' 125.
[1027] See Gower 5 ed 8, where in reference to CA 85, the author opined that the 'extremely detailed provisions of the Act which exceeds in bulk that of companies legislation anywhere else and astonishes our partners in the EC'; Ferran *Company Law* 6.
[1028] Sections 381–384 of CA 2006.

substituted or amended.[1029] While some of the amendments introduced new provisions,[1030] the resulting deletions over a period of about 22 years have reduced CCA 84 in volume from its original form.

Second, the capping of its membership to ten members is a key feature of CCA 84. Shareholder limitation allows members in CCs to structure their internal corporate governance rules along the lines of a partnership. Besides, proposals for corporation law to treat SCHCs like partnerships have been on account of their small number of members and personal relationships between the shareholders,[1031] while still according them the benefit of incorporation.[1032] This has since changed on account of s 13 of SACA 2008, which in defining profit companies makes no obvious distinction between single entrepreneur companies and those with a few members (which was no doubt a major concept behind CCA 84).[1033] This issue is considered later in this chapter.

Apparently, a small number of members makes it easier for all if not most members to be directly involved in company management.[1034] Because of the small number, 'the shareholders are in frequent contact with each other'.[1035] Therefore, 'the shareholders enjoy a close relationship similar to partners, which results in decisions without formal meetings and minutes.'[1036] Therefore, an appropriate legislative intervention for SCHCs must adopt definite shareholder limits.[1037]

Further, the 'courts have also imposed a fiduciary duty on close corporation shareholders to exercise the utmost good faith in their dealings with other

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[1029] These are ss 18, 20, 22, 23, 26, 27, 29, 30, 32, 34, 41, 46, 47, 48, 49, 54, 56, 57, 58, 59, 60, 62, 63, 64, 66, 67, 68, 72, 74, 76 and 84 of CCA 84.
[1030] Such as ss 15A, 22A, 34A, 48(2A), 62A and 66(1A) of CCA 84.
[1031] Elfin 'A critique' 440.
[1032] Ibid.
[1033] Naude 'The South African close corporation' 117 n 1; see the discussion in para 5.2.1.2.
[1034] Ferran *Company Law* 5; Mayson et al *Company Law* 68.
[1035] O'Neal *Close Corporations* § 1.07.
[1036] Miller 'Illinois close corporations: Analysis of the new Act' (1978) 27 *De Paul L Rev* 587, 593, cited in Hochstetler & Svejda 'Statutory needs of close corporations' 853.
[1037] Hochstetler & Svejda 'Statutory needs of close corporations' 879–881.

shareholders.'[1038] The import of utmost good faith is that 'shareholders in a close corporation owe one another substantially the same fiduciary duty that partners owe one another.'[1039] Based on this principle, members can bind themselves under contract to avoid minority oppression and the abuse of power by the majority, and minimise disagreements among members on management issues. The close relationships among shareholders 'enable the court to subject the exercise of legal rights to equitable considerations'[1040] or 'legitimate expectations',[1041] which are traditionally outside of corporation rules. The application of equity no doubt widens the remedy scope to members in SCHCs beyond corporation law, as I will show, of quasi-partnership companies later in this section.

Limitation of members is critical in designing an appropriate legal framework for SCHCs. In light of the definition of SCHCs in chapter 1, any number of members that is more than ten will invite two challenges. First, dispersed members will not be directly involved in company management. Second, and as a consequence of the above, it becomes illogical to ignore the separation of members from management, thus heightening the temptation to revert to detailed corporation rules to manage the expectations of members who are not directly involved in management.[1042] This structure is not compatible with SCHCs, where the separation of the boards of directors from the owners is illusory.[1043] It may well be that the drafters of CCA 84 were alive to the dangers that could undermine the object of the Act if membership was not capped to ten or fewer members.

[1038] *Dohahue v Rodd Electrotype Co of New England* 367 Mass 57, 592–93 328 NE 2d 505, 515 (1975), cited in Hochstetler & Svejda 'Statutory needs of close corporations' 857.
[1039] Ibid.
[1040] *Ebrahimi v Westbourne Galleries Ltd* (1973) AC 360 at 379 (Lord Wilberforce).
[1041] Ibid.
[1042] I Anabtawi 'Some skepticism about increasing shareholder power (2006) 53 *UCLA L Rev* 561–599; LA Bebchuck 'The case for increasing shareholder power' (2005) 118 *Harv L Rev* 833–914; LE Strine Jr 'Toward a true corporate republic: A traditionalist response to Bebchuk's solution for improving corporate America' (2006) 119 *Harv L Rev* 1759–1783; WW Bratton & ML Wachter 'The case against shareholder empowerment' (2010) 158 *U Pa L Rev* 653; LA Bebchuk 'Letting shareholders set the rules' (2006) 119 *Harv L Rev* 1784–1813.
[1043] Hochstetler & Svejda 'Statutory needs of close corporations' 862; Armour et al *Anatomy of Corporate Law* 1, 15; Mayson et al *Company Law* 68–70; Gower 7 ed 5.

Moreover, evidence suggests a convergence on shareholder limits across jurisdictions when drafting legislation for close corporations.[1044] 'Managing the close corporation through the use of shareholder agreements works well because of the relatively small number of shareholders, the desire of the shareholders to participate actively in the business of the corporation, and the frequent contact between the shareholders.'[1045] To be sure, keeping the number of members definitely small is an important aspect of legislation on SCHCs which the draftsman bench-marking CCA 84 ought to take care of.

The propositions in chapter 3 on the various business forms under CA 2012 show that – apart from SMC whose membership is statutorily one-person, which category is not suitable for SCHCs in the present case – the requirement of 'any one or more persons … with the limit of one hundred members'[1046] is broad and lacks the crucial element of definitive membership and therefore not at pace with best practice on the regulation of SCHCs.

To achieve member limits in CA 2012 will require further classification of private companies by merging SMC and private companies of two to ten members to form SCHC as a legal category of private companies comprising one to ten members. This proposal follows from the realisation that there is no stark difference between the corporate needs of a one-entrepreneur company and those of a company with two to ten members.[1047] Given the number of registered CCs in the last 26 years, as shown below, there is good reason for Uganda to draw inspiration from some features of CCA 84, to improve the legal framework for SCHCs in CA 2012.

Third, is restriction of membership in close corporation to natural persons. Section 29(1) provides that subject to subsection (1A) or (2) (b) and (c), only natural persons may be members of a corporation and no juristic person or trustee of a trust

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[1044] Bradley 'An analysis of the model Close Corporation Act' 820, 845, 847; Hochstetler & Svejda 'Statutory needs of close corporations' 862.
[1045] O'Neal *Close Corporation* § 1.07, § 5.03.
[1046] See para 3.1.2.
[1047] See para 3.1.1.3(a), (b) and (c).

inter vivos in that capacity shall directly or indirectly (whether through the instrumentality of a nominee or otherwise) hold a member's interest in a CC. SADTI was opposed to this position during the enactment of SACA 2008. However, the justification for this restriction is that '[t]his prevents companies from doing business through the instrumentality of close corporation subsidiaries.'[1048]

The drafters sought to avoid the problems that come with institutional investors when corporate entities are member in a close corporation.[1049] A problem arises because members of CCs are regarded as a partners where corporate entities are generally excluded from being members.[1050] Second, it is an established fact that SCHCs are founded on the personal relationship of the shareholders.[1051] This relationship would be threatened if juristic persons were allowed to be members of CCs, because of their different interests.[1052] The case of *Scottish Co-operative Wholesale Society Ltd v Meyer and Anor*[1053] illustrates this point.

In that case, so far as is relevant, the appellant co-operative society on 7 May 1946 incorporated a subsidiary company to enable it participate in the manufacture and sale of rayon materials and to get licences to manufacture rayon cloth, the production of which was then controlled and remained controlled until 1952. The two respondents, Dr Meyer and Mr Lucas, were both shareholders and were also appointed joint managing directors. The appellant had three nominee directors into the board of directors of the subsidiary: Scottish Textiles & Manufacturing Co. Ltd herein the 'company' but were nevertheless also directors in the appellant society.[1054] All was well and the company was said to have generally been profitable until about 1952, when there was dissension between the appellant society (acting through its nominee directors) and the respondents, who were the petitioners. In their petition, which was lodged on 14 July

[1048] Henning 'Close corporation law reform' 931.
[1049] Gower 7 ed 337–342, particularly 337–338; Dunne 'The position of the quasi-partnership type' 109.
[1050] Naude 'The South African close corporation' 120.
[1051] O'Neal *Close Corporation* § 1.02, § 1.07, cited by Elfin 'A critique' 440.
[1052] Henning 'Close corporation law reform' 931.
[1053] (1958) 3 WLR 404.
[1054] See Lord Keith of Avonholm at 415–430, for detailed facts.

1953 and brought under s 210 of the CA 48, the respondents accused the appellant society of oppressive conduct. The specific complaints were: (1) the concealing of information from the respondents by the appellant nominee directors; (2) hostility on the part of the society's nominees on the board of the company to the respondents; and (3) an attempt to dilute the shares of the Respondents. The House of Lords (in a unanimous decision) found for the respondents and disallowed the appeal, holding that the appellant society had acted towards the respondents in an oppressive manner.

This case is significant to the present study for three reasons. First, there was no personal relationship between the society's nominee directors and the minority shareholders or directors, Dr Meyer and Mr Lucas. Second, the nominee directors found themselves in a position of conflict of interest and conflict of duty.[1055] Finally, was the attempt by the society to manage the affairs of the company from outside its structure. The House of Lords treated the company as 'in substance, though not in law, a partnership consisting of the society, Dr Meyer and Mr Lucas'.[1056] And as such, 'there should be the utmost good faith between the constituent members.'[1057]

Had the three nominee directors been members of the board of the company on their own accord, perhaps the nature and extent of the oppressive conduct meted out to the petitioners would not have been of the magnitude that the House of Lords had to deal with. It is therefore a deliberate policy position to proscribe ordinary private companies from taking advantage of SCHCs.[1058] This saves minority members from oppression by the majority and preserves the personal relationship between members. This is the second salient feature of the proposed legal framework for SCHCs under CA 2012 – restricting membership of SCHCs to natural persons. This requires that the terms 'shareholder' or 'member' in CA 2012 should be defined; currently they are applied interchangeably.

[1055] See Lord Viscount Simonds at 410.
[1056] See Lord Keith Avonholm at 427.
[1057] Ibid.
[1058] Henning 'Close corporation law reform' 931.

At present, CA 2012 does not provide a definition for 'member' or 'shareholder'. This definition appears in another statute, the Insolvency Act, 2011.[1059] Section 2 provides that 'shareholder' 'has the meaning assigned to it in the Companies Act'. But CA 2012 does not define 'shareholder'. However, in terms of s 47(1), 'the subscribers to the memorandum of a company shall be taken to have agreed to become members of the company, and on its registration shall be entered as members in its register of members.' In contrast, SACA 2008 defines both 'shareholder' and 'member' and provides the context in which they are to be applied.[1060] Providing clarity on the definition of 'shareholder' and 'member' is consistent with the argument made in chapter 1 that treating SCHCs differently requires a clear definition with their legal characteristics delineated in the law.[1061]

To briefly draw on Uganda's own CJRP on the above point, the recommendation by Reid and Priest in reforming the repealed Act was to 'restrict the type and number of persons who may be members of private companies.'[1062] The ULRC modified the recommendation, dropping the restriction on the type of persons who may be members of private companies, but limiting the number of persons who can be members of a private company to 100 members, an increase from 50 in the repealed Act.[1063]

ULRC also recommended that where members of a private company exceed 50, such company should be prohibited from opting out of mandatory requirements in the Act. While this latter recommendation was not adopted in CA 2012, as demonstrated in chapter 3, and the number 50 is high given the definition of SCHCs adopted in this study, it nevertheless demonstrates that limitation of members is a key determinant of the threshold for optional rules to apply. This provides further support for this study's proposed legal framework for SCHCs that limits members to ten.

[1059] Act 14 of 2011.
[1060] See the 'Definitions' in SACA 2008.
[1061] n 4.
[1062] Reid & Priest 3.
[1063] ULRC Report 19 recommendation 5(b).

Moreover, in terms of s 30(1), the interest of any member of a corporation shall be a single interest expressed as a percentage and shall be movable property which shall be transferable in the manner provided for in the Act. Two or more persons shall not be joint holders of the same member's interest in a corporation.[1064] The import of this provision is that the rules on shares are not applicable to CCs,[1065] and neither are the capital maintenance rules on account of the solvency and liquidity provision.[1066]

The fifth key feature of CCA 84 is simple accounts. Section 56 requires CCs to keep accounting records in a prescribed format and to 'appoint an accounting officer who reports on the annual financial statements.' However, it is optional for a CC to have 'a formal audit of the annual financial statements.' SACA 2008 has largely adopted this position with respect to the audit requirements for small owner-managed firms.[1067] This is a significant departure from traditional company legislation which contained detailed mandatory account and reporting obligations.[1068] Section 167 of CA 2012 on mandatory audit requirements should be modelled on CCA 84 and SACA 2008 as best practice for the proposed SCHCs.

Finally, is de-criminalisation. The thought was that 'criminal law is a blunt and largely ineffective instrument for ensuring that technical or administrative duties imposed in an Act like the Companies or Close Corporations Act are complied with. For this reason, the Bill was decriminalised to a large extent. It creates only ten offences.'[1069] The literal and natural meaning of this policy is to limit the use of criminal law as a corporate governance tool in 'technical legislation'.[1070]

Based on the discussion above, it is fair to state that in many respects CCA 84 provides a simple legal framework that is inexpensive and tailored for small

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[1064] Section 30(2) of CCA 84.
[1065] *Borland's Trustee v Steel* (1901) 1 Ch 279 at 288 (Farewell J).
[1066] *Guinness v Land Corporation of Ireland* (1882) 22 Ch D 349 (Cotton LJ at 375–376), cited in Mayson et al *Company Law* 334. SACA 2008 has replicated this position: see s 46(1). For a full discussion on the subject, see Cassim et al *Contemporary Company Law* 354.
[1067] See para 5.2.1.2 for a full discussion.
[1068] See s 154 of CA 2012.
[1069] Naude 'The South African close corporation' 128.
[1070] Ibid.

businesses.[1071] Providing CCs with corporate status, while departing from traditional, mostly rigid corporation law principles, is an undisputed legacy of CCA 84; this accounts for the increase in the number of registered small companies in South Africa in the last three decades.[1072] The available empirical data reveals that '[f]rom 1 January 1985 until end of 2008, 2,104,122 close corporations were registered.' And '[o]n 12 June 2006 1,276,157 close corporations were still active in South Africa.'[1073] In the period 2009 to May 2011, an additional 389,357 were registered, making a total of 2,403,479.[1074] Given this legacy of CCA 84, Uganda could borrow some positive attributes in formulating its legal framework for SCHCs under CA 2012.

Further, 'even though the impending prohibition on new close corporations was already known [because of the proscription by s 13 of SACA 2008], 183,406 new close corporations were still registered in the past 16 months allowed for this purpose, as opposed to only 27,530 companies.'[1075] Indeed, this empirical data gives CCA 84 a good score card for its stated objective of '[a] simpler and less expensive legal form for the small business which consisted of a single or a small number of members in South Africa'.[1076] Any policy by SADTI that could reverse this progress is problematic.[1077]

Moreover, contrary to the SADTI position above, CCA 84 has been recommended by other jurisdictions outside of South Africa as 'an excellent piece of legislation for governing the development of small businesses'.[1078] Thus, assuredly, one way of providing SCHCs with an appropriate legal framework is by adopting some concepts in CCA 84 in CA 2012 by way of introducing a substantive Chapter which

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[1071] Davis et al *Companies and Other Business Structures* 408–409.
[1072] Gower 5 ed 13 n 53; Spisto & Samujh 'Close corporations in South Africa' 184.
[1073] Henning 'The impact of South African company law reform on close corporations' 457.
[1074] Henning 'Closely held incorporated business entities under the new statutory dispensation' 20 nn 5–6.
[1075] Ibid 20; Henning 'Close corporation law reform in South Africa' 941–944 for an empirical analysis between 1985–2000.
[1076] Spisto & Samujh 'Close corporations in South Africa' 155; Naude 118; Henning 'Close corporation law reform' 923.
[1077] Cassim et al *Contemporary Company Law* 13 for some thoughts on the advantages of CCs.
[1078] Spisto & Samujh 'Close corporations in South Africa' 184–186; JJ Henning 'South African small business corporations in comparative perspective' (2005) 2 *J Transnational L Contemporary Problems* at 188, cited in Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica* 456–479 at 459.

espouses the principles of partnership law along the lines of CCs in South Africa, and some positive attributes of SACA 2008, which are considered below.

5.2.1.2 SACA 2008 and close corporations

The enactment of South African *Companies Act*, 2008, ('SACA, 2008'), became necessary due to, among others, the political changes that took place in South Africa, culminating in a new Constitution.[1079] Davis and Geach have opined that 'it is perhaps only right that all Acts in South Africa should be subject to a complete overhaul, keeping in mind the spirit, principles and the purpose of the Constitution of the Republic of South Africa.'[1080] Away from the political developments, which is outside the scope of this study, the objectives for reforms of *Companies Act* ('CA 73') in South Africa as can be discerned from the SADTI Report[1081] are in many ways similar to those in CJRP in Uganda of the repealed Act,[1082] a discussion of which cannot be competently undertaken here as the focus of this study is limited to only aspects of SACA, 2008, which bear on small companies or close corporations.[1083]

It is well stated that a key purpose of SACA, 2008, was to reform and modernise South Africa's companies' legislation and the way of doing business.[1084] This led to many changes and the eventual repeal of CA 73. For the present discussion, however, the focus is on the changes brought about by SACA, 2008–some of which by amending CCA 84– intended to provide a suitable legal framework for small companies and render the continuance of CCA 84 and CCs wholly unnecessary.[1085] For brevity, I will consider only four of them. To begin with, smaller businesses may now incorporate as private

[1079] Davis & Geach (eds) *Companies and Other Business Structures* 4.
[1080] Ibid.
[1081] Cassim et al *Contemporary Company Law* 3–4; also s 7 of SACA 2008.
[1082] See para 1.5.
[1083] See para 1.11.
[1084] SADTI Report para 3.2.3; Cassim et al *Contemporary Company Law* 2–6; Davis & Geach (eds) *Companies and Other Business Structures* 4–5, 8.
[1085] SADTI Report para 2.2.3, Cassim et al *Contemporary Company Law* 13; Davis & Geach (eds) *Companies and Other Business Structures* 51.

companies under SACA 2008.[1086] This must be done in terms of s 13(1), which allows one or more persons, or an organ of state, to incorporate a profit company. The threshold of one member enables smaller businesses that ordinarily would have registered in terms of CCA 84 as close corporations (CCs) to incorporate under SACA 2008. The difference is that under CCA 84 there is a cap of ten natural persons, a point to which I shall return later in this section.

Moreover, compared with CA 73, SACA, 2008, is stated to present with a simpler registration process. This is evident in the reduced documentation required. To incorporate under SACA, 2008, one files a Memorandum of Incorporation ('MoI'). The MoI has been described by Davis and Geach[1087] as 'a flexible document and determines the nature of a company and the rights, powers and duties of stakeholders.' The adoption of the MoI is a departure from the position under CA 73 where formation of a company required the lodgement of two discrete documents, namely the memorandum of association and the articles of association.[1088]

The second key feature of SACA 2008 is the flexible and differential reporting and audit requirements for different categories of companies.[1089] In terms of s 30 and reg 29 of the 2011 Regulations, different companies have different reporting standards based on their turnover, the nature and extent of their activities, the size of their workforce, and their type.[1090] In terms of s 30 of SACA 2008, '[g]reater burdens of regulation fall upon state-owned companies, public companies, and certain private companies that have some public impact.'[1091] Other companies (such as owner-managed private companies) have far less stringent reporting requirements,[1092] including, in some cases, exemption from audit requirements.[1093]

[1086] Davis & Geach (eds) *Companies and Other Business Structures* 409.
[1087] Ibid 20.
[1088] Cassim et al *Contemporary Company Law* 11.
[1089] Section 30(2)*(b)*; reg 29(2) of SA Regulations.
[1090] See also s 72(4) of SACA 2008; Cassim et al *Contemporary Company Law* 18.
[1091] Davis & Geach (eds) *Companies and Other Business Structures* 20.
[1092] Regulation 29 of the 2011 Regulations.
[1093] Section 30(2A) of SACA 2008; reg 29(2)*(a)* of the 2011 Regulations.

This study has demonstrated that the legal and corporate needs of SCHCs is less reporting or flexible reporting requirements.[1094] Thus, according differential reporting and audit treatment to different classes of companies under SACA, 2008, is to be commended. This intervention is consistent with, and addresses the concerns raised during the enactment of CCA 84 for a simple legal framework for small enterprises.[1095] In Chapter 3,[1096] this study has demonstrated that the flexibility on accounting reporting and audit requirements is lacking in CA 2012 and needs to be addressed. In fact, the position in CA 2012 of mandatory audit requirements for all companies under s 167 is similar to South Africa's position under CA 73 which required all companies to have their annual statements audited.[1097]

Third, solvency and liquidity principles, which were considered earlier in the discussion of CCs, have also been enacted in SACA 2008. In terms of s 46(1) of SACA 2008, a company must not make any proposed distribution unless– *(a)* the distribution– (i) is pursuant to an existing legal obligation of the company, or a court order; or (ii) the board of the company, by resolution, has authorised the distribution; *(b)* it reasonably appears that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution. Commenting on the subject at the time of the draft Bill for CCA 84, Naude suggested that '[i]n fact, the substitution of solvency and liquidity for the traditional capital yardstick of company law is probably the most significant innovation of the Bill.'[1098]

The import of the solvency and liquidity concept is to allow members in (small) companies to take benefit of payments which would be in contravention of the law were the traditional corporation law rules on capital maintenance to apply; as long as (a) if, after such payment is made, the corporation's assets, fairly valued, exceed all liabilities; (b) if the corporation is able to pay its debts as they become due in the ordinary course

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[1094] See chapter 3.
[1095] Naude 'The South African close corporation' 117–118; Henning 'Close corporation law' 922.
[1096] See para 3.1.4.1(b).
[1097] Cassim et al *Contemporary Company Law* 18 n 51.
[1098] Naude 'The South African close corporation' 127.

of its business; and *(c)* if such payment will in the particular circumstances not in fact render the corporation unable to pay its debts as they become due in the ordinary course of business.[1099] This inevitably invites the application of the capital maintenance rules. To state it briefly, the capital maintenance rule prohibits the payment out of capital or the return of capital, only with limited exceptions.[1100] To that extent, CCs that register under SACA 2008 will find continuity of the solvency and liquidity principle.

Finally, the business rescue provisions in SACA 2008 also apply to CCs.[1101] While this subject is not discussed in any detail in this study,[1102] there is a connection between business rescue relief and the expanded role that SACA 2008 has ascribed companies in South Africa. Under s 7, companies are regarded as a means of achieving economic and social benefits for the South African public. The business rescue relief that has been extended to CCs prevents financially distressed companies from being wound up. Cassim et al stated that 'the winding-up or shut-down of a company has widespread repercussions for the incumbent management, shareholders and employees of the company, and also for creditors and the economy.'[1103] On their part, Davis and Geach[1104] stated that 'the purpose of business rescue proceedings is to put in place a process that could avoid the liquidation of a financially troubled company, thereby avoiding the consequences of a liquidation, such as unemployment and retrenchments.'[1105] The extension of these remedies to CCs is to be welcomed.

However, when looked at as a whole, there is some doubt whether some of the changes in so far as they relate to close corporations achieved their intended

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[1099] Ibid.
[1100] The capital maintenance rule is a broad subject and beyond the scope of this study. For a detailed exposition of the subject see Mayson et al *Company Law* 335, particularly the authority of *Hill v Permanent Trustee Co of New South Wales Ltd* (1930) AC 720 at 731 cited therein, where Lord Russell of Kilowen restated the rule on capital maintenance.
[1101] Section 128 of SACA 2008.
[1102] Cassim et al *Contemporary Company Law* 21.
[1103] Ibid.
[1104] Davis & Geach (eds) *Companies and Other Business Structures* 19, 21.
[1105] Ibid 19.

objective.[1106] Henning points out some of the negative impact of SACA, 2008, on close corporations;

> [N]ew corporations are proscribed, which not only translates into the phasing out of close corporations, however gradual, but leaves small entrepreneurs with only one avenue for new incorporations and that is the new Companies Act. There is the clearly discernible tendency to subject the close corporation to more and more onerous administrative duties and arrangements. Further, 'is the prohibition imposed on the incorporation of new close corporations as well as on the conversion of companies to close corporations as from 1 May 2011.'[1107]

First, preventing companies from converting to CCs in terms of s 13 of SACA 2008 means that, from the effective date of 1 May 2011, all new companies irrespective of their threshold fall under SACA 2008. Additionally, there is no return for CCs that lose their status under CCA 84. Given the history of CCA 84 referred to earlier, of creating a suitable vehicle for the less sophisticated businessperson under separate legislation, and the successes of CCA 84,[1108] this intervention is controversial. One solution is to give small companies that incorporate under SACA 2008, and subsequently find it unsuitable, the latitude to re-register as CCs under CCA 84. This would give SACA 2008 the features of flexible and simple legislation as envisaged by SADTI.[1109] The other possibility is to repeal CCA 84 and re-enact its provisions in SACA 2008.

Second, in terms of s 29 of CCA 84, a CC is determined by a definite number of one to ten members. This is intended to achieve a corporate structure designed along the lines of partnerships. According to Naude, the partnership is the essence and cardinal principle upon which CCA 84 was conceived and enacted.[1110] As demonstrated earlier in this chapter, in a corporate structure designed along the lines of a partnership, members

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[1106] Henning 'Closely held incorporated business entities under the new statutory dispensation' 20.
[1107] Ibid; s 2(1) of CCA 84.
[1108] Cassim et al *Contemporary Company Law* 12–13.
[1109] Ibid.
[1110] Naude 'The South African close corporation' 119–120.

can contract to arrange their internal governance structure to suit their needs, which otherwise would not be achieved under statute. Crucially, the partnership structure allows for informal meetings of members since in small companies such as CCs the members are also the managers and there is no need to insist on separating the board from the members,[1111] and it is also the basis for flexible or less reporting obligations.

The situation under SACA 2008 is quite different. The variables which are applied for purposes of differential treatment are the company's turnover, workforce size, and the social-economic impact of that company. While these are useful parameters upon which flexible reporting obligations can be founded, the SACA 2008 model omits the crucial element of the personal relationship between the members. In addition, it sets out much broader parameters that are much more complex to measure, compared to CCA 84. The legal and corporate governance needs go beyond the fewer or flexible reporting obligations.[1112] CCA 84's threshold of one to ten members does not only protect the personal relationship of members, but also provides for flexible reporting obligations.[1113] Moreover, it is doubtful whether the parameters under SACA 2008 are within the contractual capacity of members of small companies.

To that end, the assertion by SADTI that a 'structure that reflects the characteristics of the close corporation (as agreed to at consultation on the Companies Bill) would be available under the new dispensation'[1114] has not been realised in SACA, 2008. That undertaking could have been met either by re-enacting CCA 84 as a substantive chapter in SACA 2008, or by having a legal framework as similar as possible to CCA 84, which is not the case. This is the only way in which SADTI would truly 'obviate the need to retain the Close Corporations Act'.[1115] A country benchmarking South Africa's SACA 2008 must consider this concern.

[1111] Gower 10 ed 5.
[1112] See para 1.2.
[1113] Naude 'The South African close corporation' 126.
[1114] See NEDLAC *Report on Guidelines for Corporate Law Reform* (2005) para 3.5.5, cited by Henning 'The impact of South African company law reform on close corporations' 460–461.
[1115] See JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) 40(1) *J Jur Sci* 19–34 at 20, 25; SADTI Report para 2.2.3.

Further, s 13 of SACA 2008 provides that one or more persons may incorporate a profit company, and an organ of state, a juristic person, or three or more persons acting in concert, may incorporate a non-profit company, by– *(a)* completing, and each signing in person or by proxy, a Memorandum of Incorporation– (i) in a prescribed form; or (ii) in a form unique to the company; and *(b)* filing a Notice of Incorporation, in accordance with subsection (2).

Section 13(2) provides that the Notice of Incorporation of a company must be *(a)* filed in the prescribed manner and form, together with the prescribed fee; and *(b)* accompanied by a copy of the Memorandum of Incorporation, subject to any declaration contemplated in s 6(14)*(b)*. Considered as a whole, significant differences have been introduced by SACA 2008 with respect to the formation of companies. The first and obvious one is that the capping of members to ten, which is a definitive feature of CCA 84, has been omitted from SACA 2008.

As already demonstrated, keeping the number of members low is vital if a legal structure which mirrors a partnership is to be achieved. Where the number of members is higher, the (unintended) consequence is having to separate ownership from management through a board, since not all the members can be part of management. This has negative outcomes. The assumed personal relationship between members is eroded. The informality of their meetings becomes illusory, thus necessitating the strict application of corporation rules to keep managers in check. It is plain that without a provision in SACA 2008 that is *in pari materia* to s 2(1) of CCA 84 with regard to limiting the number of members for the purposes of certain benefits, some weaknesses are evident in the SADTI proposal that '[t]he number of shareholders does not provide an adequate basis for differentiation, as (apparently) some very large companies may have a small number of shareholders.'[1116]

While the position of SADTI is to be appreciated, the fact of the matter is that for companies' legislation to provide a legal framework for small firms along the lines of

[1116] SADTI Report 31.

the CCA 84 model, the limitation of shareholders (members) is a prerequisite. To achieve flexibility, provision would have to be made for conversion from one business form to another.[1117] This avenue is curtailed by SACA 2008. Once a CC has transitioned to a company under SACA 2008, there is no possibility of reversion to a CC.[1118] This presents SACA, 2008, as inflexible, contrary to its stated overall objective, as espoused in the SADTI Report.[1119] In the proposed legal framework for SCHCs in CA 2012, a SCHC will be permitted to convert to another corporate form or reconvert to a SCHC in accordance with a prescribed procedure and conditions, provided its members do not exceed ten. The conditions are necessary to curtail possible abuse by unintended target of SCHCs regime.

Second, the process of company formation under SACA, 2008, has various 'subject to' provisions —some of which onerous—with elaborate procedure, (if contrasted with the procedure for formation of CCs under CCA 84). It is contended that this clogs the process of registration of companies and is counter to the overall objective of SADTI reform policy of a simple and modern companies' legislation.[1120] Section 13 which provides for the right to incorporate a company or transfer registration of foreign company (for this study, foreign companies into the South African space is outside its scope), registration is subject to s 6(14)(b); 15(2)(b) or (c). Section 6(14)(b) enjoins the Minister to declare any system established or accredited by the Commission to be an acceptable mechanism for the filing of any particular document, in lieu of any other requirements set out in legislation relating to the filing of that document.[1121]

Section 15 on the other hand prescribes the format of the memorandum of Incorporation for purposes of company formation. Any agreement between shareholders relating to any matter to the company must be consistent with SACA, 2008, and the company's Memorandum of Incorporation, and any provision of such an agreement that

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[1117] See Naude 'The South African close corporation' 119.
[1118] See Davis & Geach (eds) *Companies and Other Business Structures* 51.
[1119] See Naude 'The South African close corporation' 119.
[1120] SADTI Report para 1.2 'The objectives of the new company law'.
[1121] Under s 1 'Commission' means the Companies and Intellectual Property Commission established by s 185, while 'Minister' means Minister of Cabinet responsible for companies.

is inconsistent with SACA, 2008, or the company's Memorandum is void to the extent of the inconsistency.[1122] This is another scenario of 'subject to'. I must be clear that it is trite law that private agreements are subject to the law. What is however controversial is to subject personal agreements between shareholders to a MoI which is essentially a private document save for the fact of its registration.

The implication of subjecting shareholder agreements to the MoI is that shareholders must, as a matter of course, first have to amend the MoI if they are to agree on anything which may trigger controversy with the MoI. Yet, the process of amendment of the MoI is itself extensive.[1123] It has to be in compliance with a court order; or special resolution and is itself subject to another provision—s 36. This provision curtails freedom of members to structure their affairs under contract to suit their unique needs. In terms of Naude's scholarship this can lead to sham compliance[1124] especially for small companies.

There is undoubtedly a stark contrast with registration procedure under CCA 84. There, 'the formation, administration and operation of a close corporation are subject to a minimum number of formalities and the members are subject to a minimum number of duties.'[1125]The registration of the CCs only requires members to sign a 'founding statement' in the prescribed form in triplicate and register it with the Registrar of Close Corporations in Pretoria.[1126]

Under s 12, the content of the founding statement is also straight forward. The full name of the corporation; the principal business to be carried out by the corporation; postal address for the corporation; and the address (not being the number of a post office box) of the office of the corporation; the full name of each member, his or her identity number or, in absence, the date of birth, and residence; the size, expressed as a percentage, of each member's interest in the corporation; the particulars of the

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[1122] Section 15(7) of SACA 2008.
[1123] Section 16 of SACA 2008.
[1124] Naude 'The South African close corporation' 118.
[1125] Spisto & Samujh 'Close corporations in South Africa' 157.
[1126] Ibid; ss 12 and 13 of CCA 84.

contribution of each member to the corporation in accordance with s 24(1), including any amounts of money; a description, and statement of the fair value, of any property (whether corporeal or incorporeal) or any service referred to in s 24(1); the name and postal address of a qualified person who or a firm which has consented in writing to his or her or its appointment as accounting officer of the corporation; and the date of the end of the financial year of the corporation.[1127]

Third, classification of companies in SACA, 2008, do not directly identify with a category of companies which would ordinarily fall under CCs in CCA 84. Under SACA, 2008, the use of the phrase 'close corporations' is avoided. Rather, the classes of companies are 'profit company,' 'non-profit company,' or 'public company.' The lifting of the capping on membership in s 13 on the number of persons who can form a profit company confirms represents a change of policy by SADTI. This study has demonstrated that keeping numbers small in CCs or close corporations is to avoid troubling members in those companies with the rigours of formalities of meetings. To that extent, it is doubtful whether small companies in SACA, 2008, derive the same flexibility as CCs would, under CAA 84.

In the fourth place, the types of companies under SACA, 2008, the registration process as I have shown above, suggests a significant departure in companies' formation under CAA 84. To that end when one considers SACA, 2008, in its' entirety and in particular s 13, and *Schedule* 2 thereof, it becomes apparent that the intention is to gradually phase out close corporations and ultimately have a single legislation. This is controversial given the fact that the birth of CAA 84 was upon a realisation that it is impossible to provide for smaller enterprises of single or a few members within CA 73 legal framework.[1128]

Finally, CCs remain subject of both CAA 84 and SACA, 2008, in certain respects. While CCs can take benefits under SACA, 2008, without having to convert to

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[1127] Spisto & Samujh ibid; s 12 of CCA 84.
[1128] Naude 'The South African close corporation' 117–118.

companies[1129] there are undoubtedly some associated challenges. The cross-referencing from CCA 84 to SACA, 2008, and vice versa makes use of the law cumbersome. One way around this problem was to repeal CCA 84 and re-enact it as a substantive chapter in SACA, 2008. This would have mitigated the problem that the drafters of CAA 84 sought to avoid by having a substantive legislation for small enterprises outside of CA 73.[1130] Thus, by having a Chapter directed at CCs, SACA, 2008, retains in its' legal framework the original legal theory and public policy consideration underlying CAA 84.

Next, I briefly explore small companies' regime in the UK's CA 2006.

5.3 United Kingdom

Company legislation in the UK has long classified companies as public or private,[1131] limited (by shares or guarantee), or unlimited.[1132] The latter are also sometimes referred to as 'incorporated or unincorporated' or 'registered and unregistered'.[1133] and less, as micro, small or medium size companies—by this I mean in reference to company economic size usually measured by turnover, asset value and number of employees;[1134] or fewer shareholders.

This is not to suggest that companies that are small in economic size or fewer members did not exist as one commentator has recently suggested, 'the Companies Act recognises the different needs of different sizes of company. At one end of the scale is the listed company, at the other is the very small company where directors and the shareholders are the same people and where the size of the business carried on is also small.'[1135]

[1129] Section 66(1A) of CCA 84, cited by Cassim et al *Contemporary Company Law* 13.
[1130] Naude 'The South African close corporation' 117–118.
[1131] Section 4 of CA 2006.
[1132] Sections 3 and 5 of CA 2006; s 6 for a new entrant, 'community interest companies'; Gower 10 ed 16.
[1133] Gower 4 ed 4–5.
[1134] Section 382(3) of CA 2006; s 72(4) of SACA 2008.
[1135] Gower 10 ed 17.

Despite this acknowledgment, company law in United Kingdom for the most part regarded what is today referred to as SCHCs more in the realm of partnerships for 'a single trader or a small body of partners to carry on business.'[1136] This latter category did not enjoy corporate personality. Their liability was personal. To take benefit of incorporation, a company had to meet the prescribed requirements which were usually coupled with a 'dilatory and expensive process';[1137] and 'the rules that thereafter have to be observed to protect members, creditors and the public against the dangers inherent in such a body.'[1138] Therefore, '[a]n incorporated company necessarily involves formalities, publicity and expenses at its birth, throughout its active life and on its final dissolution.'[1139]

SCHCs in the UK despite the challenges above continued to be subjected to the same rules[1140] on meetings, audit requirements and disclosure 'regardless of the number of shareholders or employees, managerial structure or size of financial operations.'[1141] It was not until the enactment of the Companies Act of 1989 ('CA 89') that some major changes were introduced in the law to address the inappropriateness of CA 85 on small companies. As one commentator has suggested CA 89 '[a]t last made a serious effort to meet their needs (of small companies).'[1142] Some of the interventions made in CA 89 was 'enabling them (SCHCs) to dispense in most cases with formal meetings and with the pretence that they had held them when frequently they had not.'[1143] This relief '[a]pplied to all types of resolution—ordinary, extraordinary, special or 'elective' except for resolutions to remove a director or an auditor before the expiration of his period of office.'[1144]

[1136] Gower 5 ed 10.
[1137] Gower 4 ed 4.
[1138] Gower 5 ed 10.
[1139] Ibid 102.
[1140] Ferran *Company Law* 640.
[1141] Ibid 5.
[1142] Gower 5 ed 103.
[1143] Ibid.
[1144] Ibid.

CA 89 also introduced 'an elective regime' enabling private companies to dispense with or relax a number of the requirements of the principal Act.' Among which is for private companies 'to dispense completely with formal meetings if all the members want to.'[1145]

Finally, CA 89 '[e]powered the Secretary of State to make provision by regulations whereby additional requirements which appear to him to relate primarily to the internal administration and procedure of companies may be dispensed with or modified by elective resolutions and to make consequential amendments to the principal Act'.[1146] Gower concludes that 'if robust use is made of this power small companies may at long last be provided with a regime more suitable to their needs. While this will be less satisfactory than providing them with a separate Act (they will still have to plough through the mammoth Companies Act to ascertain what sections apply to them) it will be a major reform removing many of the disadvantages of incorporation.'[1147]

The import of CA 89 can be seen as introducing exceptions to the general rules of corporation law or 'elective regime' to relieve SCHCs of associated burden so as to remove 'fictional' compliance. It may well be that what is seen today as the 'small companies regime' under CA 2006 must have been birthed in CA 89. However, there remained the question of where legislation for SCHCs should be housed. Gower proposed 'providing them with a separate Act.'[1148] These concerns are similar to the situation preceding the draft of CAA 84 as shown above.[1149] Thus, it can be deduced that beyond incorporation, the differences in sizes of companies cannot be ignored in the formulation of company legislation.[1150] The need to pay attention to company size is in two major areas in private companies: (1) 'where all, or most, of the shareholders participate in management';[1151] and (2) where compliance with formalities will be

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[1145] Ibid.
[1146] Ibid.
[1147] Ibid 106.
[1148] Ibid.
[1149] Naude 'The South African close corporation' 117–118; Henning 'Close corporation law' 922.
[1150] Ferran *Company Law* 4–5.
[1151] Ibid.

'fictional in the case of small companies'.[1152] Therefore, the theme in the CLRSG was 'minimising complexity and maximising accessibility' or 'think small first',[1153] which points to a convergence across jurisdictions on the needs of SCHCs.

The latter phrase is 'intended to mean that the companies legislation should be drawn up with the small company in mind as the basic entity with additional requirements being added on, in discrete layers, for larger, more sophisticated or exceptional entities.'[1154] Despite the needs of SCHCs being well-known, United Kingdom has been slow to take the South African route for a separate legislation for SCHCs. Early[1155] as well as recent calls during the CLRSG to enact a separate legislation for SCHCs 'whose directors and shareholders are identical and whose businesses were small in size' have not been heeded. This is not without reason. Apparently, 'it would be undesirable to create a regulatory barrier to expansion, which might occur if a company became subject to different rules when its directors and shareholders ceased being identical.'[1156] For the same reason, it (CLRSG) was opposed to a distinct regime for micro companies even within a single Act.[1157]

Unsurprisingly, the UK as adopted 'the single Act approach.' By this is meant one legislation dealing with all companies while incorporating aspects of SCHCs.[1158] But even then, CLRSG '[a]pplied most of its reforms to private companies as a whole, but some of them were crafted as default rules drafted with micro companies particularly in mind, and it was expected that private companies of a larger size would opt out of them. The advantage of such an approach is that the legal regime does not formally cease to be applicable to a particular small company as it expands, though it is likely to find the regime less convenient and thus opt out of it. The Companies Act 2006 adopts this approach.'[1159] This is all well and good. However, on the concerns of 'outgrowing' a

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[1152] Gower 5 ed 103.
[1153] Ferran *Company Law* 640.
[1154] Para 2.25 of the CLRSG Report (2001), cited by Ferran *Company Law* 640.
[1155] SADTI Report 12 para 2.1.
[1156] Gower 10 ed 17 n 79; Ferran *Company Law* 5.
[1157] CLRSG Report (2001) 1 para 2.7, cited by Gower 10 ed 17.
[1158] Henning 'The impact of South African company law reform on close corporations' 464.
[1159] Gower 10 ed 17.

legal regime, as contended by Gower,[1160] this can be cured by the draftsman inserting re-registration provisions to allow for easy migration—which is a common drafting style for company legislation.[1161]

The objective in this section is threefold: (1) building on the earlier discussion on close corporations, to briefly demonstrate that legal and corporate governance needs of SCHCs are similar hence legislative interventions on SCHCs across jurisdictions have been for similar reasons although the approaches have been varied; (2) to highlight how the UK has dealt with the question of SCHCs (small companies) in her company legislation; and (3) to draw some lessons from the UK on legislation for SCHCs.

5.3.1 CA 2006 on small companies

Before delving into the small companies' regime under CA 2006, a brief background to the Act is necessary. Company law reform in the UK was started by the Department of Trade and Industry ('DTI'), which set up the Company Law Steering Group 'CLRSG.' Arising from the various reports of the CLRSG,[1162] the UK government published the final report, *Modern Company Law: For a Competitive Economy.*[1163]

[1160] Ibid.

[1161] Mayson et al *Company Law* 65; Spisto & Samujh 'Close corporations in South Africa' 170; Henning 'Close corporation law reform' 932.

[1162] Mayson et al *Company Law* 14–15 para 0.5.1.4 'The Company Law Review' where the authors list various subsequent 'consultation documents' of the various working groups of the CLRSG: *(a) Modern Company Law for a Competitive Economy: Company General Meetings and Shareholder Communication* (URN 99/1144) (DTI, 1999); *(b) Modern Company Law for a Competitive Economy: Company Formation and Capital Maintenance* (URN 99/1145) (DTI, 1999); *(c) Modern Company Law for a Competitive Economy: Reforming the Law Concerning Oversea Companies* (URN 99/1146) (DTI, 1999); *(d) Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (DTI, 2000); *(e) Modern Company Law for a Competitive Economy: Capital Maintenance: Other Issues* (URN00/880) (DTI, 2001); *(f) Modern Company Law for a Competitive Economy: Registration of Company Charges* (URN 00/1213) (DTI, 2000); *(g) Modern Company Law for a Competitive Economy: Completing the Structure* (URN 00/1335) (DTI, 2000); *(h) Modern Company Law for a Competitive Economy: Trading Disclosures* (Company Law Review, 2001); Ajibo 'A critique' 43–44.

[1163] Final Report of the CLRSG (2001) XV ('Summary of recommendations') available at https://webarchive.nationalarchives.gov.uk/ukgwa/20070603164510/http://www.dti.gov.uk/cld/final_report/prelims.pdf (accessed 23 July 2022).

Thereafter, the Companies Bill was tabled in the House and was enacted into law and received royal assent on 8 November 2006.[1164] The Act resulted from the extensive company law review process that was launched by the UK government in March 1998.[1165] The Act came into force in stages, with the final provision commencing on 1 October 2009.[1166] There is a huge amount of scholarship on different aspects of the Report which are not directly connected with this study.[1167]

For the present purposes, I will restrict the discussion to the specific recommendations about small companies and ss 381-383 of CA 2006 on '*small companies regime*.' These recommendations result from one of the stated objectives of the law reform process, which was to simplify and modernise the law for small companies.[1168] The specific CLRSG recommendations were: *(a)* to simplify decision-making procedures; *(b)* to streamline other internal administrative procedures so that private companies need not hold AGMs, lay company accounts in general meeting, or appoint auditors annually; *(c)* to reduce the burden of financial reporting and audits while improving the usefulness of small company accounts; *(d)* to simplify rules on capital maintenance, including abolishing the complex rules on financial assistance for private companies; and *(e)* to encourage mediation and arbitration as alternatives to litigation, in particular by creating an arbitration scheme specifically to deal with shareholder disputes.[1169]

The discussion on small companies' regime below shows that not all recommendations were adopted. However, inserting the small companies regime in the Act is a good drafting style is inspirational for the proposed insertion of a chapter in CA 2012 on SCHCs. Its' apparent advantage is that SCHCs do not have to go through the entire statute to find provisions that are applicable to them.[1170]

[1164] See the long title to the Act.
[1165] J Dean *Directing Public Companies: Company Law and the Stakeholder Society* (2001) v–vii.
[1166] Ajibo 'A critique' 43–44.
[1167] Keay 'Corporate objective' 208; R Williams 'Enlightened shareholder value in UK company law' 360.
[1168] CLRSG Report XV.
[1169] Ibid.
[1170] Gower 5 ed 106.

5.3.1.1 Small companies' regime

The CA 2006 under s 381 establishes the 'small companies regime' specific to accounts and reports. The qualification for small companies for purposes of small companies regime is (1). Turnover not more than £5.6 million; (2). Balance sheet total Not more than £2.8 million, and (3). Number of employees not more than 50. This classification is novel within company legislation in United Kingdom. There is however no doubt that subjecting small companies to the same rules on account and audit is inappropriate. In chapter 3, I made this argument with respect to Uganda whose CA 2012 makes no distinction among companies private or public on accounts and audit requirements.

Under s 154(1) of the Act, [e]very company shall cause to be kept in the English language proper books of account 'and failure to do so attracts a penalty of 12 months imprisonment or a fine of 100 currency points.'[1171] Account and reporting requirements apply to all companies irrespective of their status. This is an area where it is proposed that there is room for improvement with respect to SCHCs in Uganda. The small companies regime under CA 2006 offers some insight in re-drafting CA 2012 provisions on account and reporting obligation for SCHCs.

5.3.1.2 Weaknesses of the UK model

The small companies' regime is limited to accounts and reports, which is only one area of need for small companies.[1172] As shown above, the CLRSG recommendations went beyond accounts and reports. The expectation was that the small companies' regime would be comprehensive on the core corporate governance needs of SCHCs. The scattered provisions approach where SCHCs have to look for provisions which apply to them is a drafting inadequacy which can be improved on to make the law user-friendly by reviewing the small companies' regime.

[1171] Kiryabwire *Company Law* 143.
[1172] Mayson et al *Company Law* 14–15.

Second, the requirement that small company status must not be lost in the succeeding year suggests that small companies will move into and out of the regime. It follows that turnover, balance sheet total and number of employees are problematic variables for tangible legislative intervention on small companies. Given the 'think small first' mantra of the CLRSG, one expected outcome for CA 2006 was a much broader small companies regime with a wide range of interventions on SCHCs, also to avoid the problem of small companies '[h]aving to plough through the mammoth Companies Act to ascertain what sections apply to them.'[1173]

Further, the small companies' regime under CA 2006 covers only a small aspect of the legal needs of SCHCs. Given CA 2006's breadth and length, a detailed schedule showing the provisions which are applicable to small companies was necessary. South Africa has done this in Schedule 3 to SACA 2008. Thus, it is proposed that a schedule in CA 2012 showing which provisions are applicable to SCHCs is one way of making CA 2012 more accessible, easy, and simple for SCHCs.

Finally, definition by turnover, balance sheet total and number of employees moves the focus from personal relationships between members to variables which are directly about the company. It is therefore not immediately obvious if a quasi-partnership company structure can be realised around these variables.

The conspicuous areas which require improvement in CA 2006 are inter-personal relations between members in small companies, registration requirements and membership of private companies. The UK can draw some lessons from CCA 84 on these issues. Interestingly, CCA 84 was first suggested in the UK but South Africa moved faster in 1984 to enact CCA 84 for CCs.[1174] The UK slow pace is not without reason. Apparently, the UK's stance is that separate legislation for SCHCs will impede the growth of these companies.[1175] However, all is not lost for small companies in the UK, as the courts there have been prepared to extend equitable remedies to these

[1173] Gower 5 ed 106.
[1174] SADTI Report 12.
[1175] Ferran *Company Law* 5.

companies[1176] (subject to statutory limitations) by treating them as if they are partnerships, I explore this subject in the next section.

The small companies' regime under CA 2016 can and should be redrafted to incorporate other areas such as meetings. A better way to redraft the law is to incorporate the provisions in a schedule similar to Schedule 2 of SACA 2008. This intervention, as already noted, would address the problem of having to 'comb through the entire Act' to find provisions that apply to SCHCs. The provisions that are intended for SCHCs are scattered all over the Act, making it generally unfriendly to users. Moreover, what amounts to the 'small companies regime' is not immediately clear. This lacuna can be cured by inserting a definition in the definition section. This is in line with the assumption in this study that providing for SCHCs starts with providing a proper definition.[1177]

Finally, I consider below, whether limited liability partnerships are an option for SCHCs in Uganda.

5.4 Limited liability partnerships

One view is that to avoid the burden of legal compliance and the sometimes-complex legal regime under company legislation one can use the limited liability partnership ('LLP') route because of its flexibility. Gower is a proponent of this view. Commenting on *Company Law Review* rejection of a separate legislation for small companies in the UK, he opined that 'those who want a corporate form which gives still more flexibility than the private company provides, especially in relation to internal decision-making structure, must go to the Limited Liability Partnership.'[1178]

[1176] *Ebrahimi*'s case 360; Dunne 'The position of the quasi-partnership type' 110–113.
[1177] Elfin 'A critique' 439.
[1178] Gower 10 ed 17; Hansmann et al 'Law and the rise of the firm' 1372.

The LLP is essentially a creature of statute–the Partnership Act, 2010[1179]–which is a distinct legislation from CA 2012, the focus of this study. In broad outline, the LLP structure has some features of the early business associations: guilds, *commenda* and *societas.*[1180] In guilds, 'each trader traded on his own account subject only to obedience to the regulation of the guild.'[1181] Their key object was to '[o]btain monopoly of any particular commodity or branch of trade usually by way of a charter from the Crown'.[1182]

Commenda, on the other hand, 'arose during the tenth and eleventh centuries as a device for financing maritime trade'.[1183] It 'had two partners: a passive investor who provided capital, and a traveling trader (often the ship captain) who contributed labor and initiative.'[1184] Today this can be equated to the general partner who manages the partnership and the limited liability partner who only stops at contributing capital. Moreover, 'profits were divided between the active and passive partners according to pre-specified proportions.'[1185] Importantly, the 'passive partner usually enjoyed limited liability.'[1186] Further, he had no control over firm matters.[1187]

Gower has proposed that *commenda* 'was in fact a cross between a partnership and a loan whereby a financier advanced a sum of money to the active trader upon terms that he should share in the profits of the enterprise, his position being similar to that of a sleeping partner but with no liability beyond that of the capital originally advanced.'[1188] In the case of the LLP, the sleeping partner (the financier) is the limited liability partner while the active trader is the general partner.

[1179] Act No 2 of 2010 available electronically at partnership-act-no.2-2010.pdf (ulrc.go.ug) accessed on 30 August 2023.
[1180] Gower 5 ed 20.
[1181] Ibid.
[1182] Ibid.
[1183] Hansmann et al 'Law and the rise of the firm' 1372.
[1184] Ibid.
[1185] Ibid.
[1186] Ibid (n 115).
[1187] Ibid.
[1188] Gower 5 ed 20.

Finally, in *societa,* '[e]ach partner is the agent of the others and liable to the full extent of his private fortune for partnership debts.'[1189] The *societa* is thus today's general partnership.[1190] While *commenda* is much closer to the modern LLP than is the guild and *societa*. A cross-cutting characteristic of these business forms is that they were small, comprising few members and in some cases, an individual.

In Uganda, LLPs are created under the Partnership Act.[1191] The maximum number of partners is twenty—one or more of whom shall be called general partner.[1192] Under s 47(3) besides the general partner the LLP shall have one or more persons called limited liability partners who shall contribute a stated amount of capital to the firm, and shall not be liable for debts or obligations of the firm beyond the amount of capital so contributed. Additionally, a limited liability partner shall not, during the continuance of the partnership, either directly or indirectly, draw out or receive back any part of his or her contribution to the partnership, and if a limited liability partner draws out or receives back any part of his or her contribution, he or she shall be liable for the debts and obligations of the partnership up to the amount so drawn or received back.[1193] Moreover, under s 47(5) a body corporate may be a limited liability partner. Finally, under s 48(1) the LLP shall be registered with the Registrar in accordance with s 50 and shall add to its name the letters ('LLP') failing which the LLP will be deemed to be a general partnership and all its' members general partners.

To comply with s 50 requires a signed statement by the partners containing–(a) the name of the limited liability partnership; (b) the general nature of the limited liability partnership's business; (c) the principal place of business of the limited liability partnership; the full names and address of each of the partners; the term, if any, for which the limited liability partnership is entered into, and the date of commencement; (f) a statement that the partnership is limited; (g) a description of the status of each partner,

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[1189] Ibid.
[1190] DJ Bakibinga *Partnership Law in Uganda* (2019) 33 n 1.
[1191] Act 2 of 2010, available at partnership-act-no.2-2010.pdf (ulrc.go.ug) (accessed 30 August 2023).
[1192] Section 47(2).
[1193] Section 47(4).

limited or general; and *(h)* the sum contributed by each partner and the form in which it is so contributed. Under s 50(2) the Registrar shall, upon receiving the particulars referred to in sub-s (1) and the prescribed fee for the registration, issue a certificate of registration of the limited partnership.

Any and all changes to particulars of the LLP have to be notified and registered with the Registrar, who shall issue a certificate such change.[1194] Under s 51(2) non-compliance with s 50(1) is an offence and attracts a penalty on conviction of a general partner of a fine not exceeding 0.5 currency points for each day during which the contravention continues. Further, a limited liability partner shall not take part in the management of the partnership business and shall not bind the firm[1195] but is nevertheless, upon seven day notice, allowed to inspect the books of the firm and ascertain the state and prospects of the partnership.[1196] Where he or she so takes part in the management of the LLP, he or she shall be liable for all debts and obligations of the firm incurred while he or she takes part in the management as though he or she were a general partner.[1197]

Finally, under s 52(5) an LLP shall not be dissolved by the death or bankruptcy of a limited liability partner neither shall their mental incapacity be a ground for dissolution of the partnership by the court unless the contribution of the limited liability partner who is mentally incapacitated cannot otherwise be ascertained and realised. This is to be welcome because it gives the LLP some level of perpetual existence. There are other notable advantages of the LLP.

Clearly, the co-relation between LLPs and quasi partnership companies is that like it is with members in quasi partnership companies, partners in LLPs are able to structure their internal relations through private agreements. LLPs are also usually small with the number of members capped by statute. The LLP structure has some obvious

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[1194] Section 51(1).
[1195] Section 52(1).
[1196] Section 52(2).
[1197] Section 52(2).

benefits. Decision-making is easy since by law only one or a few partners enjoy general partner status and are the only ones in firm management. The general partner can make quick decisions without having to worry about the constraints or bureaucracies which would arise if limited liability partners were to participate in firm management. Further, the details of internal corporate governance are regulated by agreement, giving the LLP flexibility. Finally, liability is borne only by the general partner. To this extent limited liability partners enjoy limited liability as if they were members of a corporate form.[1198]

In spite of these advantages, it is debatable whether LLPs confer the same benefits as the corporate form does in terms of company legislation.[1199] First, as its core feature, the LLP excludes the participation of other partners. As stated, limited liability partners are prohibited from participating in the affairs of the partnership. However, participation in the business is expected among members of SCHCs.[1200] This is a stark difference between the LLP and other corporate forms, including quasi-partnership companies, which include all their members in their affairs.[1201] This creates the undesired agency problem, where limited liability partners have to incur huge costs to align the interests of the general partner, who is in control of the affairs of the business, with their interests to avoid conflicts of interest and conflicts of duty for the general partner.[1202] The blanket exclusion of limited liability partners only subject to what partners have agreed to is a major weakness in LLPs. The indiscriminate liability placed on limited liability partners for participating in the affairs of the LLP presupposes that all such actions are *mala fide* which is not necessarily correct.

Second, while it is assumed that LPPs comprise a small number of partners, a potential problem arises in the event that membership of the LLP reaches the statutory maximum of 20. Moreover, the law does not give any guidance on the number of partners who may become general partners. To employ a hypothetical case. Where an

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[1198] Hansmann et al 'Law and the rise of the firm' 1372.
[1199] Gower 10 ed para 1–2; 1–3.
[1200] See paras 1.2 and 5.4.
[1201] Ibid.
[1202] Armour et al *The Anatomy of Corporate Law* 29–30; Robison & Santore 'Managerial incentives' 282.

LLP has the maximum number of 20 members; 19 are limited liability partners and one is the general partner. Depending on the contract between the partners, the ratio of 1:19 appears disproportionate and breeds potential partner conflict. It creates the problem of dispersed and weak limited liability partners who cannot monitor and oversee the general partner. In this sense, the general partner can be equated to a board and the limited liability partners with shareholders in a typical corporate form under companies' legislation.

Third, LLP operates on the assumption that not all the partners will be interested in active management of the firm. However, when looked at from the perspective of SCHCs, this is an obvious shortcoming. The legal characteristic of SCHCs that this study has adopted is that their shareholders are few and virtually all of them are involved in management. So, if owner management is a recognised feature of SCHCs, the members will face structural hardships in adopting an LLP structure that does not contemplate that all the partners will manage the firm. In any case, LLPs by design have partners, while SCHCs have shareholders – except that they are also managers.

Fourth, there is lack of diversity of risk. According to Ferran, '[t]he great advantage that the corporate form has over firms which are sole traders or partnerships is with regard to financing.' She argues that 'the corporate form is best suited to raising large amounts of business finance and to limiting, or diversifying, financial risk.' The structure of the LLP as described above does not provide a vehicle to raise business finance. First, the prohibition on making public offers to raise business capital that applies to SCHCs also applies to LLPs. Second, empirical surveys show that financial institutions are generally dissuaded from lending to individuals for which LLPs are, in terms of liability. If they do lend to individuals, they do so with onerous repayment terms.[1203] In the circumstances, LLP's assured source of capital is inward – the partners. This option too depends on how the general partner runs the business.

[1203] See related discussion in Tarinyeba Kiryabwire *The Design of Micro Credit Contracts and Micro Enterprise Finance in Uganda* (2010) Law Africa 49.

Fifth, although treating a company as a quasi-partnership is a judicial intervention, it is nevertheless a company under company legislation, which gives it complete legal personality.[1204] LLPs, on the other hand, fall under partial corporate bodies. With partial corporate personality, the gaps must be addressed by contracts, which are subject to statutory law. Thus, it is averred that save for professional entities such as law firms, LLPs serve better as temporary business forms for start-up businesses. However, in the long term, the advantages that accrue from corporate form under CA 2012 outweigh the advantages of maintaining LLP status.[1205]

Finally, as noted earlier, LLPs are created under the Partnership Act–which is a distinct legislation – not the focus of this study. This study is primarily concerned with how SCHCs can be provided with an appropriate and effective legal framework within CA 2012 – the single legislation model.[1206] This is in line with the key objective of the CJRP: to establish comprehensive company legislation which is beneficial to various business categories in Uganda and provides an easy and simple corporate form to a wide range of businesses.[1207] Therefore, while the LLP provides an alternative business form, the present discussion has demonstrated that the LLP is not appropriate for all business interests – at least, not for SCHCs.[1208] An obvious weakness of LLPs is the exclusion of other partners from participating in the management of the firm, while member participation is an important aspect of the SCHC corporate form.[1209]

For these reasons, this study favours a single but flexible company legislation – by way of inserting in CA 2012 a chapter with clear provisions which apply to SCHCs, founded on principles espoused in CCA 84, the small companies' regime in CA 2006, and the principles of quasi-partnerships as discussed in this chapter. The details of how this proposal can be realised are set out in *Appendix B* in Chapter 7.

[1204] *Scottish Co-operative Wholesale Society Ltd v Meyer and Another* (1958) 3 WLR 404.
[1205] Gower 10 ed 1, 2.
[1206] Para 1.10.
[1207] ULRC Report 4; Hansard, 22 March 2012, 3044, 3045, 3052, 3132.
[1208] ULRC Report 4; Hansard, 22 March 2012, 3044, 3045, 3052, 3132; Gower 10 ed 1.
[1209] See para 5.4 and the discussion in paras 5.2.1.1, 5.3.1 and 5.4.1.

CHAPTER SIX

ENFORCEMENT OF THE CoCG OUTSIDE OF THE CA 2012 FRAMEWORK

6.1 An overview of the application of CoCG to SCHCs

In Chapter 3, I pointed out that the Code of Corporate Governance ('CoCG') (s 14) has particular conceptual issues which undermine its efficacy. First, the process of amending the CoCG (s 14(6)) is exclusive involving only the Minister in consultation with Capital Markets Authority ('CMA'). I argued that this limits stakeholder participation and excludes potential end-users given the importance that the legislature attached to the CoCG.[1210] Moreover, the involvement of the CMA – an institution which by law regulates only listed companies – in this regard is problematic.

Second, the enforcement model adopted for the CoCG in private companies does not provide effective enforcement (s 14(4)). In addition, it is not aligned to best practice on enforcement models. Third, the CoCG contains extensive principles most of which are inapplicable to private companies which raises doubt about whether the CoCG was drafted with SCHCs in mind. This leaves SCHCs in particular with limited options on which aspects of the CoCG to adopt. In chapters 3 and 5, it was demonstrated that badly drafted legislation leads to sham compliance or no compliance at all.

In this Chapter, I seek to provide further possible intervention on how to improve on the CoCG. I contend that the CoCG lacks a mechanism for independent audit checks and verification of what is being reported, a key concern with most codes,[1211] and that the CoCG need not be under CA 2012 after all. This latter proposition draws on the King Code in South Africa. Alternatively, if the CoCG is retained under CA 2012, besides broadening the amendment process under s 14(6) of CA 2012 beyond the Minister and the CMA to benefit from the expertise of other professional bodies and institutions, a

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[1210] Hansard, 21 March 2012, 3048, 3058.
[1211] Murphy 'Corporate codes' 430–431.

mechanism for independently auditing compliance with the CoCG should be established for all complying companies. This latter proposal draws on the social and ethics committee ('SEC') under s 72(4) of SACA 2008. SEC is a committee independent of the board which reports on the board directly to shareholders.[1212]

The discussion in this Chapter is in three parts. First, the chapter reviews integrated sustainability reporting in the CoCG, which is the principle upon which the proposal to separate the CoCG from CA 2012 is founded. Second, it explores best practices on codes with specific reference to SACA 2008, by focusing on the SEC and the King Code. Third, the Chapter proposes interventions which should be adopted to remedy the weaknesses identified. The key proposal is that provision should be made for clear and basic principles of corporate governance for SCHCs in the CoCG. This proposal accords with the proposal in Chapters 3 and 5 for the insertion in CA 2012 of a chapter which deals exclusively with SCHCs.

Finally, the Chapter explores the possibility of stakeholder enforcement of the CoCG outside of the CA 2012 legal framework. The focus is on possible government partnership with non-state actors, such as the Institute of Corporate Governance of Uganda ('ICGU'), the Federation of Small and Medium-sized Enterprises – Uganda ('FSME'), and the Institute of Certified Public Accountants of Uganda ('ICPAU'), on the review of the CoCG. The discussion proceeds on the assumption that, in principle, the CoCG will be separated from CA 2012, and in place of the CMA and the Registrar, a broader quasi-public body will be established to enforce the CoCG.

6.2 Integrated sustainability reporting the CoCG: Principles and concepts

An examination of arts 15 and 16 of the CoCG reveals that the drafter of the law had a stakeholder approach in respect of some aspects of the CoCG. The two articles provide for integrated sustainability reporting and organisational integrity or a code of ethics.

[1212] Ibid 401–402.

Article 15 (1) provides that [a] company shall report on its policies and procedures and systems and commitments to the following—(a) social; (b) ethical; (c) safety; (d) health; and (e) environment. That, stakeholder reporting requires an integrated approach and issues shall be categorised into the following reporting levels[1213]— (a) first level: matters arising from documents, (b) second level: implementation of practices and the steps taken to implement, and (c) third level: demonstrate the benefit of changes.

Article 15(3) provides that the boards shall consider the following: *(a)* nature of the organisation; *(b)* performance expectations consequent upon the going concern concept; *(c)* extent to which the company's action, or lack of action led to the reported matter; *(d)* non-financial information shall be reliable, relevant, clear and unambiguous, verifiable and timeless, and *(e)* guidelines for materiality shall be developed, to ensure consistent reporting.

Under art 15(4) the following matters shall require specific consideration: *(a)* safety and occupational health objectives issues, including HIV/AIDS; *(b)* environmental reporting and following the option with the least impact on the environment; *(c)* human capital development, including—(i) number of staff; and (ii) training—to which it is contended, are not legal attributes with which any business form under CA 2012 is known. These are better dealt with from the perspective of environmental law[1214] or employment law.[1215] This may require a sector-specific regulatory approach.[1216] If, however, they are to be addressed under the CoCG, the principles according to which they are measured must be clearly set out and consistent with environmental law and policy and employment law, and well-articulated in CA 2012, as the principal legislation. I will return to this issue later in this section.

[1213] Art 15(2) of the CoCG.
[1214] F Martin 'Corporate social responsibility and public policy' in R Mullerat (ed) *Corporate Social Responsibility: The Corporate Governance of the 21st Century* (2005) 77–95 at 88.
[1215] Hansmann & Kraakman 'The end of history of corporate law' 441.
[1216] R Baldwin & M Cave *Understanding Regulation: Theory, Strategy and Practice* (1999) 37.

Meanwhile, art 16(1) provides that '[a] code of ethics shall be set for all stakeholders.' Further, (2) there is need to ensure commitment to the code of ethics at a high level including– *(a)* procedures to implement, monitor and enforce the code of ethics at a high level; *(b)* assessing integrity when promoting; and *(c)* training on company values. (3) The disclosure shall include the directors' opinion as to the extent to which ethical standards are met. (4) Continuing relationships with those with lower ethical standards shall be re-evaluated.

Drawing on the above articles, it is contended, first, that while the CoCG embraces some aspects of stake-holding, as can be seen in the requirement for stakeholder reporting, it is not clear who a stakeholder is and what stakeholder reporting is. These concepts are not defined in CA 2012 or in the CoCG. The context in which they are applied is not explained in the Act. This gives rise to many critical questions: To whom do these companies report? How do they report? Who are the stakeholders in this context? What are their interests and what is the nature and extent of their participation in company matters? What is their relationship with the board? What is the nature of the duty owed them? And what is the enforcement mechanism?

To be sure, there are many stakeholders with various interests, as explained in chapter 2.[1217] They include employees, creditors, the community, customers and shareholders. Dean has proposed categorising stakeholders as 'primary' or 'secondary' stakeholders.[1218] The former have a direct relationship with the company by law while the latter have an indirect relationship and are usually affected by company operations.[1219] Neither the CoCG nor CA 2012 clarifies these concepts.

Away from CA 2012, in terms of s 72*(4)(a)(iii)*, of SACA, 2008, the nature and extent of the activities of a company is one of the considerations for the Minister to require a company to have in place a Social and Ethics Committee ('SEC'). These

[1217] Para 2.2.3.
[1218] Dean *Stakeholder Society* 103.
[1219] In terms of s 30(2)*(cc)* of SACA, 2008, the nature and extent of company activity is one of the considerations on whether or not to exempt such a company from certain statutory reporting obligations.

requirements cover stakeholders who are otherwise affected by the operations of the company but do not have a direct relationship with the company.

Undoubtedly, earlier in Chapter 2,[1220] it was noted that stake holding in all form is a broad subject. It is a subject which has been applied in different contexts and perspectives. For the present purpose, suffice is it to say that where legislation has enacted stakeholding as a mode of running business, it has been clear on the context and principles of its application.

The scholarship on stakeholder interventions – the enlightened shareholder value ('ESV') in the UK CA 2006,[1221] which specifies stakeholder interests that managers have to take into account in their duty to the firm; Germany's codetermination law where employees directly participate in the upper boards of directors of large public firms in specific sectors;[1222] the constituency statutes in United States which authorise or require managers to consider stakeholder interests in managerial decisions;[1223] and the social and ethics committee ('SEC') requirements under SACA 2008, for prescribed firms in South Africa – all suggest the need for legislative precision on the context, parameters, and the extent of utility of the application of stakeholder concepts.

To illustrate this point, s 172(1) of CA 2006 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, and in doing so have regard (amongst other matters) to– *(a)* the likely consequence 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 standards of business conduct, and *(f)* the need to act fairly as between members of the company.

[1220] See para 2.2.3ff.
[1221] Section 172(1) of CA 2006. See Ajibo 'A critique' 38–41.
[1222] Hansmann 'Worker participation and corporate governance' 600–601.
[1223] Keay 'Towards stakeholderism?' 9.

Section 172(2) of CA 2006 provides that [w]here or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes. (3) The duty imposed by this section has the effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

While s 7 (b) (iii) of SACA, 2008, provides that the purposes of this Act are to—promote the development of the South African economy by—encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the *social* and economic life of the nation. An examination of these provisions shows a clear intention of the drafter on stakeholder considerations. These specificities and legislative precision are lacking in the CoCG. The term 'stakeholders' is used broadly and falls short of best practice on legislative precision, while the social attributes for which the CoCG requires companies that adopt it to report on are not born out of the principal Act—CA 2012.

Second, it is apparent that the stakeholder manager model has been applied predominantly in large public corporations.[1224] This further complicates the utility of stakeholder reporting for SCHCs under the CoCG. It can be asserted that the CoCG was not drafted with the unsophisticated businessperson or SCHC in mind.

Third, the Dodd–Berle debate about the purpose of the firm[1225] is a key consideration when formulating a legal framework on stakeholder reporting. As demonstrated in chapter 2, while Dodd argued that companies have societal obligations, Berlie's position was that societal interests will be taken into account if, ultimately, it promoted promotes shareholder value.[1226] There is no indication in the CoCG that these principles have been taken care of.

[1224] See Hansmann 'Worker participation and corporate governance' 600–601.
[1225] Berle 'Powers in trust' 1049; Berle 'A note' 1365–1372; Dodd 'For whom are corporate managers trustees?' 1148–1150.
[1226] Hansmann & Kraakman 'The end of history' 441–448.

Finally, leaving it to the board to make provision for procedures to implement, monitor and enforce the code of ethics at a high level is problematic. This affects the credibility and integrity of the compliance reports. While the boards may have their internal reporting procedures, the law must be clear on how these processes can be independently verified. Otherwise, this amounts to the boards reporting to themselves. Auditing compliance in line with the general principles of auditing must be independent of the board.[1227] Best practice requires establishing a professional body to deal with all ethical matters that are the subject of the CoCG.[1228] This body – member-based – should be representative of both the private and public sector, professional bodies such as the ICPAU, and other interest groups' associations such as the ICGU and the FSME to give the process legitimacy. This is the approach in the King Code. I will return to these institutions later in this chapter.

This is particularly so because boards are required to report on safety and occupational health objectives, including HIV/AIDS and the environment. These are complex matters of considerable public importance; their application to companies in terms of CA 2012 needs to be clear, with a mechanism for independent monitoring. For example, safety and occupational health is a subject with a constitutional basis.[1229] The expectation is that questions about compliance will be evaluated using clear parameters.

On account of the gaps identified above, it is proposed that both CA 2012 and the CoCG need reworking to clarify the context in which the term stakeholder is being applied. For example, what are the stakeholder interests and how can they be catered for in the CoCG framework?[1230] A departure from the shareholder value model[1231] in the

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[1227] J Zerk *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (2006) 37–38.
[1228] C Crane & D Matten *Business Ethics* (2004) 39, 44; Martin 'Corporate social responsibility and public policy' 92; and Zerk *Multinationals and CSR* 37.
[1229] Art 40 of the Constitution, 1995.
[1230] TL Blackburn 'The unification of corporate laws: The United States, the European Community and the race to laxity' (1994) 3 *George Mason Independent L Rev* 1 at 53, cited in R Drury 'The Delaware syndrome' (2005) *J Bus L* 1–24 at 8.
[1231] Section 198*(c)* of CA 2012 gives prominence to shareholders.

repealed Act requires direct policy intervention with a clear legal framework in CA 2012.[1232]

At any rate, requiring stakeholder reporting under the CoCG, and yet the same is not provided for in the principal legislation offends the rule of drafting which requires that subsidiary legislation must conform to the letter and spirit of the principal legislation.[1233] This weakness is one justification for proposing that the CoCG be separated from CA 2012.

In the next section, I explore SEC under SACA 2008.

6.3 Social and ethics committee

The Social and Ethics Committee ('SEC') is a creature of SACA 2008. Section 72(4) of the SACA provides that [t]he Minister may by regulation prescribe that a company or a category of companies must have a social and ethics committee, if it is desirable in the public interest, having regard to– *(a)* its annual turnover; *(b)* the size of its workforce; or *(c)* the nature and extent of the activities of such companies.

Under reg 43(4) of the Companies Regulations, 2011, '[a] company's social and ethics committee must comprise not less than three directors or prescribed officers of the company, at least one of whom must be a director who is not involved in the day-to-day management of the company's business, and must not have been so involved within the previous three financial years.'[1234]

SEC has a wide mandate of 'monitoring the company's activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice,

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[1232] B Lantry 'Stakeholders and the moral responsibilities of business' (1994) 4 *BEQ* 431; *Parke v Daily News Ltd* (1962) Ch 927; *Re Welfab Engineers Ltd* (1990) BCLC 833.
[1233] *Uganda Law Society v KCCA and Attorney General Misc. Cau*se No. 243 of 2017 (unreported) (Ssekaana J) High Court of Uganda, 8 May 2020, at 8. Available at Uganda Law Society v Kampala Capital City Authority & Anor (Miscellaneous Cause 243 of 2017) [2020] UGHCCD 82 (08 May 2020) Ulii.
[1234] Companies Regulations, 2011.

with regard to matters relating to: (i) social and economic development, including the company's standing in terms of the goals and purposes of *(aa)* the 10 principles set out in the United Nations Global Compact Principle; *(bb)* the OECD recommendations regarding corruption; *(cc)* the Employment Equity Act; *(dd)* the Broad-Based Black Economic Empowerment Act; (ii) good corporate citizenship.'[1235]

SEC has been viewed by some commentators as 'a move to protect the interests of stakeholders in the context of company law in South Africa'.[1236] SEC is a clear manifestation of a move by South Africa towards the stakeholder model of both firm management and doing business in certain respects. The Minister responsible for companies has a direct role in the constitution of SEC.[1237] The guiding parameters are: if it is desirable in public interest, having regard to the company's annual turnover, the size of its workforce, or the nature and extent of its activities. These parameters are adopted in SACA 2008 with respect to compliance obligations for small firms.[1238]

SEC is designed to operate within the corporate structure of the firm. It is a committee within the board which enjoys statutory authority as well as independence on specified matters.[1239] Undoubtedly, the SEC is not an ordinary committee of the board. Under reg 43(5), the functions of the SEC are wide and involve monitoring the activities of the company on a broad range of issues, including social issues, employees and the environment.[1240]

Furthermore, SEC draws the attention of the board to matters of concern,[1241] and can report 'through one of its members, to shareholders at the company's annual general meeting on the matters within its mandate'.[1242] The latter is particularly important so that SEC can have direct access to shareholders. This helps to prevent its' report from being

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[1235] Ibid; Esser & Delport 'Part 1' 110.
[1236] Ibid.
[1237] Section 72(4) of SACA 2008.
[1238] See s 30(2A) of SACA 2008; Davis & Geach (eds) *Companies and Other Business Structures* 36.
[1239] Regulation 43.
[1240] Regulation 43(5).
[1241] Regulation 43(5)*(b)*.
[1242] Regulation 43(5)*(c)*.

manipulated by the board, which may have a vested interest in what is being reported. To a significant extent, while SEC is a committee of the board, the statutory protection and independence it enjoys in its establishment and operations shields it from the pressure that could be mounted by the board if it were an 'ordinary' committee appointed under the articles and memorandum of association.

Esser and Delport have cast doubt on the efficacy of SEC, citing its 'unclear terms of reference',[1243] its 'overlap with other committees'[1244] and the fact that it is 'without any fiduciary duty'.[1245] These are valid concerns. However, a further look at the mandate of SEC and the overall corporate structure under SACA 2008 suggests that the intended and proper mandate of SEC is to monitor and report. SEC is not clothed with any power to make managerial decisions because that is not the corporate structure under SACA 2008. The protection granted to SEC under SACA 2008 is to ensure that it reports and monitors independently of the board. It may, however, be useful to introduce a provision on conflicts of interest for members of SEC to mitigate possible unethical practices which could undermine SEC's integrity. The structure of SEC is worth considering for complying firms under CA 2012.

In the next section, I explore the King Code.

6.4 King Code: Composition, structure and membership

There is no code of corporate governance in SACA 2008. However, there is the King Code or ("King").[1246] The King is a private soft law instrument. It is a product of the Institute of Directors in Southern Africa ('IoDSA') and the King Committee on Corporate Governance in South Africa ('the King Committee'). So far, the IoDSA has

[1243] Esser & Delport 'Part 2' 229.
[1244] Ibid 230.
[1245] Ibid.
[1246] King IV Code on Corporate Governance in the King IV Report on Corporate Governance for South Africa 2016 at 5, available at https://www.adams.africa/wp-content/uploads/2020/04/King-IV-Report.pdf (accessed 9 January 2021).

published four King Codes: King 1 (1994), King II (2002), King III (2009) and King IV (2016). The King Committee was established in 1992 with Mervyn King as chairman.[1247] The members of the King Committee do not receive any form of remuneration for their time and efforts.[1248] Their joint commitment is rather to corporate South Africa.[1249]

Given its composition and breadth across professional bodies in South Africa, public and private sectors, King is broad based and inclusive. Let me illustrate this point. King III was supported by the Companies and Intellectual Property Registration Office,[1250] Chartered Secretaries South Africa, the Companies and Intellectual Property Registration Office, the Compliance Institute of South Africa, the Direct Marketing Association of South Africa, and the Ethics Institute of South Africa.[1251]

The other organisations are the Independent Regulatory Board for Auditors, the Institute of Internal Auditors (SA), the Johannesburg Stock Exchange ('JSE') Limited, the Securities Regulation Panel, the South African Chamber of Commerce and Industry, the South African Institute of Chartered Accountants, the South African Institute of Professional Accountants, and the Centre for Responsible Leadership at the University of Pretoria.[1252]

Since its inauguration in 1992, the King Committee has produced four Codes: King I, King II, King III and, most recently, King IV, which is currently in force. Uganda can draw lessons for an enforcement strategy for the CoCG from the enforcement of the King Code. Given its composition and breadth across professional bodies in South Africa, public and private, including the Companies and Intellectual Property Registration Office,[1253] the IoDSA passes for a quasi-public body and undoubtedly occupies a significant space in shaping the doing business in South

[1247] King II 7.
[1248] King III 6.
[1249] Ibid.
[1250] See ss 185 and 188 of CA 2008; King IV 119–120.
[1251] Kind IV Ibid.
[1252] Ibid 2.
[1253] Section 185 of SACA 2008.

Africa.[1254] Unsurprisingly, the executive summary of King II refers to the King Code as 'an acceptable international brand'.[1255] The King Code could be equated with the American Law Institute's Principles of Corporate Governance (1994) or the UK's Cadbury Report (1992), which resulted in the Combined Code in the UK.[1256]

6.4.1 King I

The King Report on Corporate Governance 1994 ('King I'), published on 29 November 1994, is the inaugural code of corporate governance in South Africa. The work started in 1992 'to consider corporate governance in the context of South Africa'.[1257] It set the foundation on which King II, King III and King IV would subsequently be built, and set out to 'promote the highest standards of corporate governance in South Africa'.[1258] King I 'went beyond the financial and regulatory aspects of corporate governance in advocating an integrated approach to good governance in the interests of a wide range of stakeholders.'[1259]

The King I committee also adopted a participative corporate governance system of enterprise with integrity, and formalised the need for companies to recognise that they no longer act independently from the society and the environment in which they operate.[1260] King I espoused the participative or 'inclusive' approach to corporate governance.[1261] This is worth emulating in the review of the CoCG. As argued earlier, the review of the CoCG by only the Minister and the CMA is restrictive. In addition, I contended that by law CMA deals with listed companies and therefore has little to do with private companies, particularly SCHCs.

[1254] King III.
[1255] Ibid.
[1256] Gower 17 ed 291.
[1257] King II 7.
[1258] Ibid.
[1259] Ibid.
[1260] Ibid.
[1261] Ibid 8.

6.4.2 King II

Set out principally to review King I, King II in 2002 dealt with compliance with the King Code, and revisited 'the inclusive approach' of corporate governance proposed in King I.[1262] It maintained the inclusive approach to corporate governance for the sustained growth of the firm and its relationship with other stakeholders.[1263]

6.4.3 King III

King III (2009) is, arguably, a review of SACA 2008. It emphasised a code of principles and practices on a non-legislative basis.[1264] Like King II, it emphasised the 'inclusivity' of stakeholders as essential for achieving sustainability.[1265] It adds that the legitimate interests and expectations of stakeholders must be taken into account in decision-making and strategy.[1266] King III also adopted the 'apply or explain' compliance approach.[1267] It has had a broad membership.

King III was supported by 13 professional bodies, which included Chartered Secretaries South Africa, the Companies and Intellectual Property Registration Office, the Compliance Institute of South Africa, the Direct Marketing Association of South Africa, the Ethics Institute of South Africa, the Independent Regulatory Board for Auditors, the Institute of Internal Auditors (SA), the JSE Limited, the Securities Regulation Panel, the South African Chamber of Commerce and Industry, the South African Institute of Chartered Accountants, the South African Institute of Professional Accountants, and University of Pretoria: Centre for Responsible Leadership.[1268]

[1262] King II 21, 163.
[1263] Ibid.
[1264] King III 7.
[1265] Ibid 14.
[1266] Ibid.
[1267] King IV 7.
[1268] Ibid 119–120.

6.4.4 King IV

King IV (2016) takes into account the 'fundamental changes in both business and society'.[1269] It recognises the 'new global realities',[1270] where there is 'greater expectation from stakeholders than ever before',[1271] and also the need for businesses to be alive to the 'triple context of the economy, society and the environment' so as to maintain the 'organisation's value'.[1272]

King IV is wide in scope and is intended to be 'easily applicable to all organisations: public and private, large and small, for profit and not-for-profit', although compressed from 75 principles in King III to 17 basic principles. Sixteen of these principles can be applied by any organisation.[1273]

King IV has adopted the 'apply and explain' enforcement model – a departure from the 'apply or explain' model in King III. In addition, '[a]ll organisations are required to substantiate a claim that good governance is being practised.'[1274] King IV also underscores stakeholder relationships in a 'stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interest of the organisation over time'.[1275]

The principles espoused in King IV suggest that there is merit in the utility of explanations as an enforcement mechanism of the CoCG. Moreover, it is possible to have a simpler and user-friendly code that is applicable to all firms, rather than the CoCG in its current form, which appears to have been drafted for listed companies.[1276] In general, the King Code offers Uganda viable options for the enforcement of the CoCG.[1277] Thus, to improve the enforcement of the CoCG, I suggest a basic compliance

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[1269] Ibid 3.
[1270] Ibid.
[1271] Ibid.
[1272] Ibid 4. See a related discussion in Davis & Geach *Companies and Other Business Structures* 218.
[1273] Ibid 6–7.
[1274] Ibid.
[1275] Ibid 5; Part 5 of King IV Code 43–73.
[1276] The CoCG is mandatory for public companies in Uganda. See Gower 17 ed 321–326.
[1277] See T Wixley, G Everingham & K Louw *Corporate Governance* 5 ed (2019) 13–17 for a discussion of King IV.

model of 'explain' for the non-adoption of the CoCG by private companies that are not SCHCs.

Why should the King Code model be followed? In the next section, I explore the core concepts and principles under the King Code from which Uganda can draw inspiration upon which to improve on the CoCG and particularly s 14(4), and (5) of CA 2012.

6.4.5 King Code: Core concepts and principles

The King Code espouses the principles of (1) broad stakeholder participation – including government agencies; (2) inclusivity; and (3) consultation in its formulation and reviews.[1278] Below, I explore these principles to demonstrate that the CoCG can use some of these principles to improve its enforcement.

First, the King Reports are not hard law.[1279] While the government participates in its reviews through various state actors, the King Code is not the property of the government. The copyright belongs to the IoDSA, a private institution.[1280] In the strict sense, the King Code lacks the force of law. However, its 'apply or explain' approach (King I) is a tested enforcement model.[1281] This has since been improved upon, with King IV adopting an 'apply and explain' approach. The judicial reference to, and application of, the King Code gives it the requisite legal basis.[1282] This development supports my proposal in chapter 1 that the CoCG need not be part of the CA 2012 to be enforced. There are other models for the enforcement of the CoCG.[1283]

Second, King Code is not an individual corporate code of governance. The number of participants who support the King Code and its processes qualify it as a quasi-public

[1278] King IV 3.
[1279] King IV 35.
[1280] King II.
[1281] King III 5.
[1282] *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co. Ltd*.
[1283] Zerk *Multinationals and CSR* 37–38.

legal instrument.[1284] Consequently, there is room for public scrutiny, which is not readily available in the commonplace individual codes of corporate governance.[1285] The broad-based composition of the King Committee and its subcommittees[1286] makes the King Code a unique brand and also gives it legitimacy, credibility and a wider public appeal, which facilitates its utility.

Finally, the King Code emphasises a stakeholder-inclusive and participatory approach. Creditors, employees, environmentalists and trade unions in Uganda are likely to find the King Code model attractive. There is good reason to believe so, since every stakeholder counts under the King Code framework. It is contended that the enforcement model of the King Code has some benefits. Notably, the CoCG is not inclusive and participatory. The result is that the CoCG reviews cannot benefit from expertise from other professional bodies beyond the Minister and CMA who are the only bodies mandated to amend it. In the next section I look at some of the weaknesses of the King Code which a country bench-marking this model should be aware about.

6.4.6 Weaknesses of the King Code

The King Code is soft law whose application in private companies is only persuasive. It is, however, mandatory for public companies – a subject beyond the scope of this study. However, given the judicial decisions in which the King Code has been cited,[1287] it is contended that there is an emerging body of progressive judicial opinion that is reinforcing the King Code in shaping the corporate governance discourse in the South African business space. This development could also influence policy on the thorny issue of *locus standi* for third parties under SACA 2008.

[1284] Murphy 'Corporate codes' 397–403.
[1285] A Blackett 'Global governance, legal pluralism and the decentred state: A labor law critique of corporate codes of conduct' (2001) 8 *Indiana Journal of Global Legal Studies* 401–447 at 401–412; S Cleveland 'Global labor rights and the Alien Tort Claims Act' (1998) 76 *Texas L Rev* 1533, 1551.
[1286] Ibid.
[1287] Esser & Deport 'Part 1' 106.

Esser and Delport have cast doubt on the possibility of the success of third-party suits under SACA 2008 due to the absence of explicit third-party rights.[1288] This concern has some merit. One sure way to remedy this concern was to grant statutory enforcement rights in SACA, 2008. However, that is but only one side of the coin. The fact of the matter is that first, the discussion in chapter 2 reveals that there was no legislative intention to grant third-party rights in SACA 2008. This appears to be the case where corporate legislation has sought to broaden the managerial duty beyond shareholder value to incorporate social aspects of society.

Second, notwithstanding the absence of explicit third-party rights in SACA 2008, all is not lost. It is averred that the wide and generous principles of interpretation in the enforcement of the Act give the courts in South Africa latitude to adopt instruments like the King Code, despite the latter substantially retaining its soft law character, if doing so will promote the spirit of the law.[1289] Judicial enforcement King Code suggests that in the future third parties could found public interest actions under King Code in democratic South Africa.

6.5 Enforcement of CoCG outside of CA 2012

Arising from the discussion of the features of King Code above, it is proposed that a broader platform be created outside of CA 2012 framework where government participates not as a regulator but rather as a stakeholder.[1290] The justification for this platform is that as demonstrated in this chapter, the questions on social, ethical and stake-holding are sector-specific which require expertise beyond the Minister and CMA—bodies currently in charge of reviewing and enforcing the CoCG.

The claim in this study is that the CMA–Minister framework limits stakeholder engagement. A much broader stakeholders' platform, which brings together the various

[1288] Ibid 105–108.
[1289] Sections 5 and 7 of SACA 2008.
[1290] King IV 5.

categories of businesspersons in the private sector in the form of a quasi-public body, is proposed. This body should be charged with the sole duty of continually reviewing and monitoring the progress of the CoCG.

The conceptual framework underlying this body is that it is member-based and an all-equal platform for the exchange of ideas by various stakeholders, public and private alike, on matters of corporate governance. The body will draw from the various experts and disciplines to enrich the content of the CoCG. Moreover, this platform will allow for and promote consensus. The results are stakeholder-based and easily enforceable as the stakeholder position.[1291] Participation gives the process legitimacy and credibility.[1292]

Once a stakeholder position is taken on a specific aspect of the CoCG, the body will be able to hold its members accountable. Alternatively, the government may elect to enforce the agreed position through pre-qualification – for purposes of doing business, rewards and incentives, blacklisting, and public recognition. Evidence of compliance can also form a condition that precedes doing business with government.[1293]

The companies will be required to at least offer an annual explanation on what they have or have not done, and the reasons.[1294] All companies that are not SCHCs should be obliged to explain. This is consistent with the suggestion made in chapter 3 that company meetings should be mandatory for all companies that are not SCHCs.

The suggested member-based body is a hybrid of self-regulation. On self-regulation Zerk had this to say;

[1291] Murphy 'Corporate codes' 424–425.
[1292] Ibid 390.
[1293] There is already precedent in the oil sector. In terms of s 10 of the Petroleum (Exploration, Development and Production) Act 3 of 2013, the principal legislation on oil and gas in Uganda, the Petroleum Authority of Uganda is supposed to keep a National Suppliers Database ('NSD') which is a record of all prequalified providers of goods, works and services, and services in the oil and gas sector in Uganda. Administratively, for one to be prequalified, the supplier must present evidence of the National Social Security Fund ('NSSF') clearance and tax clearance. To obtain these clearances, the applicant must satisfy certain administrative requirements. In the case of a corporate firm, the applicant must supply the Memorandum and Articles of Association, the Certificate of Incorporation, Annual Returns, Return of Allotments, Particulars of Directors, and Notification of Situation of Registered Office.
[1294] See King IV 7.

> Self-regulation takes a variety of different forms. At one end of the spectrum, regulation can be left entirely to the companies concerned. A trade association or professional body may be given responsibility for organizing and administering the self-regulatory scheme, which will frequently involve a requirement that its members adhere to a code of conduct. The administering body may also be given responsibility, by its members, for investigating and taking action in response to complaints that the terms of the code have been breached. Some self-regulatory systems may, however, include an element of governmental oversight.[1295]

Drawing on Zerk's work, it is argued that separating the CoCG from CA 2012 would give it flexibility, but nevertheless the force of law by way of a code of ethics for its members.

Below I consider three possible members of the quasi-public body to illustrate this point further: ICGU, the FSME and ICPAU.

6.5.1 Institute of Corporate Governance of Uganda

The Institute of Corporate Governance of Uganda ('ICGU') was incorporated in 1998 as a company limited by guarantee and was officially launched in 2000.[1296] The ICGU's 'membership is drawn from diverse professions, businesses and institutional sectors with varying ideals and expectations.'[1297] The core objective of the ICGU is 'promoting good corporate governance practices in Uganda as an essential prerequisite for the accountability, integrity and credibility of institutions.'[1298]

[1295] Zerk *Multinationals and CSR* 37–38.
[1296] Available at http://icgu.org (accessed 8 February 2019).
[1297] Ibid.
[1298] Ibid. See J Tumuheki 'Towards good corporate governance: An analysis of corporate governance reforms in Uganda' (LLM thesis, UCT, 2007) 12, available at https://open.uct.ac.za/bistream/item/4439/thesis_law_tmhjus001.pdf?sequence=1 (accessed 7 January 2020) for a detailed discussion of the role of the ICGU.

The ICGU's vision is to be 'an enterprise that upholds international best practice in corporate governance'. As of 24 August 2018, the ICGU had a total membership of 316 – 219 individuals and 97 corporate members.[1299] Importantly, all the regulators under CA 2012 – URSB and the CMA – are members.[1300]

Other notable members are the Bank of Uganda, financial institutions, public and private universities, audit firms, other regulators, the ICPAU and the Insurance Regulatory Authority.[1301] Law firms, hospitals, government enterprises, authorities and corporate firms of various sizes are also members.[1302] The membership of the ICGU[1303] is quite large and offers an opportunity for government–private sector engagement or alliances on the CoCG outside of the CA 2012 framework.

In many respects, as shown above, the composition of the ICGU is similar to that of the King Committee. For that reason, my view is that it presents a viable forum for the proposed government–stakeholder engagement with respect to the CoCG in many ways. First, the ICGU conducts research and training on matters of corporate governance. The research data would facilitate scientific and evidence-based regular reviews and amendment of the CoCG, as opposed to the current position, where the Minister and the CMA are responsible for amending the CoCG.

Chapter 3 illustrated that a key consideration in enacting the CoCG was that it had to be a 'living' document which had to be updated regularly to take account of the changing business world.[1304] Drawing on that proposition, it is contended that the research component of the ICGU is consistent with the spirit of the law in CA 2012 and would support the process through data generation.

Second, the ICGU itself could be transformed further, along the lines of the King model, to become the pioneering body. In its current form, the ICGU has the potential to

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[1299] Ibid.
[1300] Ibid.
[1301] Ibid.
[1302] Ibid.
[1303] Ibid.
[1304] Hansard, 21 March 2012, 3058.

form the primary platform for the mobilisation of the private sector on matters related to the CoCG in Uganda and, perhaps, the region. The King model, because of its 'soft law' approach, takes care of the most critical aspect of the enforcement of the CoCG which was overlooked: the financial implications of creating public institutions where resources are limited. But, from a theoretical perspective, the King model deflects the criticism of the over-regulation of the private sector space and the associated compliance burden, because of its participatory and all-inclusive stakeholder approach.[1305]

Third, on the ICGU membership, one is recognised as a person who 'upholds the ideals that the institute promotes such as ethics, integrity, accountability, responsibility, among others.' As discussed earlier, all these aspects are incorporated in the CoCG.[1306] In addition, the recognition of corporate managers or their companies is certification and, as argued earlier, an alternative enforcement tool for the CoCG. The recognition potentially translates into social capital, and a brand for Uganda's firms, and essentially enhances their competitiveness as firms that are run on sound corporate principles. Thus, there is an incentive for managers to professionalise and act professionally. The firms, in the long term, will be able to attract the necessary global trade networks, alliances and competencies in terms of human resources. The ICGU model therefore offers an alternative platform for further strengthening the proposed enforcement of the CoCG in the private sector generally.

With the requisite mandate, ICGU can transcend the training.[1307] Particularly, given its diverse membership, it is probable that ICGU could in the future develop its own code of corporate governance. This possibility negates the need to have the CoCG codified in statute. Alternatively, upon persuasion by government as a member of the ICGU, ICGU could adopt the CoCG in totality and be at the forefront of its enforcement.

[1305] King IV 17, 120.
[1306] See para 6.2ff.
[1307] Ibid.

In either case, ICGU code will serve a number of purposes: clarity and certainty, as well as the enforcement of the principles and ideals of the ICGU.[1308]

Members can sign up to the code and commit to its adoption. Periodically, and depending on the enforcement model adopted, the ICGU would review the adoption of the code through an agreed forum of members. In the same forum, the ICGU would get feedback from members where the code is not being implemented. It is contended that the fear of a blacklist in the case of deliberate non-compliance and the loss of networks will force forward-looking managers to professionalise and rebrand on core aspects of the code without recourse to regulation. Zerk's position on self-regulation supports this claim.[1309]

6.5.2 Federation of Small and Medium-sized Enterprises – Uganda

The Federation of Small and Medium Sized Enterprises-Uganda ('FSMEU') is a lobby platform for small businesses in Uganda. It was registered in 2017 as a not-for-profit association and it is a company limited by guarantee, with approximately 25,000 members nationwide.[1310] The FSME operates through a board of directors whose composition is representative of the four major regions of Uganda: Central, Western, Northern and Eastern.[1311] It also has sub-committees in the areas of policy and advocacy, membership and services, and finance and fundraising.[1312]

The core mission of the FSME is to ensure that 'there is a conducive and fair environment for running [s]mall and medium sized businesses in Uganda, through amplifying their voice on different issues.'[1313] This mission resonates with the CJRP's strategy on SCHCs.[1314] The FSME also provides opportunities for networking, business

[1308] Ibid.
[1309] Zerk *Multinationals and CSR* 37–38.
[1310] At https://fsmeuganda.org (accessed 6 November 2020).
[1311] Ibid.
[1312] Ibid.
[1313] Ibid.
[1314] ULRC Report 4.

advisory services and training, with a view to unlocking the potential of small companies and ensuring that they contribute to employment creation, innovation and economic growth.

Moreover, its membership of 25,000 offers a strategic platform for stakeholder engagement with SCHCs and is a useful tool for broadening the use and enforcement of the CoCG in SCHCs outside of the CA 2012 framework. It is contended that subsequent regulatory reforms on SCHCs stand to benefit from engagement with the FSME. The MTIC 2015 Policy Document noted the lack of an apex body for MSMEs:

> **2.2.8 Uncoordinated Structure of MSME Sector**
>
> Presently, the MSME sector is highly fragmented which undermines competitiveness, growth and sustainability of the sector. As a result, the MSMEs do not have a single common voice and forum for effective policy dialogue to and influencing policy in lobbying government support. This can be attributed to weak internal capacities of associations representing MSMEs and the liberal policies of that lack industry to industry supplier linkages and development. *A strong and coordinated apex body* to strengthen and enable MSMEs to copy successfully within globalisation for increased flows of Foreign Direct Investment (FDI) is needed including facilitation of linkages between large enterprises and MSMEs.[1315]

The above statement summarises the structure of SCHCs in Uganda and the conditions under which they operate. The need for a specific legal framework for SCHCs cannot be overemphasised. The incorporation of FSME in 2017, five years after CA 2012, addressed only partly the associated problem of a 'lack of an apex body'. Undoubtedly, membership of the FSME will give SCHCs a voice in the proposed stakeholder platform with respect to their legal and corporate governance needs.

[1315] MTIC 2015 Policy Document 8 (emphasis added).

6.5.3 Institute of Certified Public Accountants of Uganda

Institute of Certified Public Accountants 'ICPAU' is a body corporate established under s 2 of the Accountants Act 19 of 2013. The functions of the ICPAU are *(a)* to regulate and maintain the standard of accountancy in Uganda; and *(b)* to prescribe and regulate the conduct of accountants and practising accountants in Uganda. Given its function, the membership of the ICPAU is critical in this proposed legal framework.

The ICPAU can assist with formulating simplified accounts for SCHCs. This will address the weakness of CA 2012 on accounts and reporting requirements, which are too detailed for SCHCs. All companies are subjected to the same regulatory framework,[1316] which is contrary to best practice where legislation has tended to differentiate companies for accounts, reporting and audits.[1317] The ICPAU can be engaged to draft appropriate accounts and reporting requirements for SCHCs in line with international best practice on account of its statutory mandate.[1318] The presence of the ICPAU on the proposed quasi-public body is therefore critical.

6.6 Retaining the CoCG under CA 2012

Retaining the CoCG under CA 2012 is not out of the question. Nit is not desirable. Should government elect to retain the CoCG in CA 2012, the following proposals are made. First, an obligation to explain should be introduced for all private companies that are not SCHCs. It has already been observed that private companies with ten or more members should be required to comply with CA 2012. The requirement to explain, if well-structured, constitutes enforcement.[1319] The explanations would constitute primary data and feedback on the enforcement of the CoCG, which would help the Minister and

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[1316] See para 3.1.4.1(b) and (c).
[1317] See para 5.2.1.2.
[1318] Gower 10 ed; see a survey by LM Lekhanya 'Functions and reliability of international financial reporting systems of rural SMEs in Kwazulu Natal: Knowledge and understanding of financial management' (2013) 3(3) *IJAR AFMS* 127–129.
[1319] See para 3.4.1.2.

the CMA in their periodic reviews of the CoCG.[1320] On the basis of this data, necessary adjustments can be made and ultimately incorporated into the CoCG to improve its enforcement.

Second, the review process of the CoCG should be broadened beyond the Minister and the CMA to include the Registrar, a representative of the Ministry of Trade, two representatives of the private sector, and the ICPAU. It has already been stated that issues relevant to the CoCG require expertise beyond that of the Minister and the CMA.

Third, the form of declaration of the annual compliance should be prescribed. The companies that are obliged to declare–in line with proposals made in this study–need to be sure about what they are required to declare. Currently, this is lacking in the law. Finally, concepts such as stakeholder, social attributes and code of ethics need to be clearly defined in CA 2012. The parameters of their application need to be provided for in both the principal Act and the CoCG. This study's view is that these are complex concepts and their application in company management – and in SCHCs – remains controversial. Currently, they are only stated in general terms and therefore their application can be problematic.

[1320] Section 14(6) of CA 2012.

CHAPTER SEVEN

CONCLUSION, RECOMMENDATIONS AND THE FUTURE

7.1 A note on the research objective

The principal research objective of this study was to determine whether CA 2012 provides an appropriate and effective legal framework for Small and Closely Held Companies ('SCHCs'). This question arose from the acknowledgement during the Commercial Justice Reform Program ('CJRP') (in 1998) which led to the enactment of CA 2012 that companies' legislation in Uganda is complex for SCHCs. In so far as is relevant one declared objective of the CJRP was to enact a new law which is simple, accessible and flexible to accommodate various business forms, including SCHCs.[1321]

Arising from this study objective, the central question which this study sought to answer was whether CA 2012 achieved this objective in relation to the legal needs of SCHCs.[1322] In going about this task the study applied the evaluative framework of optional audit requirements; less or exempt accounting reporting requirements; limiting membership of SCHCs to natural persons; no requirement for separation of management from members since members of SCHCs are invariably in management; and clear optional or elective regime for SCHCs as benchmarks upon which an appropriate and effective legal framework for SCHCs should be formulated.[1323]

In the result, the discussion of the business forms and legal categories (chapters 1, 3); the legal and corporate governance; and institutional framework under CA 2012 (chapters 1, 2, 3, 4, 6); and best practice on the regulation of SCHCs– in the UK and South Africa– as comparable jurisdictions (chapters 4, 5) has determined that CA 2012 has some weaknesses with respect to the legal needs of SCHCs, as are summarised below.

[1321] Para 1.3.
[1322] Para 1.11 for the specific research questions.
[1323] Para 1.1.

7.2 Summary of research outcomes

The summary of the research outcomes set out below follows from the specific research questions which the study sought to answer.[1324] These are then followed by specific recommendations which are borne out of the substantive discussion in the thesis.

7.2.1 Business forms under CA 2012

On the research question: *What are the legal and corporate governance gaps in CA 2012 with respect to SCHCs?* —the study has determined that first, single member company, ('SMC'), private company, or unincorporated company are not appropriate business vehicles for SCHCs. SMC is designed exclusively for one member. In essence, SMC label leaves out other smaller firms with members ranging between 2 to 10.[1325]

Moreover, allowing corporate entities to incorporate SMC is contrary to best practice.[1326] The discussion of close corporations ('CCs') in South Africa and quasi-partnership companies in the UK has revealed that it is best practice to restrict the membership of SCHC to natural persons.[1327] This is so because SCHC concept is rooted in the personal relationships and utmost good faith among individual members.[1328] This may be problematic to achieve where membership is opened to juridical persons.[1329] To that extent, CA 2012 falls short on the legal needs of SCHCs.[1330]

Second, the classification of private companies does not specifically consider SCHCs. Private companies can have one to 100 members (ss 4 and 5) but technically two to 100 members, because SMC is a separate category. This classification is broad which makes it impracticable to provide for the unique legal needs of SCHC.[1331] To

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[1324] Para 1.11.
[1325] See paras 1.2, 3.1.1–3.1.1.2.
[1326] See paras 3.1.1.2, 5.2.1.1; 5.4.1.
[1327] Ibid.
[1328] Ibid.
[1329] Ibid.
[1330] See para 1.3; n 1.
[1331] See para 3.1.2.

distinctively provide for SCHC in CA 2012 requires specificity on application of the law. Additionally, unlimited liability company is a problematic option because of the unavailability of corporate form which remains a key incentive for registration of businesses.[1332] Yet, making the corporate form cheap and easily available was a key consideration in the CJRP.[1333] Finally, public companies by their nature are not available to SCHCs because of the legal restrictions on the latter to make public offers. Going by the definition adopted of SCHC in Chapter 1[1334] the various business forms in CA 2012 in their current form offer limited viable business options for SCHCs.

7.2.2 Corporate governance under CA 2012

In further answer to the research question: *What are the legal and corporate governance gaps in CA 2012 with respect to SCHCs?* —this study has determined that, apart from the AGM, which is optional for private companies, all private companies are subject to the same regulation under CA 2012. This can be seen in the accounts and reporting obligations (s 154)[1335] and the appointment of auditors (s 167).[1336] This is a departure from best practice.[1337] Additionally, the CoCG– although optional for private companies – has a number of weaknesses. First, what is to be declared in the statement of annual compliance is not set out in the law. This leaves room for speculation and uncertainty of the law which is what the CJRP sought to cure in CA 2012.[1338] Second, the CoCG contains extensive accounts provisions, including incorporating international standards, which are far above the needs of SCHCs.[1339] Third, the CoCG espouses integrated reporting and stakeholder enforcement of the CoCG without clear parameters for measuring compliance.[1340] Yet these are complex concepts that require clear definitions

[1332] See para 3.1.3.
[1333] See para 1.3.
[1334] See para 1.2.
[1335] See para 3.1.4.1(b).
[1336] See para 3.1.4.1(c).
[1337] See paras 5.2.1.1, 5.2.1.2; 5.4.
[1338] See para 3.4.1.2.
[1339] See paras 3.1.4.2(b); 6.2.
[1340] See para 6.2.

and clarity on their application.[1341] Finally, granting power to amend the CoCG exclusively to the Minister in consultation with the CMA denies SCHCs the flexibility needed to tailor the CoCG to their unique needs. Flexibility of the law was a key objective that the CJRP sought to achieve in CA 2012 to accommodate various business forms and interests.[1342]

On account of these weaknesses, this study asserts that the CoCG is not drafted with SCHCs in mind with the result that SCHCs that opt in for the CoCG will assume an onerous legal regime with uncertainties.[1343] Consequently, it is proposed that a schedule of simplified corporate governance principles – particularly in accounting and reporting – for SCHCs be incorporated in the CoCG.[1344]

7.2.3 Best practice on the regulation of SCHCs

On the research questions: *What are the (peculiar) legal needs of SCHCs in Uganda?*[1345] *With focus on the UK and South Africa, as comparable jurisdictions, what is best practice on the regulation of SCHCs?* the study reached the following outcomes:

First, the discussion of the UK's CA 2006 and South Africa's CCA 84[1346] has shown that what are referred to as SCHCs in this study have the characteristics of quasi-partnerships or domestic companies in other jurisdictions. They are characterised by: *(a)* a limited number of shareholders – drawing on CCA 84, I have suggested no more than ten members; *(b)* a restriction on the transfer of shares; and *(c)* the participation of most

[1341] Ibid.
[1342] n 1; para 1.3; ULRC Report 3.
[1343] See para 3.4.1.2.
[1344] See paras 3.1.4.1(b) and 6.5.3.
[1345] Including; the following sub-questions: (1) *What in law are SCHCs; What are their legal characteristics; (2) What are the (peculiar) legal needs of SCHCs in Uganda; (3) Why should legislation provide a different regulatory framework for SCHCs; (4) What are the parameters for a simple and accessible company law for SCHCs; (5) What interventions can remedy the legal challenges faced by SCHCs under CA 2012; and (6) What lessons can be drawn from the UK and South African experiences on the regulation of SCHCs to address the challenges in CA 2012*, see para 1.11 para 2.
[1346] See paras 5.2 and 5.3.1.

if not all members in management – hence there is no requirement for the separation of ownership from management through a board of directors – and, for the same reason, a requirement or justification for fewer or flexible reporting obligations; and *(d)* the restriction of members to natural persons.[1347] This study recommends that the insertion of a chapter in CA 2012 that espouses the quasi-partnership structure would provide an appropriate legal framework for SCHCs in Uganda.[1348]

Second, I have established that the peculiar legal needs of SCHCs are *(a)* less regulatory burden; *(b)* ease of decision-making; *(c)* flexible rules on internal operations.[1349] I have demonstrated that a legal framework designed along partnership lines will meet these needs.[1350] Partnerships allow enables members to contract between themselves to structure their internal operations to suit their (unique) needs.[1351] The discussion of *Ibrahimi*'s case demonstrated that courts in common-law jurisdictions have enforced such contracts instead of known corporation laws like the majority rule in decision-making.[1352] Thus, it is proposed that ss 4(1) and 5 be redrafted to merge SMC with other smaller companies whose members do not exceed ten to create the SCHC category.[1353]

Third, I have determined that companies' legislation has provided for the differential treatment of SCHCs for two major reasons: first, as a matter of policy, to promote small businesses;[1354] and second, because of the practical challenges that arise from subjecting small to the same regulatory framework with the other companies.[1355] There are different approaches to achieving this purpose. The UK employed the single legislation approach, integrating aspects of SCHCs through the small companies' regime in CA 2006 with 'opt in' or 'opt out' provisions. In addition, the courts in the UK have

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[1347] See paras 5.2.1.1–2 and 5.3.1.
[1348] See paras 5.3.1.2 and 5.5.
[1349] See paras 3.1.1.3, 3.1.4.1, 3.4.1.2 and 5.3.1.1.
[1350] Ibid.
[1351] See para 3.1.1.3(c).
[1352] See para 5.4.1.
[1353] See para 3.1.1.3(a).
[1354] See para 5.2.1.
[1355] Ibid.

built on the law of contract and partnership law to offer the requisite flexibility to accommodate the needs of SCHCs through quasi-partnership companies.[1356]

However, given the wide range of recommendations by the CLRSG on small companies,[1357] the small companies' regime under CA 2006 is narrow in scope.[1358] Its focus on accounts and audits leaves out other important aspects –particularly the personal relationship among members in SCHCs–which equally affects smooth operations in small companies.[1359]

Moreover, the optional and elective regime for SCHCs is scattered throughout CA 2006. One needs to go through the voluminous CA 2006 of no less than 1,300 provisions to establish which provisions apply to SCHCs.[1360] This drafting style is problematic. This study proposes a legal regime in CA 2012 for SCHCs modelled on CCA 84 which need not be a separate legislation as in South Africa. It is sufficient to insert a chapter in CA 2012 which espouses the principles in CCA 84 and quasi-partnership companies.[1361]

South Africa, on the other hand, established a distinct corporate form using separate legislation – CCA 84 was enacted specifically for CCs.[1362] CCs are small businesses with one to ten members.[1363] While CCs enjoy perpetual succession, they are technically not companies.[1364] However, given the amendments introduced by s 13 of SACA 2008, which has proscribed the registration of new CCs or conversions to CCs from 1 May 2011, the future of CCs is uncertain. Perhaps the South African model has been tested and the legislature found it more convenient to move all companies, small or large, under SACA 2008.[1365]

[1356] See para 5.4.1.
[1357] Para 5.3.1.
[1358] See para 5.3.1.2.; see related discussion in Para 5.3 especially on the reservation by the UK for a separate legal regime for SCHCs.
[1359] Para 4.3.2.
[1360] Para 5.3.1.
[1361] Para 4.3.3.
[1362] Para 5.2.
[1363] Para 5.2.1.1.
[1364] Ibid.
[1365] Para 5.2.1.2.

Additionally, while fewer reporting obligations, and in some cases exemption for small private companies in terms of s 30(2A) of SACA 2008, are to be welcomed, this study has argued that the variables of turnover, the size of the company's workforce, and the nature and extent of their activities (similar to the UK's approach) is problematic.[1366] This approach, as shown with regard to the UK's small companies regime, misses the crucial element of restricting the number of members upon which CCA 84 was founded.[1367] The restriction on the number of members of CCs was to achieve two purposes: first, to secure the personal relationship between members because of their assumed closeness of relations; and second, to protect the informality of their operations and to save them the rigours of the formalities in companies legislation because in CCs, as in SCHCs, most if not all the members are involved in the day-to-day operations of the company.[1368] In the proposed legal framework for SCHCs under CA 2012, a key determinant of whether a company is small or not will be the number of members.[1369]

Fourth, the study demonstrated that whether the UK model or the South African model is applied, an appropriate and effective legal framework for SCHCs must combine company law with partnership law. This enables the courts to employ equitable remedies where strict application of stature would lead to absurdities.[1370] The discussion of quasi-partnership companies, a common-law concept, illustrates this proposition. I have shown that despite the limitations of SCHCs, in the absence of explicit statutory provisions in company legislation as is the case with CA 2012, members of SCHCs can design an appropriate internal corporate governance framework through private shareholder agreements to give themselves much-needed flexibility.[1371] This approach has been shown to mitigate minority oppression because of the

[1366] Ibid.
[1367] Ibid, also para 5.2.1.1.
[1368] Ibid.
[1369] Para 5.2.1.1.
[1370] Para 4.3.
[1371] Para 4.3.2.

expectation that most or all members of SCHCs will be directly involved in company affairs.[1372]

Fifth, on account of the above policy considerations, 'special provisions',[1373] 'elective provisions',[1374] 'exempt provisions'[1375] and the 'small companies regime'[1376] have developed in company legislation to deal with the unique needs of SCHCs. However, these provisions are scattered throughout CA 2006. The Act has 1,300 provisions and 16 schedules, so it can be a daunting task for SCHCs to read through the entire Act to establish which provisions are applicable to them.[1377] This is contrary to the stated objective of law reform in the UK of 'simplifying and modernising the law for small companies.'[1378] It would be helpful if a schedule to all the provisions which relate to SCHCs were inserted in the Act for ease of reference. For example, Schedule 2 to SACA 2008 sets out all the amendments that were introduced by the Act and that relate to or affect the operations of CCs.[1379]

Sixth, by definition, SCHCs are companies with one or a few members, restricted transfer of stock, and with most if not all members in management. The UK has adopted a definition using turnover, balance sheet total and number of employees. These definitions form the basis upon which SCHCs have been provided for differently across jurisdictions.[1380] This is a possible feature of the proposed amendment of CA 2012.

Finally, I have demonstrated that practical challenges arise from subjecting SCHCs to the same compliance requirements as other companies. South Africa realised this hardship and enacted CCA 84, which has been in force since 1 January 1985. Notwithstanding the amendments introduced by SACA 2008, empirical data on the number of CCs that have been registered since 1985 – in their tens of thousands – points

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[1372] Ibid.
[1373] Para 5.3.
[1374] Ibid.
[1375] Ibid.
[1376] CA 2006 s 381.
[1377] See para 5.3.1.2.
[1378] Ferran *Company Law* 640.
[1379] See para 5.2.1.2.
[1380] Armour et al *Anatomy of Corporate Law* 15.

to the success of CCA 84. Therefore, it is suggested that the SACA 2008 amendments should be reconsidered. In the next section, and in further answer to the research question: *With focus on the UK and South Africa, as comparable jurisdictions, what is best practice on the regulation of SCHCs?* I list specific recommendations and suggestions on the way forward on the research problem.[1381]

7.3 Specific recommendations

7.3.1 Guiding principles on interpretation

Provision should be made for principles of interpretation in CA 2012 along the lines of ss 5 and 7 of SACA 2008, which provide guiding principles for its' enforcement.[1382] Guiding principles offer insights into and are an important tool for the enforcement of CA 2012.[1383] This is one way of integrating the core objects of the CJRP into CA 2012.[1384] Thus, a broad statement of purpose in CA 2012 which takes cognisance of the role of various business forms and legal categories in its interpretation would benefit SCHCs.[1385] Additionally, in keeping with developments elsewhere,[1386] the common law should be integrated in CA 2012 by way of a substantive provision to fill the gaps in the law as opposed to its general application under the Judicature Act.[1387]

[1381] Para 1.9.
[1382] Para 6.4.6.
[1383] See *Appendix B*, second schedule.
[1384] Para 1.3.
[1385] n 1.
[1386] Para 4.3.4.
[1387] Paras 4.3.3.1; 4.3.4.

7.3.2 Remedying the gaps in CA 2012

This study has demonstrated that the gaps which were identified in the companies' legislation during the CJRP with respect to SCHCs' legal needs have not been addressed in CA 2012.[1388] These were *(a)* 'company law makes little attempt to respond to the peculiar needs of small firms either in accessibility and simplicity of operation or in substantive provision';[1389] and *(b)* the law does not support 'start up and development of such business'.[1390] CA 2012 is a complex law for SCHCs.[1391] Apart from s 138, which makes company meetings optional for private companies, and I have proposed this should be only with respect to SCHCs,[1392] SCHCs are subject to the same regulation and compliance requirements as other companies. To this end this study recommends that differential treatment of SCHCs should be extended to cover accounts and audit.[1393]

While SMC is to be welcomed for extending corporate form to sole proprietorships, this study has demonstrated that SMC excludes private companies with two to ten members. Drawing on the discussion in chapter 5 on international best practice on SCHCs,[1394] s 4(1) of CA 2012 be redrafted to merge SMC with other smaller private companies with two to ten members to create SCHCs. Moreover, SCHCs should be the subject of 'default' or 'optional' provisions in the area of accounts and reporting, audits which are currently mandatory for all companies, and meetings. The justification for this proposal is that members of SCHCs meet frequently and do not need to be subjected to the rigours of formal company meetings.[1395] Further, membership of SCHCs should be restricted to natural persons.[1396] This approach would cure the inadequacies of the various business options in CA 2012 to fit the needs of SCHCs.[1397]

[1388] n 4 and n 5.
[1389] Paras 1.3 and 1.6.
[1390] Ibid.
[1391] Paras 3.1.1.2, 3.1.1.2(a) and (b), 3.1.2–3, 3.4.1.2 and 6.2.
[1392] Para 3.1.4.2(a).
[1393] Para 3.1.4.1 *(b), (c).*
[1394] Paras 5.2.1, 5.3 and 5.4.
[1395] Paras 3.1.1.3(a) and 3.1.4.1(a), (b) and (c).
[1396] Para 3.1.1.3 (a), (b) and (c).
[1397] Para 3.1.1.2.

7.3.3 Simplification of the CoCG

This study has shown that the CoCG is expansive with complex concepts that are inapplicable to SCHCs.[1398] The CoCG was not drafted with SCHCs in mind.[1399] The accounting principles under art 17 of the CoCG on financial reporting are an example.[1400] These principles should be simplified in their application if the CoCG is to achieve the CJRP's stated objective of a simpler companies' legislation for SCHCs.[1401] A schedule with simplified principles applicable to SCHCs should be inserted in the CoCG.[1402] This can be achieved with support from the professional bodies such as the Institute of Certified Public Accountants of Uganda ('ICPAU').[1403] If the CoCG is to be retained under CA 2012, the provision needs to be reworked so that the nature and what is to be declared under s 14(4) under a statement of compliance needs to be clarified.[1404] Declarations of the nature required in s 14(4) require some standard form, clarity, and certainty.[1405]

Second, the review of the CoCG needs to be broadened beyond the Minister and CMA.[1406] An expanded membership for reviewing the CoCG benefits from the expertise of the non-state actors beyond the CMA and the Minister.[1407] The motivation for this proposal is the King Code in South Africa which operates outside of SACA 2008, and yet achieves good results. [1408] Its membership is broad, including both government and the private sector,[1409] yet it has been cited and applied by the courts in South Africa.[1410] The King Code precedes the commercial law reforms that led to SACA 2008.[1411]

[1398] Paras 3.4.1.2 and 6.2.
[1399] Para 3.4.1.2.
[1400] Paras 3.1.4.2(b) and (c) and 3.4.1.2.
[1401] Para 1.3 n 1.
[1402] See *Appendix B* on proposed amendments.
[1403] Para 6.5.3; 6.5.2.
[1404] Paras 3.4.1.2; 6.2.
[1405] Ibid.
[1406] Para 6.7.
[1407] Para 6.5.2.
[1408] Para 6.4.
[1409] Ibid.
[1410] Para 6.4.6.
[1411] Para 6.4.

7.3.4 post-legislative reviews

Given the objective of the CJRP to bring about the first major reforms in company legislation in Uganda in over 50 years,[1412] to align the law with international standards, periodic post-regulation reviews and audits should be undertaken by the ULRC and the MoJCA to track the progress of the Act against its stated objectives.[1413] It will also help generate new empirical data on SCHCs in Uganda. The 2022 amendment so far as it relates to the present subject indicates that law reform is a continuous process.[1414]

7.3.5 Redrafting of specific provisions in CA 2012

Drawing on the arguments made in chapters 1, 3, 4, 5 and 6 on the inadequacies of CA 2012 on SCHCs,[1415] it is recommended that ss 2, 4, 14, 138, 154 and 167 of CA 2012 be redrafted to cure ambiguities in the law.[1416] The details of the proposed amendments are set out in *Appendix B: Schedule of Amendments*.[1417]

7.3.6 Strengthening the Registrar

CA 2012 defines 'registrar' as the Registrar of Companies or an assistant registrar or other officer performing the duty of registration of companies under this Act.[1418] The Registrar has a quasi-judicial function.[1419] He or she can hear and dispose of matters that are not in court.[1420] He or she can investigate or cause investigations,[1421] or cause the inspection of company books or documents.[1422] He or she can also make orders that are

[1412] Para 1.3; n 3.
[1413] Para 3.1.1.1.
[1414] Para 3.1.1.2.
[1415] Paras 3.1.1.2, 3.1.1.2 (a), (b) and (c), 3.1.2, 3.1.3, 3.1.4.1, 3.1.4.2, 3.4.1.1–2, 5.2.1; 6.2.
[1416] See *Appendix B.*
[1417] Ibid.
[1418] Section 2 of CA 2012; see the discussion in para 3.5.1.
[1419] Regulation 4 of the Companies (Powers of the Registrar) Regulations No 71 of 2016; Para 3.5.1.
[1420] Ibid; para 3.5.1.
[1421] Section 172 of CA 2012; para 3.5.1.
[1422] Sections 173 and 174 of CA 2012; para 3.5.1.

necessary with respect to matters before him or her, or arising from inspection or investigation.[1423]

Compared to the repealed Act, there is an insignificant difference in the composition and power of the Registrar in CA 2012. Reid and Priest's recommendation was for a much-strengthened CMA with the powers of the Registrar transferred to the CMA under the new company law.[1424] However, this recommendation was not adopted; under the current law the CMA's mandate concerns listed companies.[1425]

In addition, where private companies file annual statements of compliance with the CoCG, the law is not clear about what the Registrar should do with these statements.[1426] The Act needs to clarify what the Registrar's function is with respect to these annual statements of compliance, given the importance that the legislature attached to the CoCG.[1427] To that end it is recommended that provision be made in the law to oblige the Registrar to submit annual reports about these statements to the Minister of Justice and Constitutional Affairs. These reports can be a basis for future policy reforms.

Third, the Registrar must be mandated to make practice directions for the proper administration of CA 2012.[1428] Thus, it is recommended that subsequent reviews of CA 2012 should grant the Registrar autonomy on operational issues, including the power to make practice Directions to give effect to CA 2012. The Minister can retain general policy oversight over the institution of the Registrar. Finally, the Registrar's relationship with the CMA under CA 2012 with respect to private companies should be streamlined. This study has illustrated that at present there is an overlap in their roles.[1429] If implemented, the resultant problem of dual compliance which is certainly burdensome, particularly for SCHCs, would be cured.[1430]

[1423] Ibid; para 3.5.1.
[1424] Reid & Priest 30; para 3.5.1.
[1425] Para 3.5.1.
[1426] See para 3.4.1.2.
[1427] See paras 3.4.1.1–2.
[1428] Paras 3.1.4.1; 3.5.1.
[1429] Para 3.4.1.2.
[1430] Ibid; para 3.4.1.2.

7.3.7 Register for SCHCs

This recommendation draws on the proposals to redraft ss 4 and 5 to merge SMC and other smaller companies with two to ten members to create SCHC as a legal category.[1431] Thus, it is recommended that provision should be made in CA 2012 to establish a distinct register for SCHCs that will be kept by the Registrar. This will help with the generation of new and reliable empirical data for proper planning and to inform future government policy interventions on SCHCs as an industry.

7.4 Conclusion

In the final analysis, this study concludes that CA 2012 is not an appropriate legislation for SCHCs. The study has illustrated the problem of first, the overlay of the law with complex concepts that are inapplicable to or unsuitable for SCHCs. Second, subjecting all companies to the same accounts and audit requirements makes the law inflexible, contrary to the stated objective of the CJRP.[1432] Third, the available business forms are unsuitable for the legal needs of SCHCs. Fourth, the corporate governance framework under the Act is complex for SCHCs. Finally, the law is not aligned with best practice on the regulation of SCHCs as shown of comparable jurisdictions of South Africa and the UK. As such it is fair for this study to conclude that the stated objective of the CJRP for a simple, flexible, and accessible law for SCHCs has not been met in CA 2012.

The key proposal in this study is to amend ss 2, 4, 14, 20, 138, 154, and 167 of CA 2012 to address the above shortcomings. The study incorporates *Appendix B*, which outlines the draft amended provisions to support the legislative process. It is hoped that the Minister of Justice and Constitutional Affairs, (MoJ& CA'); the Attorney-General; and Parliament will be drawn to the policy issues raised in this study to improve on the CA 2012 with respect to SCHCs within the broader objectives of the CJRP.

[1431] See para 3.1.1.3(a).
[1432] n 1; para 1.3.

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APPENDICES

Appendix A: *Table F*

Section 14

CODE OF CORPORATE GOVERNANCE

BOARDS AND DIRECTORS.

1. THE BOARD.

(1) The Board is accountable for the performance and affairs of the company, and in the performance of its duties is expected to act in good faith, with due diligence and care and in the interests of the company.

(2) The Board's authority may be delegated to management and board committees but it remains the responsibility of directors.

(3) The board shall be a unitary Board with executive and non-executive directors.

(4) It is the responsibility of the Board to—

(a) provide strategic direction;

(b) retain full and effective control;

(c) comply with laws and regulations;

(d) define levels of materiality;

(e) delegate certain powers to management;

(f) if material, reserve powers to itself;

(g) have access to company information and records;

(h) agree on a procedure to allow directors to obtain independent professional advice;

(i) decide on the number of directors required to make the board effective;

(j) identify and monitor key risk and key performance areas;

(k) identify and monitor non-financial aspects;

(l) record facts and assumptions which lead it to conclude that the business will be a going concern in the next financial year and if not state what steps it is taking;

(m) explain the effect of all proposed resolutions to be passed at shareholders meetings;

(n) encourage shareowners to attend general meetings;

(o) ensure that the chairperson of the audit and remuneration committee and as many directors as possible attend shareholders' meetings;

(p) provide curriculum vitaes of all directors who are to be appointed;

(q) have a board charter setting out its responsibilities which shall be published in the annual report and should, at least, make the board responsible for—

(i) strategic plans;

(ii) monitoring operational performance;

(iii) monitoring performance of management;

(iv) determining policies and procedures;

(v) risk management;

(vi) internal controls;

(vii) communications policy;

(viii) director selection;

(ix) induction of directors; and

(x) evaluation of directors.

(r) determine a balance between governance constraints and entrepreneurial performance;

(s) review major plans of action;

(t) review and guide annual budget and business plans of the company;

(u) oversee major capital expenditures, acquisitions and divestiture;

(v) ensure formal and transparent board nominations and elections;

(w) ensure the integrity of the company's accounting and financial reporting systems; and

(x) oversee the process of disclosure and communication.

2. BOARD COMPOSITION

The board shall be composed of—

(a) a balance of executive and non-executive directors;

(b) non-executive directors shall comprise the majority;

(c) sufficient non-executive directors shall be 'independent' directors;

(d) a nomination committee, consisting entirely of non-executive directors, with the majority independent directors and chaired by the board chairperson, is to select directors in a transparent manner; and

(e) rotation of directors, to ensure continuity.

3. CHAIRPERSON AND CHIEF EXECUTIVE OFFICER (CEO).

(1) There shall be a division of responsibilities between Chief Executive Officer and Board Chairperson to ensure no one has unfettered power or authority.

(2) When the Chief Executive Officer and chairperson's roles are combined—

(a) a deputy chairperson who is an independent director shall be appointed; or

(b) there shall be a strong independent director component of the board and the combined roles shall be justified in each year's annual report.

(3) The performance of the chairperson shall be evaluated annually or on any other basis agreed by the board.

(4) If the role of chairperson and Chief Executive Officer are combined, an independent deputy chairperson shall lead the evaluation.

(5) The Chief Executive Officer's performance shall be evaluated by the chairperson or a sub-committee appointed by the board, not less than once a year.

(6) The remuneration committee shall take the performance appraisal into account when setting the Chief Executive Officer's remuneration.

4. DIRECTORS.

(1) No one block of directors shall dominate the Board. This shall be controlled by a division of power.

(2) Non-executive directors shall have the skill and experience to bring to bear on—

(a) strategy;

(b) performance;

(c) standards of conduct; and

(d) resources.

(3) The annual report shall categorise directors as—

(a) executive director who is involved in the day-to-day management or are employed by the company or its subsidiaries;
(b) non-executive director who is not an executive director; and
(c) independent director being a non-executive director who—

(i) does not represent or is not nominated by a major shareholder;

(ii) is not employed by the company in the past 3 financial years;

(iii) is not an immediate family member of a person who is, or was in the past 3 financial years, employed in an executive capacity;

(iv) is not a professional advisor;

(v) is not a significant supplier to, or customer of the group;

(vi) has no significant contractual relationship with the group; and

(vii) is free from any business or other relationship, which could materially interfere with his or her ability to act independently.

(d) The practice of using 'shadow directors' is discouraged.

(e) Executive directors shall be encouraged to hold non-executive directorships in other companies.

(f) Non-executive directors shall consider the number of directorships they should hold, in order that they are able to perform effectively.

(g) A company shall organise an orientation programme to-

(a) introduce new directors to the company; and

(b) brief the directors on their fiduciary duties.

(h) Directors shall be briefed on new laws and regulations, from time to time by the company secretary.

5. REMUNERATION.

(1) To retain quality directors, sufficient remuneration shall be made to the directors.

(2) A remuneration committee shall be appointed by the board to consider executive remuneration.

(3) The committee shall—

(a) consist preferably entirely but at least mainly of independent directors;

(b) make recommendations to the Board.

(4) The Chief Executive Officer may attend meetings of the committees, by invitation, for most business, but shall excuse himself or herself while his or her remuneration is considered.

(5) An independent non-executive director shall be the chairperson of the remuneration committee.

(6) The annual report shall disclose membership of the remuneration committee.

(7) The chairperson of the remuneration committee shall attend annual general meetings, to answer questions from shareholders.

(8) The annual report shall contain a declaration of individual director's remuneration, share options and other benefits.

(9) Performance-related elements shall constitute a large portion of each executive's package.

(10) Any share options granted to non-executive directors shall be approved by shareholders, usually at the annual general meeting and be in accordance with the Act.

(11) It is preferable to issue shares to directors, as part of their remuneration, rather than grant share options, to avoid the loss of independence by following the option route.

(12) For share options—

(a) a vesting period is required for options to non-executive directors: to avoid short-term decision making and the consequences of resignation and removal and the impact on independence shall be evaluated by the board;

(b) re-pricing of options shall only be done on the approval of shareholders;

(c) any discount to ruling price will require shareholder approval.

(13) Full disclosure is required, for each director in respect of options and other share issues.

(14) An executive director's contract shall not be for more than three years otherwise shareholder approval is required.

(15) The annual report shall contain a ‘Statement of Remuneration Philosophy’.

(16) Succession planning is necessary for the chief executive officer and executive management.

(17) The remuneration committee is to recommend pay for nonexecutive directors on a merit basis and accordingly, each non-executive director shall be paid an appropriate rate, which may be different from that of other non-executive directors.

(18) The board shall present the recommendations of the remuneration committee for the purposes of determining the remuneration of directors.

6. BOARD MEETINGS

(1) The board shall meet at least once every three months.

(2) The annual report shall record—

(a) the number of meetings; and

(b) attendance of each director at meetings.

(3) The board members shall be briefed prior to each board meeting.

(4) Non-executive directors shall have access to management, without executive directors being present.

(5) The whole board shall set the policy and procedure for the access.

(6) The board shall regularly—

(a) review processes and procedures; and

(b) ensure the effectiveness of internal controls.

(7) The board shall ensure that it receives non-financial information, to address broader stakeholder issues and measures.

7. BOARD COMMITTEES.

(1) The board committees shall assist the board in the performance of its duties; but the directors shall remain responsible notwithstanding delegation to a committee.

(2) A formal procedure for delegation shall exist to discharge the board's duties and to facilitate decision making.

(3) The board committees' terms of reference or mandates shall state their lifespan.

(4) There shall be transparency and full disclosure of committee matters.

(5) All companies shall have, at least—

(a) an audit committee; and

(b) a remuneration committee.

(6) Non-executive directors shall play an important role in committees.

(7) An audit committee shall becompsed of chairperson and at least three other persons of reputable integrity not being members of the board.

(8) Board committees, with the exception of operational committees, shall be chaired by an independent non-executive director.

(9) Independent outside professional advice may be sought by board committees.

(10) The annual report shall state—

(a) the members of board committees; and

(b) the number of meetings held.

(11) Chairpersons of board committees shall attend the annual general meetings.

(12) The board committees' performance shall be regularly evaluated.

8. BOARD AND DIRECTOR EVALUATION.

(1) The board through the nominations committee or other board committee shall regularly, through self-evaluation by all directors, review the board's effectiveness and its composition by—

(a) a mix of skills;

(b) experience;

(c) demographics; and

(d) diversity.

(2) The evaluation shall be done at least once a year.

9. DEADLINES IN SECURITIES.

The board shall have a practice of—

(a) prohibiting directors and officers from trading in the period between the end of an accounting period and the date on which results are published; and

(b) the company secretary shall implement the practice.

10. COMPANY SECRETARY.

(1) The company secretary shall have a pivotal role in the corporate governance.

(2) The company secretary shall be empowered by the board to enable him or her to properly perform his or her duties; and shall—

(a) provide directors individually and collectively with detailed guidance on discharging their responsibilities;

(b) shall induct or participate in the induction of directors;
(c) assist the chairperson and the chief executive officer in setting the annual board plan;
(d) administer other strategic board level matters;
(e) provide a central source of guidance on ethics and good governance; and
(f) be subject to a fit and proper test, as also directors.

RISK MANAGEMENT

11. RESPONSIBILITY

(1) The board is responsible for the total process of risk.

(2) Management is responsible to the board in respect of risk management processes for designing, implementing and monitoring.

(3) The board in liaison with management shall-

(a) set risk management policies; and
(b) ensure those policies are communicated to and implemented by all employees.

(4) The company secretary shall implement the practice.

(5) The board shall use recognized models to provide reasonable assurance that risk management and internal controls are serving objectives to-
(a) provide effective and efficient operations;
(b) safeguard assets;
(c) comply with laws and regulations;
(d) ensure business is sustainable;
(e) reliable reporting; and

(f) a responsible attitude to stakeholders.

(6) In order to make an annual statement on risk management in the company a systematic, documented assessment of key risks shall be undertaken.

(7) The board shall regularly receive reports on risk management on the following risks—

(a) physical and operational;
(b) human resources;
(c) technology;
(d) business continuity;
(e) credit;
(f) market;
(g) compliance;
(h) disaster recovery plans, which often involve insurance and risk funding planning, should be addressed.

(8) The risk management process and evaluation of risks shall be addressed by a special committee, or a board committee, which shall report to the board.

(9) Risk management and internal controls shall be embedded in the day- to-day activities.

(10) A 'whistle blowing' process, which allows protected reporting, shall be considered, to enable employees and others to report misdemeanours.

12. APPLICATION AND REPORTING.

(1) Controls, including ethical value, shall be in place to reduce risk and attain objectives.

(2) Risk shall be assessed in a continuous manner and controls instituted to respond to risk.

(3) Risk management systems shall manage risks, protect and enhance the interests of shareholders and stakeholders.

(4) The systems shall deliver—

(a) risk identification;
(b) a management commitment to the process;
(c) risk mitigation activities;
(d) documented risk communications;
(e) documentation of the costs of non-compliance and losses;
(f) documented internal control and risk management;
(g) assurance of efforts to risk profile; and
(h) a register of key risks.

(5) Key risk areas and key performance indicators must be identified by the board.

(6) Management shall report to the board on—

(a) effectiveness of internal controls;
(b) significant control weaknesses identified; and
(c) action taken to reduce control weaknesses and to reduce risk.

(7) The board shall disclose that—

(a) it is responsible for internal control systems and risk management, which are regularly reviewed;

(b) an ongoing process for identifying, evaluating and managing significant risks is and has been in place;

(c) an adequate system of internal control to provide reasonable, but not absolute assurance exists to manage risk and to achieve business objectives;

(d) a documented and tested disaster recovery plan exists;

(e) material joint ventures have been—

(i) dealt with as part of the group risk management; or

(ii) by other means, details of which shall be provided; and

(f) any additional appropriate information on the risk management process shall be provided.

(8) If the board is not able to make any of the disclosures described in this paragraph this should be explained.

(9) The review of processes may identify areas in which risk management can be turned to competitive advantage.

INTERNAL AUDIT

13. STATUS AND ROLE

(1) When the board decides not to implement internal audit, the annual report shall explain why and how effectiveness of processes and systems will be tested.

(2) The internal auditors shall comply with the code of ethics issued by the institute.

(3) Internal audit shall—

(a) report to all audit committee meetings;
(b) have access to the chairperson of the audit committee;
(c) have access to the chairperson of the board; and
(d) report to the chief executive officer.

(4) The audit committee shall concur with any decision to appoint or dismiss the head of internal audit.

(5) When internal and external audit are provided by the same auditing firm, segregation between the functions to ensure independence, shall be agreed by the board, and audit committee.

14. SCOPE OF INTERNAL AUDIT

(1) Internal audit is an independent objective assurance activity which brings a disciplined approach to evaluate risk management, control and governance.

(2) Effective internal audit shall provide assurance that—
(a) risk is adequately identified and monitored;
(b) internal control systems are effective;
(c) feedback on risk matters is effective; and
(d) management generated information is reliable.

(3) The internal audit plan shall be based on a risk assessment and shall include emerging and existing risks;

(4) The risk assessment shall be formally reviewed not less than once a year.

(5) Internal audit work plan must be approved by the audit committee.

(6) Internal audit shall ensure that comprehensive assurance reviews are conducted by experts, without any duplication.

INTEGRATED SUSTAINABILITY REPORTING

15. SUSTAINABILITY REPORTING

(1) A company shall report on its policies and procedures and systems and commitments to the following—

(a) social;

(b) ethical;

(c) safety;

(d) health; and

(e) environment.

(2) Stakeholder reporting requires an integrated approach and issues shall be categorised into the following reporting levels—

(a) first level: matters arising from documents,

(b) second level: implementation of practices and the steps taken to implement, and

(c) third level: demonstrate the benefit of changes.

(3) The boards shall consider the following—

(a) nature of the organization;

(b) performance expectations consequent upon the going concern concept;

(c) extent to which the company's action, or lack of action led to the reported matter;

(d) non-financial information shall be reliable, relevant, clear and unambiguous, verifiable and timeless, and

(e) guidelines for materiality shall be developed, to ensure consistent reporting.

(4) The following matters shall require specific consideration-

(a) safety and occupational health objectives issues, including HIV/AIDS;

(b) environmental reporting and following the option with the least impact on the environment;

(c) human capital development, including—

(i) number of staff; and

(ii) training.

16. ORGANISATIONAL INTEGRITY OR CODE OF ETHICS.

(1) A code of ethics shall be set for all stakeholders.

(2) There is need to ensure commitment to the code of ethics at a high level including—

(a) procedures to implement, monitor and enforce the code of ethics at a high level;

(b) assessing integrity when promoting; and

(c) training on company values.

(3) The disclosure shall include the directors' opinion as to the extent to which ethical standards are met.

(4) Continuing relationships with those with lower ethical standards shall be re-evaluated.

ACCOUNTING AND AUDITING.

17. AUDITING AND NON-AUDIT SERVICES.

(1) Financial statements shall be presented in line with applicable national laws and in accordance with International Financial Reporting Standards unless otherwise allowed by the Institute of Certified Public Accountant Uganda.

(2) Auditors' independence should not be impaired.

(3) Internal and external audit services shall supplement one another through good audit processes.

(4) Internal and external auditors shall consult and co-ordinate effort.

(5) The audit committee shall set the principles for the use of external auditors for non-audit services.

(6) Separate disclosure shall be made to members of the non-audit services provided by the external auditor.

18. REPORTING OF FINANCIAL AND NON-FINANCIAL INFORMATION

(1) The Audit committee shall determine whether or not interim reports should be audited.

(2) If interims are not audited, the audit committee shall report to the board on the reasons for the non-audit after which the interims are to be adopted by the board.

(3) The board should encourage internal or external audit consultation.

(4) Non-financial reports: any external validation shall be reported in the annual report.

19. AUDIT COMMITTEE

(1) The audit committee shall consist of a chairperson and at least three other persons of reputable **intergrity** coming from outside the Board.
(Author: error in original text).

(2) Written terms of reference shall be given to the audit committee to deal with membership, authority and duties.

(3) Written terms of reference shall be given to the audit committee to deal with membership, authority and duties.

(4) The annual report shall indicate if the—
  (a) written terms of reference are given; and
  (b) committee has complied with its terms of reference.

(5) The annual report shall disclose membership.

(6) The chairperson of the audit committee shall attend the annual general meeting to answer relevant questions.

20. RELATIONS WITH SHAREOWNERS

(1) Dialogue with institutional investors by constructive engagement will assist in understanding objectives.

(2) Institutional investors should take all relevant factors into account.

(3) Notices of general meetings shall explain the effect of all items of special business and reasonable time shall be allowed for discussion at general meetings.

(4) The use of a poll at general meetings shall be considered for contentious issues, and the results of decisions shall be published.

21. COMMUNICATION

(1) The board shall report, on significant and relevant matters, in a balanced and understandable manner.

(2) Reports shall be—

(a) transparent;
(b) reflect accountability;
(c) objective; and
(d) comprehensive.

(3) A balance between positive and negative is required to ensure a full, fair and honest account of performance.

(4) The directors' report shall contain—

(a) directors' responsibility to report fairly;

(b) an auditor's report on financial statements;

(c) adequate,

(i) accounting records kept;

(ii) internal control; and

(iii)risk management;

(d) consistent and appropriate accounting policies and prudent judgments have been applied;

(e) accounting standards which were followed with departures quantified and explained;

(f) a statement that there is no reason to believe that the company will not be a going concern in the year ahead; and

(g) the provisions of the Code of Corporate Practice and Conduct followed.

22. IMPLEMENTATION OF THE CODE.

All boards and individual directors shall ensure that the principles contained in the Code are observed.

Appendix B: Schedule of proposed Amendments

Sections 2, 4, 5, 14, 138, 154, and 167

(Under Para 7.3.5)

In re-drafting ss 2, 4, 5, 14, 20, 138, 167, and 198, I seek to cure the gaps, ambiguities which have been identified in the Act as particularised below. First, in s 2, to insert a definition of member for purposes of SCHC to mean natural persons and to restrict membership in SCHC to natural persons.[1433] Additionally, to provide an effective legal framework for SCHC requires that their legal characteristics is clearly provided for.[1434]

In second place, to limit membership to SCHC to 10. This intervention follows from the finding in this study that in comparable jurisdictions, membership to SCHCs is restricted to a few members.[1435] This is lacking in CA 2012 and needs to be fixed.[1436] Moreover, the classification of members of private companies of any one to one hundred in s 5(1)*(b)* of CA 2012 is broad.[1437] In between, there are many companies which are not SMC but still operate like partnerships hence the proposition to restrict the number of SCHC to ten. This latter proposal is also supported by close corporations which are established under CCA 84 in South Africa.[1438] The contention is that any private company whose members exceed ten should be subjected to mandatory requirements for the reasons advanced in Chapters 3, and 5.[1439]

Third, to create SCHCs as a label.[1440] SCHC will be a private company whose members are any 1 to 10. This can be done by re-drafting s 4 and s 5(1)*(b)* to merge SMC with other private companies whose members range from 2 to 10. This amendment has been justified for two reasons: first, membership to SMC is exclusively one. This

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[1433] See para 5.2.1.1.; 5.3.1.1.
[1434] See para 1.2.
[1435] Ibid; paras 5.2.1.1., 5.3.1.1.
[1436] Ibid; paras 3.1.1.2–3; 3.1.4.1.
[1437] See para 3.1.4.
[1438] See para 5.2.
[1439] See para 3.1.4.2 (a), (b), and (c); 5.2.1, 5.3.
[1440] See para 3.1.1.3 (a).

leaves out other smaller companies which are not SMC but nevertheless small enough to take benefit of SMC. This study has demonstrated that this classification is not appropriate for SCHCs.[1441] On account of their corporate structure and character as discussed in this thesis[1442], it is recommended that an amendment be made in the Act espousing the principles in South Africa's CCA 84.[1443]

Fourth, and in the alternative, to insert a chapter or a schedule in CA 2012 consolidating all the proposed amendments which will focus on specific legal needs of SCHCs in direct answer to the call in the ULRC Report.[1444] Here, the law will define SCHCs on clear parameters—based on (1) membership from 1-10; (2) with membership restricted to natural persons; as well as (3) provide for clear optional provisions such as discretion on company meetings; audited accounts; and (4) simplified accounts and less reporting obligations to mitigate the burdens of compliance.[1445] This recommendation is supported by best practice.[1446] A distinct Chapter for SCHCs creates room for their differential treatment within the CA 2012 legal framework with clear statutory incentives and stimulus for the smaller firms in terms of optional or flexible statutory requirements.[1447] Besides, as opposed to having scattered provisions which deal with SCHCs a chapter dealing with only SCHCs provides an easy reference to the law in terms of the CJRP objective for a simple law and flexible law. It avoids SCHCs having to comb through the over-300 provisions to ascertain which provisions apply to them.[1448]

Fifth, in s 14(4) to prescribe the format for the statement of compliance for firms that adopt the CoCG. The corporate governance check list subject of the statement of compliance needs to be clear for uniformity and consistency in enforcement.[1449] Further, there is dual annual reporting obligation to the CMA and the Registrar for firms that

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[1441] Paras 3.3.1; 3.1.2.
[1442] Paras 1.3; 1.6.
[1443] See paras 3.1.4.1; 5.2.1; 5.3.1.
[1444] Ibid; Appendix B.
[1445] Ibid.
[1446] See paras 5.2.1, 5.3, 5.3.1.1.
[1447] See para 5.3.1.1.
[1448] See Schedule 3 of SACA 2008.
[1449] See para 3.4.1.2.

adopt the CoCG.[1450] The amendment is clarify of the CMA and the Registrar, on whom does the responsibility fall to prescribe the statement of compliance fall for SCHCs. This is critical because this study has demonstrated that under the law, the CMA's mandate is exclusively listed firms. In terms of s 5(1)*(a)* of the Capital Markets Authority Act[1451] the core mandate of the CMA is to regulate capital markets and related matters in Uganda. This places CMA in a remote relationship with private companies generally, and SCHCs, in particular. The Registrar on the other hand regulates private firms. This leads to variance in enforcement of the provision on account of their distinct and ambiguous mandates. The Companies (General) Regulations, 2016[1452], which came into effect on 22nd January 2016 also does not provide for the prescribed form under s 14 or make this clarification.

In parallel, Companies (Powers of the Registrar) Regulations, 2016[1453], which came into force on 18th November 2016, is made under s 262(3) of CA 2012. For completeness, s 262(3) provides that subject to this Act, the Minister may make regulations for the purpose of regulating the discharge of the functions of the Registrar General under this Act. Quite clearly, the prescribed form on the statement of compliance could not have been made under these regulations. It remains guesswork on what the declaration entails.

The absence of the form on declaration eleven years after the enactment of CA 2012 raises enforcement concerns on s 14.[1454] Thus, it is proposed that provision be made by way of re-drafting s 14 to prescribe the format of declaration of annual statement of compliance. A further clarification be made that private companies that are obliged to make the declaration should do so only to the Registrar.[1455]

[1450] Ibid.
[1451] Cap 84 as amended by the Capital Markets Authority Amendment Act 12 of 2011, available electronically at Capital Markets Authority Act - ULII; Capital Markets Authority (Amendment) Act, 2016 - ULII and obtained on 20 August 2023.
[1452] S.I. No. 7 of 2016.
[1453] S.I. No. 71 of 2016.
[1454] See para 3.4.1.2.
[1455] Ibid.

In the sixth place, on s 138 to require that only companies whose members are 10 and below to opt out of company meetings. As demonstrated earlier, URLC recommendation was that any company whose member is 50 and above should not be allowed to opt out of mandatory obligations under the Act. This study proposes that the threshold of 50 is high and leaves almost no company within this threshold. The basis for this claim is that an earlier finding by the ULRC revealed that not many companies in Uganda hit the 50-member threshold.

But the real reason for this proposal is that given the definition of SCHC in chapter 1, any company whose members are above ten will encounter some challenges to operate as quasi-partnership company. This study has established that quasi partnership companies are founded on mutual trust and on the understanding that most, if not, all of its' members will participate in the management. To that end, where members are more than ten, such company is bound, as a matter of course, to require a separate board from owners. Once there is separation of management from ownership, it becomes problematic to talk about SCHCs.[1456] In that case, strict application of corporation rules on meetings, accounts, must follow.

S 154. This study has established that it is best practice not to require SCHC to report as much as other companies do.[1457] The discussion of the small companies' regime in the UK under CA 2006 and SACA, 2008, supports this claim.[1458] The proposed amendment to s 154 which subjects all companies to the same account and disclosure requirements seeks to bring CA 2012 at pace with this best practice.[1459]The amendment of s 154 is to make account requirements for SCHCs.

Finally, to amend s 167 in keeping with best practice to make it also optional for SCHCs.[1460] Below, I now provide the draft amendments to the specified provisions:

[1456] See para 5.2.1.2. *'SACA, 2008 and close corporations.'*
[1457] See paras 3.1.4.1 *(b), (c)*; 5.2.1.1.; 5.2.1.2; 5.3.1.1.
[1458] See para 3.1.4.2 (b), (c), 5.2.1.2.
[1459] Para 5.3.1.1.
[1460] See para 3.1.4.1*(c).*

Section 2: Interpretation

I propose to amend s 2 to introduce the definition of 'member' or 'shareholder' in relation to 'SCHCs' to mean a natural person. This proposition is founded on the discussion in chapter 5 which shows that these terminologies are capable of definition and ought to be defined. Yet, they are not defined in CA 2012. Importantly, I have demonstrated that for legislation to provide for preferential treatment for SCHCs, it must be preceded with a clear definition and well-stated legal characteristics. The purpose of amending the interpretation section is also to make it clear that membership to SCHCs shall be restricted to natural persons in line with international best practice as demonstrated in chapter 5. Consequently, I propose to re-draft section 2 as follows:

'Section 2: Interpretation'

'*Member*' or 'shareholder' in reference to Single Member Company or SCHCs means a natural person.

'*Small and closely held-company*' or '*SCHC*' shall have its meaning as prescribed in s 4(Ia).

Section 4 and 5

In section 4, it is proposed to insert sub section '1a' to read as follows:

(1a) subject to subsection (2), and s 5(1) (b) a private company with members whose number is less than 10 shall be called small and closely held company or 'SCHC Ltd' which shall be a body corporate with perpetual succession and seal. The consequence of this proposal is that SMC and other smaller companies whose members do not exceed 10 will be merged to create SCHC, as contended in Chapters 3, 5.

Section 14. Adoption and application of Table F.

Section 14 is amended by substituting for s 14(4) the following sections:

'Section 14(4) A Company that has adopted the code of corporate governance shall annually file a statement of compliance with the Registrar or the Capital Markets Authority, as the case may be, in a prescribed format by the Registrar,

The proposed amendment is intended to cure the lacuna on what is to be declared in the annual statement of compliance under the prescribed format. The Registrar shall retain the power and discretion to amend the format of annual declaration.

Section 138. Annual general meeting.

I propose that s 138(2) be re-drafted to qualify its application to only SCHCs. This is because, in the discussion in chapter 5 on quasi-partnership companies, it has been established that not subjecting SCHCs to mandatory meetings requirements is because members of SCHCs are in day-to-day management of the company and meet often. In any case, there is in fact no board distinct from members. They meet informally and are able to meet as and when they wish to. This consideration does not apply to all private companies.

Section 138 (2) needs to capture this reality. It should not be the case that meetings should be optional for all private companies.[1461] Meetings have good corporate governance aspects and need to be protected. As shown in Chapter 3, the recommendation by ULRC was that companies whose members are 50 or more should be subjected to mandatory requirements of the law. I have however demonstrated that the 50 threshold is a higher number and would leave no one in the mandatory category since by ULRC's own account not so many companies in Uganda have membership hitting the 50-member threshold.[1462] The proposed amended s 138 (2) which seeks to

[1461] Sullivan 'Relationship between the board and members' 572-77.
[1462] ULRC Report 18.

benefit SCHCs whose members, as stated above, are proposed to be 1-10 should read as follows:

‘Section 138: Company Meetings’‘(2) A private company whose members do not exceed 10 may at the requisition of a member hold an annual general meeting.’

Section 154(1) Keeping of books of account.

I propose to amend section 154(1) to make it optional for SCHCs to have audited books of accounts. In consequence, Section 154(1) should read as follows:

‘(154) (1) Every company except SCHC shall cause to be kept in the English language proper books of account with respect to—.’ The rest of the provision be maintained as is.

Section 167. Appointment and remuneration of auditors.

(1) Every company not being SCHC shall at each annual general meeting appoint an auditor to hold office from the conclusion of that general meeting, until the conclusion of the next, annual general meeting.

Schedule 1: Provisions applicable to SCHC.

As demonstrated in chapters 3, and 5, companies’ legislation in Uganda have been voluminous and complex. This is characteristic of company legislation in other jurisdictions as shown of SACA, 2008, and CA 2006. The explanation given by Mayson et al in their book *Company Law*[1463] for this outcome is that, apparently, the drafting style was to condense every aspect of company law into one legislation.[1464] This explains why there has been attempts, including at the enactment of CA 2012, to divorce

[1463] Para 5.4.1.2.
[1464] See ULRC Report 9 para 2.1.2.2.

'non-core' company matters from company legislation.[1465] This study has however shown that appropriate legal framework for SCHCs can be achieved within a single legislation however voluminous provided the drafting style is one with SCHCs in mind.[1466] In consequence, it is proposed that as an intervention, a *schedule* be inserted into CA 2012 which clearly sets out a summary of all provisions which are applicable to SCHCs. This is to avoid SCHCs having to comb through voluminous company legislation to establish which provisions are applicable to them.[1467] The proposed schedule serves the purpose of easy reference to and accessibility of the law in line with one of the stated objectives of CJRP at the enactment of CA 2012.[1468]

Schedule 2: Principles of Interpretation.

As demonstrated in this study, the purpose of the schedule of principles of interpretation is to codify some basic principles OR objectives of the CJRP to inform the interpretation of CA 2012 by the courts. The motivation for these principles arises from the discussion on ss 4, 5 of SACA, 2008. In these principles is proposed to codify some of the objectives of CA 2012, the CJRP, and international best practice. These include: (a) 'in interpreting CA 2012, courts shall have regard to the unique regulatory and corporate governance needs of SCHCs'; (b) 'SCHCs lie at the heart of Uganda's economy.' (c) the need to protect corporate form as 'a contracting and finance device.'[1469] And finally (d) common law shall apply in the interpretation of the Act.[1470]

[1465] Ibid, at 7.
[1466] See Ferran *Company Law* 640.
[1467] Para 5.6.1.2.
[1468] Para 1.3.
[1469] Armour, Enriques et al *The Anatomy of corporate law* 5.
[1470] See Chapters 3, 4, and 5.