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Institute *of* Certified Secretaries

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EDITORIAL COMMENTARY

The Governance Journal was borne out of a partnership between the Institute of Certified Secretaries (ICS) and the University of Nairobi with the aims of stimulating intellectual debate on corporate governance, promoting a culture of research and learning in the field of corporate governance, and facilitating success of business and economic growth.

It is premised on the rationale that the creation of a vibrant private sector is one of the many mechanisms that governments utilize to promote the growth of an economy. Over the last twenty years, Africa has become the world's most rapidly growing economic region as a result of the vibrancy of its private sector. Indeed, the success of a myriad of governments' development plans is partly dependent on the contribution of the private sector and state-owned corporations in creating opportunities for economic growth. The creation of wealth through investments, production of goods, and provision of jobs and services is a factor that is dependent on the efficient application of corporate governance practices. It is for this reason that the governance of corporations is considered to be as important as that of governments, as it equally drives economic growth and, in turn, enhances standards of living and poverty alleviation.

For Africa's economic growth to be sustained, policymakers, scholars and practitioners are required to devise sound policies and laws that will stimulate business growth and corporate resilience. It is the aim of the journal to feature articles that will contribute towards the creation of a competitive and dynamic framework for business that is sensitive to the need for: facilitating commerce and industry; reducing the speed and cost of setting up a business; removing unnecessary regulatory burdens for business; creating a competitive legal framework that attracts investors and protects their interests; taking care of the needs of small businesses; protecting the local industry; devising user-friendly, easily accessible, and flexible legislation; simplifying decision-making procedures; creating well-positioned and regulated securities markets; reinforcing the role of gatekeepers; treating shareholders equitably; enforcing shareholders' rights efficiently; intensifying corporate disclosure; improving audit and accounting standards; fortifying the efficiency of state-owned entities; promoting business continuity and recovery; creating a vigilant financial press etc.

The journal, which enjoys a broad readership amongst policy makers, corporate executives and scholars, makes significant contributions to knowledge creation and policy advisory. The journal welcomes submission of articles in the following broad parameters of corporate governance: board of directors; transparency and disclosure; accountability, risk management, and internal control; ethical leadership and corporate citizenship; shareholder rights and obligations; stakeholder relationships; sustainability and performance management; compliance with laws and regulations; governance of state owned entities; reform of the investment and corporate regulatory framework; corporate governance in times of crisis; comparative corporate governance; and theoretical foundation of corporate governance.

The journal welcomes the submission of articles on a rolling basis. All articles are peer reviewed before they are accepted for publication. Articles should be submitted to the ICS Research and Business Development Manager at research@ics.ke and reference should be made to the journal's editorial policy at https://www.ics.ke/downloads-center-2/category/7-governance-journal.

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Editor-in-Chief

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GOVERNANCE JOURNAL

Content	*Author*	*Page*
Corporate Ownership: A Critique of the Companies (Beneficial Ownership Information) Amendment Regulations 2022	*Jaffry Waqar*	1
The Extent to Which a Corporation is a Nexus of Contracts	*Deborah K. Sese*	18
Separation of Ownership and Control: A Catalyst for Corporate Failure in Kenya?	*Nathan W. Wamalwa*	31
Board Evaluations: Why they Matter and How they Should be Conducted	*Winny Cheptoo*	51
Is the Only Social Responsibility of a Business to Increase Its Profit?	*Jessica Mwenje*	60
The Corporate Veil: A Catalyst for Soulless Foreign Investments and Human Rights Abuses	*Husnah Julius*	75
Assessing the Level of Awareness of the CS Profession in Kenya	*Institute of Certified Secretaries (ICS) and Registration of Certified Public Secretaries Board (PCPSB)*	93

Corporate Ownership: A Critique of the Companies (Beneficial Ownership Information) Amendment Regulations 2022

***Jaffry Waqar*[1]**

"Unveiling the beneficial owners who control companies and other legal entities is necessary to determine where illicit funds are moving and who is moving them".[2]

Abstract

Corruption is a Kenyan problem just as it is a world problem. Company rooted corruption and money laundering have been an on-going debate warranting transparency and accountability in the public and private sector as well.[3] *Beneficial ownership transparency is an emerging jurisprudence that has highlighted the importance of corporate ownership in company law. While scholars continue to argue on the relevance or redundancy of the concept of ownership in the corporation,*[4] *the requirement of disclosure of beneficial owners incorporated into Kenyan legislation has come in to augment the concept of corporate ownership. This paper argues that demystifying corporate ownership is in fact vital for the recognition of beneficial owners of a company. In support of this argument, the paper will critically examine the new legislation, the Companies (Beneficial*

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[2] 'Illicit Financial Flow: Report of the High Level Panel on Illicit Financial Flows from Africa', *African Union Commission and United Nations Economic Commission for Africa,* page 81. *See also* Rachel Etter-Phoya, Eva Danzi and Riva Jalipa, 'Beneficial ownership transparency in Africa The state of play in 2020' (Tax Justice Network Africa, 2020), 8.

[3] Ken Mutuma, 'Addressing a National Crisis of Ethics: Starting with the Private Sector' (2020) 1 Governance Journal 1, 55.

[4] Virgile Chassagnon, Xavier Hollandts, 'Who are the owners of the firm: shareholders, employees or no one?' (2014) 10 JIE 1, 47.

Ownership Information) (Amendment) Regulations 2022 in order to assess the importance of beneficial ownership transparency. Lastly, the paper will interrogate the existing implementation mechanism and draws conclusions as to the way forward for better implementation.

1. Introduction

The dynamics of law have stimulated a recent development in Kenya's company law. The discussions around the relevance of corporate ownership are now of much greater significance following the introduction of beneficial ownership transparency. As the ultimate question remained; who really owns a company, the government eventually saw the need to publicly trace the 'natural person(s)' behind the activities of a company.[5] Through an amendment of the Companies Act no. 17 of 2015 by the Statute Law (Miscellaneous Amendment Act) 2019, the Companies (Beneficial Ownership Information) Regulations, 2020 (hereafter, the 2020 Regulations) was introduced.[6] Additional requirements were then made to the 2020 Regulations thereby facilitating the enactment of the Companies (Beneficial Ownership Information) (Amendment) Regulations, 2022 (hereafter, the 2022 Regulations).[7] The 2022 Regulations give effect to section 93A of the Companies Act which stipulates the mandatory requirement of every company to keep a register of its beneficial owners.[8]

It should be appreciated that, in line with global standards, Kenya is making an effort to strengthen transparency in its corporate world by the introduction of these regulations. Again, this step was motivated by the commitment towards Vision 2030 with specific emphasis on transparency, accountability, public participation and the much needed transformation

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[5] Edwin Baru, Aleem Tharani, 'Kenya: Beneficial Ownership Disclosure Requirements Expanded And Extended To Public Procurements And PPPS', (Bowmans law, 30 March 2022) <https://www.bowmanslaw.com/insights/infrastructure/kenya-beneficial-ownership-disclosure-requirements-expanded-and-extended-to-public-procurements-and-ppps/> Accessed 5 August 2022.

[6] Kenya Subsidiary Legislation, Legal Notice No. 12 of 2020, Companies (Beneficial Ownership Information) Regulations 2020 <https://brs.go.ke/assets/downloads/The%20Companies%20(Beneficial%20Ownership%20Information)%20Regulation%202020.pdf> Accessed 5 August 2022.

[7] Ibid.

[8] Companies Act No. 17 of 2015, s 93A.

of public procurement in Kenya.[9] It is not lost that beneficial ownership is a long established concept in company law.[10] Yet its disclosure is a rather recent global trend widely being probed by literature and its judicial developments gradually surfacing.[11]

As these regulations surrounding beneficial transparency are quite new to the Kenyan legal system, it is yet to unfold how they will shape case law, bearing in mind that disputes regarding compliance and related matters will inevitably emerge. Notably, identifying the beneficial owners of a company will assist in establishing the corrupt routes of companies by unveiling their anonymity. As a result, the enactment of 2022 Regulations is a remarkable step towards combating corruption and money laundering in the midst of increasing illicit financial flows in Kenya.[12]

The paper begins by briefly discussing corporate ownership as a relevant concept in company law and further elaborating the term the beneficial owner by drawing inferences from recent foreign judicial developments. This discussion then culminates in establishing the importance of beneficial ownership transparency and exploring the principles that guide it. The bulk of the paper is dealt with by the next section which outlines the salient provisions of the Regulations 2022. The paper then delves into the examination of the implementation mechanisms in place and the implications of the 2022 Regulations on individual rights. The conclusion sums up the discussion and proposes the way forward for effective implementation of the regulations.

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[9] Explanatory Memorandum to the Companies (Beneficial Ownership Information) (Amendment) Regulations 2022 <http://www.parliament.go.ke/sites/default/files/2022-03/The%20Companies%20%28Beneficial%20ownership%20information%29%2C%20amendment%20regulations%2C%202022.pdf> Accessed 5 August 2022.

[10] Pablo Porporatto, 'Who is all behind this? - The beneficial owner' *(Inter-American Centre of Tax Administration)* < https://www.ciat.org/who-is-behind-all-this-the-beneficial-owner/?lang=en> Accessed 5 August 2022.

[11] Bajpai Rajni, Myers C. Bernard, '*Enhancing Government Effectiveness and Transparency: The Fight Against Corruption - Alexandra Habershon, Solvej Krause and Zosia Sztykowski, Chapter 9: Beneficial Ownership Transparency*' (The World Bank, 2010) page 249.

[12] Transparency International Kenya, *'Illicit financial flows in Kenya',* (Global Financial Integrity, 2021) <https://gfintegrity.org/report/illicit-financial-flows-in-kenya/> Accessed 7 August 2022.

2. Corporate Ownership: A Concept Relevant to Beneficial Ownership Transparency

This paper does not intend to dig into the heart of the corporate ownership debate. However, it is noteworthy that the concept is crucially relevant in light of transparency and accountability in the corporate world. Therefore, the proceeding discussion mainly explores the concept of corporate ownership in relation to the beneficial owner.

The concept of corporate ownership is varied and corporate governance literature has argued for decades on the issue as to who actually owns the firm.[13] Ownership has been defined differently by various scholars. Consequently, the split in definitions has created the impression that corporate ownership is viewed differently.[14] For a long time, the contractarian theory had dominated the discussion on corporate ownership advancing the shareholder approach that suggests that shareholders are the ultimate owners of the company for the plain reason that they own shares.[15] This approach has been rejected as unrealistic and can arguably be stated to have plunged the concept of ownership into the relevant versus redundant rhetoric.

For instance, Fama expressively rejects the concept of ownership stating that, *"the firm is just the set of contracts covering the way inputs are joined to create outputs and the way receipts from outputs are shared among inputs. In this 'nexus of contracts' perspective, ownership of the firm is an irrelevant concept."*[16] In contrast, Milgrom, Roberts and MacPherson acknowledge the notion of corporate ownership in terms a "bundle of exclusive individual rights" with specific reference to the right to property.[17] More specifically, there are in place six attributes of ownership engraved in literature that help define ownership:

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[13] Virgile Chassagnon, Xavier Hollandts, 'Who are the owners of the firm: shareholders, employees or no one?' (2014) 10 (1) Journal of Institutional Economics, 47-69.

[14] Ibid.

[15] Ibid.

[16] Simon Learmount, John Roberts, 'Meanings of Ownerships of the Firm', (ESRC Centre for Business Research, University of Cambridge Working Paper No. 238, 2002) , 4.

[17] Ibid.

> *"The right to possess, implying exclusive physical control that is allowed by the resource, in addition to the right to non-interference;*
> *The right to use, entailing exclusive use and a duty on the part of others not to use without permission;*
> *The right to the capital, implying the power to dispose of and transfer title of the resource, which can be sub-divided into the right to alienation, consumption and modification;*
> *The right to manage, which includes the power to contract with others concerning control over uses of the resource;*
> *The right to security, including the right against expropriation, which qualifies the previous four attributes;*
> *The right to the income, that is the increased benefit accruing to the resource as a result of trade."*[18]

Admittedly, the concept of corporate ownership cannot completely be discarded simply because of the argument that shareholders are not the true owners of the company. Rejecting the notion of ownership would equally mean rejecting liability or accountability of the illicit actions of corporate business. While the above rights confer certain individuals the power to 'own' a company, the rights alternatively pose a duty to be held accountable for the illicit use of the company.[19] The Organization for Economic Co-operation and Development (OECD) Corporate Governance Working Paper No. 7 illuminatingly reports that apart from the protection of the interest of minority shareholders, corporate governance also aims at protecting the interest of other stakeholders of a company and the interest of the public in general.[20] This is where the interplay of disclosure of the owners of the business sets in in order to understand the complexity of corporate ownership structures.[21] The question therefore is not whether

[18] Ibid, 7.

[19] Eric Vermeulen, 'Beneficial Ownership and Control: A Comparative Study - Disclosure, Information and Enforcement' (OECD Corporate Governance Working Papers No. 7, 2013) <Beneficial Ownership and Control : A Comparative Study - Disclosure, Information and Enforcement | OECD Corporate Governance Working Papers | OECD iLibrary (oecd-ilibrary.org)> Accessed 17 August 2022.

[20] Ibid.

[21] Ibid.

the concept of corporate ownership is redundant (because it is not) rather the question becomes, who is the ultimate owner of the corporate firm?

2.1 The Beneficial Owner

As earlier stated, beneficial ownership is a long established concept, arguably tracing its origin in trust law and the era of the Crusades around the 12th Century.[22] During the Crusades, combatants would entrust their lands to certain individuals who would then cultivate these lands and pay taxes on their behalf until the land owners return from the war.[23] A two fold ownership concept emerged from this practice; the beneficial owner (the land owner) and the legal owner (the trustee; the assigned caretaker of the land).[24] However, the concept of beneficial ownership experienced an evolutionary change in early 1970s where it instituted its application in international tax law and, corruption and anti-money laundering laws.[25] Following this development, the concept of ownership is not only well known but greater focus is now accorded towards its transparency to fortify the fight against corruption and money laundering.[26]

In Kenya, the beneficial owner is defined by the Companies Act 2015 as the, 'natural person who ultimately owns or controls a legal person or arrangements or the natural person on whose behalf a transaction is conducted, and includes those persons who exercise ultimate effective control over a legal person or arrangement.'[27] Following the amendment of regulation 3 of the 2020 Regulations by the 2022 Regulations, the Regulations further give insight on the threshold of a beneficial owner

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[22] TPablo Porporatto, 'Who is all behind this? - The beneficial owner' *(Inter-American Centre of Tax Administration)* <https://www.ciat.org/who-is-behind-all-this-the-beneficial-owner/?lang=en> Accessed 17 August 2022.

[23] Ibid.

[24] Ibid.

[25] Tim Davies, Stephen B. Walker, Mor Rubinstein, Fernando Perini, *The State of open Data: History and Horizons* (African Minds, 2019), 55.

[26] Ibid.

[27] Companies Act No. 17 of 2015, s 3.

in stipulating that, 'it is a natural person who individually or jointly; (a) directly or indirectly holds at least ten percent of the issued shares in a company, (b) directly or indirectly exercises at least ten percent of the voting rights, (c) directly or indirectly holds the power to appoint or remove a director of the company and lastly, (d) directly or indirectly exercises significant influence or control over the company.'[28]

In determining who is the beneficial owner, the Canadian Tax Court in *Velcro Canada Inc. v Canada and Prévost Car Inc. v Canada,*[29] observed that the beneficial ownership concept reveals four attributes: possession, use, control and risk. Presumably, the attributes serve as a test of beneficial ownership,[30] in addition to the threshold listed in the 2022 Regulation. More importantly, the Court of Justice of the European Union also described the meaning of a beneficial owner in *N Luxembourg 1 v Skatteministeriet,*[31] with regards to relief from withholding tax on interest and royalties. The Court stated that a beneficial owner is one an entity which economically benefits from the interest received and has the power freely to determine its use.[32] Simply put, the beneficial owner is therefore the natural person who enjoys the use and assumes the risks and control of the assets of a corporate vehicle.[33]

2.2 Disclosure of the Beneficial Owner

It has been established that the beneficial owners are the individual or individuals that actually economically benefit from the activities of the company. So the disclosure of the beneficial owner of the company means that the law now requires company to keep a register of the

[28] Companies (Beneficial Ownership Information) (Amendment) Regulations 2022, regulation 3.

[29] *Velcro Canada Inc. v Canada* (2012) CA: Tax CC/CCI, *Prévost Car Inc. v Canada* (2008) TCC;231 further affirmed in *Prévost Car Inc. v Canada* (2009) FCA 57.

[30] Brian Arnold, 'Chapter 3: The Concept of Beneficial Ownership under Canadian Tax Treaties', page 46.

[31] *N Luxembourg 1 v Skatteministeriet* (2019) Case C-115/16.

[32] Ibid.

[33] Brian Arnold, 'Chapter 3: The Concept of Beneficial Ownership under Canadian Tax Treaties', <https://www.ibfd.org/sites/default/files/2021-06/Beneficial%20Ownership_Samplechapter.pdf> Accessed 17 August 2022.

beneficial owners of the company to enhance transparency and accountability in the corporate sector. Why the need for transparency? Anonymity of the beneficial owners allows companies to hide the master minds behind illicit transactions of the companies without having an appropriate mechanism for tracing these perpetrators.[34] It should be noted that the growing urge of disclosure beneficial ownership was triggered by the release of the Panama Papers in 2016, a staggering 11 million plus documents, whistleblowing illicit financial flows by several individuals as the anonymous beneficial owners of offshore entities registered as shell companies.[35]

The Kenya Power and Lighting Company (KPLC) scandal involving former CEO of the company, Samuel Gichuru, is illustrative.[36] As the beneficial owner of the Windward Trading Limited, a company registered in Jersey, Gichuru was able to obtain and hide proceeds of money laundering activities.[37] Although KPLC tendered contracts in Kenya to engineering and energy companies worldwide, payments for such contracts were instead made to the Jersey company, Windward Trading Limited.[38] What followed the incidences was a decade old investigation process and a series of litigation commencing at the Chief Magistrates Court, the first court of call on extradition matters. The legal tussle concerned the main issue as to whether the Attorney General or the Director of Public prosecution had the authority to proceed with the extradition; a clear manifestation of how law enforcement and the ends of justice can be delayed by a procedural technicality.[39] Finally, the

[34] The Secretariat of the Global Forum on Transparency and Exchange of Information for Tax Purposes, 'A Beneficial Ownership Implementation Toolkit', (Inter-American Development Bank, OECD 2019) page 14.

[35] Molli Ferrarelo, 'One year after the Panama Papers leak, starting a shell corporation in the US may be easier than getting a library card' (*Brookings Now*, 7 April 2017) <https://www.brookings.edu/blog/brookings-now/2017/04/07/one-year-after-the-panama-papers-leak-starting-a-shell-corporation-in-the-us-may-be-easier-than-getting-a-library-card/> Accessed 18 August 2022.

[36] 'Jersey confiscates £3.6 million proceeds of corruption', (Government of Jersey, 25 February 2016) <https://www.gov.je/News/2016/pages/jersey-confiscates-proceeds-of-corruption.aspx> Accessed 18 August 2022.

[37] Ibid.

[38] Ibid.

[39] *Director of Public Prosecutions v Okemo & 4 others* (Petition 14 of 2020) [2021] KESC 13 (KLR) (Crim) (5 November 2021) (Judgment) (with dissent - W Ouko, SCJ).

Supreme Court in *Director of Public Prosecutions v Okemo & 4 others* allowed the DPP to proceed with the extradition of Gichuru to Jersey for prosecution.[40]

Evidently, an open register of the beneficial owners of a company is important to identify the source of such illicit activities especially by the owners of shell companies.[41] These companies are characterized by zero operations and are sometimes registered as offshore companies in states that are preferred for their low corporate tax environment. The same goes for phantom firms which are secret companies operating to disguise the corrupt activities thereby siphoning money from the public domain.[42] The infamous 2003 Anglo Leasing case is a classic example of the involvement of a phantom firms in a major graft scandal.[43] Thus, the focal point in the disclosure of the beneficial ownership is to pave way for the following:

a) To increase financial transparency, integrity and accountability in the corporate sector, whether public or private
b) To combat corruption, money laundering, tax evasion and terrorism financing
c) To deter registration of shelf companies and phantom firms
d) To protect public interest
e) To promote the right of access to information
f) To facilitate ease of enforcement and implementation of the law

Although Kenya is not part of the Group of 20 countries (G20), equally noteworthy are their G20 High Level Principles on beneficial ownership transparency which states should endeavor to adopt in their beneficial ownership transparency legal framework.[44] These principles

[40] Ibid.

[41] King Carl Tornam Duho, Daniel Ninsin Quansah, Duke Ayim Agbozo, Gabriel Yonmearu, 'Beneficial Ownership as a Tool for Transparency in Corporate Ghana: An Introductory Piece', (Dataking Policy Brief 003, 2022), 1.

[42] Transparency International Kenya, *'Illicit financial flows in Kenya',* (Global Financial Integrity, 2021) <https://gfintegrity.org/report/illicit-financial-flows-in-kenya/> Accessed 21 August 2022.

[43] Ibid.

[44] G20 High-Level Principles on Beneficial Ownership Transparency, 2014 <https://www.mofa.go.jp/files/000059869.pdf> Accessed 21 August 2022

underscore the essential elements of beneficial ownership in order to enhance implementation of beneficial ownership disclosure. The principles enshrine that countries should:[45]

a) Define beneficial owner as the natural person(s) who ultimately owns or controls the legal person or legal arrangement.
b) Assess the existing and emerging risks associated with different types of legal persons and arrangement addressed domestically and internationally.
c) Ensure onshore maintenance of beneficial ownership information that is adequate, accurate and current.
d) Ensure that competent authorities have timely access to adequate, accurate and current information regarding the beneficial ownership of legal persons.
e) Ensure that trustee information is maintained accurately, adequately and the information is current.
f) Require financial institutions to identify and take reasonable measures to verify the beneficial ownership of their customers.
g) Ensure that their national authorities cooperate effectively domestically and internationally.
h) Support the efforts to combat tax evasion by ensuring that beneficial ownership information is accessible to their tax authorities.
i) Address the misuse of legal persons and legal arrangements which may obstruct transparency.[46]

3. Salient provisions of the Companies (Beneficial Ownership Information)(Amendment) Regulations 2022

The Explanatory Memorandum to the 2022 Regulations envisages that the Regulations will enhance the *"proper conduct of business in the registration and disclosure of beneficial ownership information".*[47] In

[45] Ibid.

[46] Ibid.

[47] Explanatory Memorandum to the Companies (Beneficial Ownership Information) (Amendment) Regulations 2022 <http://www.parliament.go.ke/sites/default/files/2022-03/The%20Companies%20%28Beneficial%20ownership%20information%29%2C%20amendment%20regulations%2C%202022.pdf> Accessed 21 August 2022.

amending the 2020 Regulations, the 2022 Regulations have introduced some key changes that aim at strengthening the beneficial ownership transparency framework in Kenya.

3.1 Defining the Beneficial Owner

The 2022 Regulations adopt the definition of a beneficial owner under the Companies Act 2015 and the 2020 Regulations verbatim.[48] It goes without saying that the definition is almost globally accepted and has been adopted by various jurisdictions in their legislations such as the G20 nations; a requirement provided by the G20 High Level Principles on beneficial ownership transparency.[49] Emphatically, the definition makes reference to a 'natural person' rather than a legal person. It can therefore be argued that the legislative intent behind the inclusion of natural person(s) as beneficial owners links the rights, duties and risks of such ownership to an identifiable human being rather than a legal person. Through this definition, ownership of a corporate firm can be traced to a single or set of individuals to ultimately economically benefit from activities of the company. The significance of transparency is therefore upheld right from the legislative definition of a beneficial owner.

In addition, by clearly describing a beneficial owner, the Act and the Regulations acknowledge and add relevance to the concept of corporate ownership. Corporate ownership in this regard is tied to the beneficial ownership notion thereby shutting down the controversy as to whether ownership in the corporation is redundant because it in fact is of substance. Through this definition ownership of a corporate firm can be traced to a single or set of individuals to ultimately economically benefit from activities of the company.

[48] Companies Act No. 17 of 2015, s 3.

[49] Legal Notice No. 12 of 2020, Companies (Beneficial Ownership Information) Regulations 2020. G20 High-Level Principles on Beneficial Ownership Transparency, 2014 <https://www.mofa.go.jp/files/000059869.pdf> Accessed 21 August 2022.

3.2 Threshold of a Beneficial Owner

Regulation 3(1) gives effect to section 93A of the Companies Act providing that every company shall keep a register of their beneficial owners.[50] The threshold of a beneficial owner are spelt out in terms of holder of: issued shares, voting rights, right to appoint or remove a director and finally, significant influence or control of a company. These elements form the criteria for determining a beneficial owner. The 2022 Regulations particularly amends regulation 3(2) which lists down the criteria for determining a beneficial owner expressively pointing out that such ownership can be held individually or jointly. The 2020 Regulations did not have the phrase 'individually or jointly' in its description of the beneficial ownership threshold for notification.[51] This change allows joint beneficial owners to be held equally accountable.

Further, both 2020 and 2022 pieces of legislation provide for the direct and indirect beneficial ownership. Indirect beneficial ownership therefore means that the natural person ownership is held through either a legal person, trust or even another individual.[52] The legislation is therefore alive to the fact that some companies may have a complex chain or structure of ownership. Regardless of this complexity, it appears that the legislation intended to pierce through the anonymity veil and identify the indirect beneficial owner.

3.3 Particulars Required for Disclosure

The 2022 Regulations provide that a company should enter in its register the particulars of a beneficial owner inter alia name, national identity number or passport number, nationality, phone number etc.[53] These particulars ought to be lodged at the Registrar of Companies vide Form BOFI.[54] Where there is a change these particulars, the company

[50] Companies (Beneficial Ownership Information) (Amendment) Regulations 2022, regulation 3(1).

[51] Companies (Beneficial Ownership Information) Regulations 2020, regulation 3(2).

[52] The Secretariat of the Global Forum on Transparency and Exchange of Information for Tax Purposes, 'A Beneficial Ownership Implementation Toolkit', (Inter-American Development Bank, OECD 2019) page 14.

[53] Companies (Beneficial Ownership Information) (Amendment) Regulations 2022, regulation 3(3).

[54] Ibid, regulation 3(5).

ought to lodge the change of particulars with the Registrar vide form BOF2.[55] Additionally, where a person ceases to serve as a beneficial owner, the company should file a notice to the Registrar on form BOF3.[56] The requirement for disclosure of particulars indicates the need to identify the beneficial owners and to be constantly updated of changes on the same, hence improving transparency as to beneficial owners' information. Disclosure of particulars further deters illicit financial flows and tax evasion since the personal details of the beneficial owner are known.

3.4 Duties of the Company

Remarkably, the Regulations relay the obligation to disclose upon the company, therefore instilling the spirit of transparency and accountability. Apart from the duty to keep and maintain a register of beneficial owners at the Registrar, the Regulations assign companies with additional rules on the duty to investigate, issuing a warning notice on non-compliance, restriction of interest of a person on non-compliance and notification of unidentified beneficial owners. Concerning the duty to investigate, the Regulations provide that a company, through a notice to the beneficial owners, should investigate and obtain particulars from any person it reasonably believes to be the beneficial owner(s) of the company.[57] Response to the notice should be made within twenty one days after which the company should issue a second notice, the warning notice to such persons.[58] Following lapse of fourteen days after non-compliance of the warning notice, a company shall then have the power to restrict such persons from the relevant interests they hold and further notify the Registrar of such restriction.[59] The effect of the restriction is that the individual(s) cannot exercise their rights as to the interests, transfer of interest is not permitted, no shares may be issued to the individuals nor payments in respect of the

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[55] Ibid, regulation 3(6).

[56] Ibid, regulation 3(7).

[57] Ibid, regulation 4(1).

[58] Ibid, regulation 5.

[59] Ibid, regulation 7.

interest held.[60] Once the notice is complied with after the specified, the company can withdraw the restrictions within fourteen days of compliance.[61] In the event the company has not been able to identify its beneficial owners following the above procedure, the company then has an obligation to note in its register stating the same.[62]

3.5 Disclosure of Beneficial Ownership Information

The 2022 Regulations makes an outstanding change in the disclosure of beneficial ownership information through the amendment of regulation 13 of the 2020 Regulations. Regulation 13(1) provides that companies were not permitted to disclose information regarding beneficial ownership except when communicating with the beneficial owner concerned or for regulations compliance purposes or court order compliance.[63] Initially, public disclosure of such information was also prohibited.[64] Thus, disclosure of beneficial ownership information was only to be made to a competent authority upon a written request by that authority to the Registrar.[65]

The amended regulation has now created room for greater transparency by including a new sub-regulation 2A notwithstanding the provisions of regulation 13(1) above.[66] The new regulation stipulates that a company can now disclose its beneficial ownership information to procuring entities and contracting authorities when participating in public procurement and asset disposal, and public private partnership arrangements respectively.[67] Alternatively, the procuring entity or contracting authority may make a request to the Registrar to obtain

[60] Ibid, regulation 9.

[61] Ibid, regulation 10.

[62] Ibid, regulation 11.

[63] Companies (Beneficial Ownership Information) Regulations 2020, regulation 13 (now amended).

[64] Ibid.

[65] Ibid.

[66] Companies (Beneficial Ownership Information) (Amendment) Regulations 2022, regulation 13(2A).

[67] Ibid.

beneficial ownership information of the said company.[68] Further, in the event a company is awarded a tender by a procuring entity, that company now ought to publish its beneficial ownership information and make it publicly available.[69] Lastly, in line with article 35 of the Constitution of Kenya on the right to access of information, the 2022 Regulations now makes disclosure of such information public, whereby the government has an expanded power to publish any beneficial ownership information relating to any company if such information affects the country.[70]

4. Hope for implementation

A history of graft scandals that had ensured a minority yet privileged set of individuals would benefit from public tenders has led to the need for enhanced transparency and fiscal integrity in Kenya.[71] The 2022 Regulations evidently tailors the current legal framework on beneficial ownership information towards global standards of transparency. While the intervention is being hailed for its developmental change in the corporate world for buttressing the concept of corporate ownership, the bone of contention lies in its effective implementation against the backdrop of conflicting rights and other compliance issues.[72]

At the outset, it cannot be gainsaid that the Regulations do make a commendable attempt to incorporate a self-compliance mechanism for companies to adhere to transparency requirements. The step by step notification process cutting across regulation 4 to regulation 11 demonstrate a self-compliance mechanism that is undeniably realistic and applicable in Kenya. The process ensures companies take the initiative to be transparent in their dealings. To further bolster enforcement of the

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[68] Ibid.

[69] Ibid.

[70] Ibid.

[71] Transparency International Kenya, *'Illicit financial flows in Kenya',* (Global Financial Integrity, 2021) <https://gfintegrity.org/report/illicit-financial-flows-in-kenya/> Accessed 21 August 2022.

[72] 'Kenya publishes additional regulations on beneficial ownership' (*Global tax news*, 27 April 2022) <https://globaltaxnews.ey.com/news/2022-5432-kenya-publishes-additional-regulations-on-beneficial-ownership> Accessed 27 August 2022.

provisions, the new legislation imposes a, *"Kenya Shillings Five Hundred Thousand fine for non-compliance and Kenya Shillings Fifty Thousand for each day of non-compliance."*[73] Furthermore, the disclosure can assist in ascertaining the ultimate beneficiaries of multi-million shillings tenders and whether such public tenders are rotating amongst a few unscrupulous entrepreneurs.

Nevertheless, when matters relating to the duty to disclose arise, the opposite right as to privacy similarly demands attention. The Regulations require disclosure of a beneficial owner's personal information.[74] Undoubtedly, the individual whose information is publicized may invoke his or her right to privacy under article 31 of the Constitution.[75] While the Regulations aims at promoting the right of access to information, the Government is simultaneously required to protect the privacy rights of individuals. The Constitution does contemplate limitation of the rights and fundamental freedoms under article 24 and sometimes the greater public interest and security concerns far outweigh individual rights.[76] It is with this in mind that the Government, in the Explanatory Memorandum to the 2022 Regulations, undertakes to ensure that the data processed with respect to beneficial owners is protected under the Data Protection Act 2019.[77]

5. Conclusion

In light of the foregoing, beneficial ownership has emerged as a crucial concept in unravelling the ownership structure of a company. Its disclosure therefore should continue to remain a priority in every business registration to promote open and accountable management of

[73] Ibid.

[74] Companies (Beneficial Ownership Information) (Amendment) Regulations 2022, regulation 3(3).

[75] Constitution of Kenya, 2010, article 31.

[76] *Nubian Rights Forum & 2 others v Attorney General & 6 others; Child Welfare Society & 9 others* (Interested Parties) [2020] eKLR.

[77] Explanatory Memorandum to the Companies (Beneficial Ownership Information) (Amendment) Regulations 2022 <http://www.parliament.go.ke/sites/default/files/2022-03/The%20Companies%20%28Beneficial%20ownership%20information%29%2C%20amendment%20regulations%2C%202022.pdf> Accessed 27 August 2022.

financial flow in the country. In response to the concerns raised regarding implementation and protection of rights, the beneficial ownership regime evidently has scope for improvement to better facilitate its objectives without compromising other vitally equal interests.

Firstly, as disclosure involves a corresponding activity of collection of data, this paper proposes that the Government should be guided by the principles of data protection under section 25 of the Data Protection Act and the rights of the beneficial owners of a company as data subjects pursuant to section 26 of the Act.[78] Secondly, it is a general rule that for every rule, there is an exception. However, in the case of the 2022 Regulations, the legislation at no point provides an exception to the publication of beneficial ownership information. This is not to say that the exceptions ought to be broad and all-encompassing but a circumscribed exception to the general rule on disclosure will permit limited instances where beneficial owners can raise the ground of serious violation of right to privacy. Through effective implementation of the rule of law, the Government may strive harder to strike a balance between the conflicting interests for want of transparency. Finally, beneficial ownership information transparency can support good corporate governance by curtailing illicit financial flows that has contributed to corrupt and poor corporate governance.

[78] Data Protection Act No. 24 of 2019.

The Extent to which a Corporation is a Nexus of Contracts

Deborah K. Sese[1]

Abstract

The place of corporate entities in the economy cannot be downplayed; indeed, with each passing day, more and more corporations are incorporated or registered, and it is very unlikely to find big ticket transactions being conducted by businesspersons in their individual capacities. Commercial transactions are characterized by 'angel investors', persons who basically give their money to businesses and walk away to only await financial gains on their investment. In fact, unique forms of corporations, such as private equity entities, are now more visible as investors in corporations which conduct various forms of businesses; most of these entities are not involved in the day-to-day operations of the corporations they invest in, but rather seek to enjoy some form of consent powers for purposes of protecting their interests. The question on the nature of a corporation is therefore very relevant, and at the core of this question is the debate on the corporation as a nexus or series of contracts.

Since the 19th century, there have been several theories on the nature of the corporation, ranging from considerations of the corporation as a mere assembly of natural persons whose existence cannot be separated from the corporation, the corporation as a legal entity separate and distinct from its shareholders or members as determined in the locus classicus Salomon v Salomon & Company, the corporation as a creation of the state and the corporation as a product of private bargains among individuals. The theory on the corporation as a product of private bargains was adopted by neo-classical economic theorists who argued for anti-regulation and shareholder

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benefit as the core tenets of freedom of contract. The argument for anti-regulation stems from the era when states regulated who could form a corporation and emphasis on what social problems the corporation sought to solve to warrant grant of a charter to operate and should therefore not be confused to mean that the proponents shunned away from any kind of regulation of their operations. The debate on the corporation as a tool of private bargains, now coined as the corporation as a nexus of contracts is still alive and evident in various commercial litigation proceedings and decisions. This article seeks to explore the development and validity of this concept, which may also be referred to as the 'contractarian theory of corporations.' It also seeks to elucidate to the reader other relevant discussions regarding the nature of the corporation as a creation of the state, the corporations as a product of trust law and the corporation as a natural entity born of the minds of individuals who come together to conduct business.

1. Introduction

A contract is defined as an agreement between or among parties creating mutual obligations that are enforceable by law. The elements of a valid contract include offer and acceptance, consideration, legality and capacity.[2] A corporation on the other hand is defined as a legal entity, incorporated with the purpose of doing business and creating profit, and is distinct from its owners. The argument that a corporation is a nexus of contracts was first formulated in *'The Theory of the Firm-Managerial Behaviour, Agency Costs and Ownership Structure'* by Michael Jensen and William Meckling in 1976. The argument attempts to explain that ultimately, a corporation represents a set of reciprocal arrangements that have been agreed upon among the owners of the corporation, the directors and the managers, the suppliers, investors and other persons who deal with the corporation with a view to making profit. The concept borrows from the arguments on shareholder benefit as the primary concern in the operations of a corporation, but also introduces an economic analysis of the existence of a corporation. This article will discuss the extent to which a corporation is a nexus of contracts, departing from the history of the conception, its development and justification, criticisms against the concept and an analysis of the extent to which it is true or unsatisfactory.

[2] Miceli J. Thomas, *The Economic Approach to law*, (Stanford University Press 2017).

2. History

In 1937, Ronald Coase argued that activities will only be included within a firm if the costs of contracting in the market are higher than the costs of direction by authority. He stated that outside the firm, the movement of prices directs production which is coordinated through a series of exchange transactions in the market. Within the firm, these market transactions are replaced by the directions of an entrepreneur coordinator or a manager.[4] The basis of Coase's argument was that some economic activities take place within firms such that they are directed by authority, while others take place across markets, such that they are determined by contract. His argument was based on the cost analysis of decisions, which is seen in the Coase Theorem on consideration of transactions costs in bargaining. This article will analyse whether this argument is valid, as shareholders would in their individual capacities contract in the market, but for some benefits based on efficiency, both legal and economic.

In 1972, Armen Alchian and Harold Demsetz objected to Coase's arguments, stating that it is a delusion to see the firm characterised by the power to settle issues by fiat, authority or disciplinary action that is superior to that available in the market.[5] They posited that the forces in the market are not any different from those within a firm- that in the market, where there is breach of contract, punishment takes the form of withholding future business or seeking redress in the courts. Within a firm, an employer imposes punishment for lack of performance by terminating the employment relationship or seeking legal redress. They instead argued that the difference between a firm and the market is the utilization of team input, agreement and monitoring within the firm, hence a corporation is a nexus of contracts but with agreement on management, whose role is to oversee the voluntary negotiations among the various actors who participate in the business activities of the firm.[6]

[3] Ronald H. Coase, The Nature of the Firm (1937). <https://onlinelibrary.wiley.com/doi/full/10.1111/j.1468-0335.1937.tb00002.x> Accessed 19th August 2022.

[4] Ibid.

[5] Armen A. Alchian & Harold Demsetz *Production, Information Costs and Economic Organization* (The American Economic Review 62(5) 1972). <https://www.jstor.org/stable/1815199> Accessed 26th August 2022.

[6] William W. Bratton, *The Nexus of Contracts Corporation* (The Cornell law Review 1989) <https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=3409&context=clr> Accessed 29 August 2022.

Jensen and Meckling agreed with Armen Alchian and Harold Demsetz but noted that the argument on team input in production was not exhaustive. On their part, they argued that contractual relations are the essence of the firm, not only between employees and employers but also among suppliers, creditors or financiers and customers. This is where the conception that the firm is a nexus of contracts originated; that *'most organizations are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals.'*[7] Whether this concept revives the argument of a corporation as a legal fiction, a mere aggregate of natural persons who have privately agreed to conduct business is a point of consideration.

3. Justification

3.1. A Corporation as a Bundle of Contracts

It has been argued that corporations are only a guise in which cooperating individuals act; that they are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals.[8] This argument, which may be summed up as 'corporations represent or are simply a bundle of contracts' holds water when one considers how a corporation operates. Before an entity is incorporated, the interested persons come together and agree that they wish to incorporate an entity to conduct certain business with a view to making profit. In sole corporations, this is still the case as the individual puts his ideas together and decides to incorporate an entity. Once there is a meeting of the minds, the person(s) instructs a representative to advice on and assist with incorporation. In some instances, these persons will enter into a shareholders' agreement or a joint venture agreement as relevant to the desired business. Such an agreement is a contract and is binding among the shareholders. The parties also agree on the terms of the articles of association or the constitution of the corporations (in the instance of a company) or other form of statutory document required as

[7] Michael C. Jensen &William H. Meckling, *The Theory of the Firm-Managerial Behaviour, Agency Costs and Ownership Structure'* (Harvard Business School, 1976) <https://www.sfu.ca/~wainwrig/Econ400/jensen-meckling.pdf>

[8] Easterbrook, Frank H. & Daniel R. Fischel, Limited Liability and the Corporation (1985) 52 (1) University of Chicago Law Review, 89–117.

per the laws of that jurisdiction. The articles of association are binding as between the corporation and the shareholders and regulate (in addition to and subject to the relevant statute), how the affairs of the corporation are conducted. The process of incorporation or registration on its own demonstrates that the assertion that a corporation is a nexus of contracts is true. Once the corporation commences its operations, it acts on behalf of its shareholders and enters into contracts with various persons including financiers, suppliers, managers and employees to ensure that the business desired by the shareholders is carried out and that they make profits. The shareholders appoint directors, who act as the brains and hands of the corporation. The directors have obligations (in both common law and statute), which they must perform, and where they fail to do so, both the shareholders and the corporation have remedies against them. The directors are also authorised to appoint a management team consisting of persons experienced in the corporation's area of business to oversee the day to day running of the corporation. It is therefore evident that at every level, there is some form of contract being entered into by persons authorized to act on behalf of the corporation.

3.2. Decision Making in a Corporation

In a contract, parties are free to make decisions that reflect or would best achieve the desired results. In a corporation, shareholders also enjoy this freedom, albeit within the regulations or provisions of the governing statutes, the constitution of the corporation and any private agreements among them such as a shareholders' agreement. While some authors argue that such regulations are a hurdle to the concept of the corporation as a nexus of contracts, decision making ultimately rests with the shareholders and in some instances, the directors who are duly authorised to act on behalf of the company. The provisions of the governing statutes and regulations only serve to give direction on how matters should be run and to protect the interests of the shareholders (and minority shareholders), provisions which cannot be comprehensively included in an agreement. Moreover, the fact that persons agree to incorporate an entity under the laws of a specific jurisdiction implies that they agree to be bound by the provisions of the

governing statute, and where they intend to exclude some provisions (which can be excluded as per that law), they do so in the articles of association or constitution of the corporation. The proponents of this concept argue that to the extent that there is any need for legislation, its objective should be to provide mandatory contract returns that are designed to mitigate or lessen agency costs.[9] The proponents of anti-regulation of corporations also sought to dismiss the corporation as a fiction or a legal person, and argued that the corporation is a natural entity as it is a product of private individuals who have chosen to do business together. As such, the formation of a corporation should not be the basis for subjecting the financial interests of these individuals to laws that would otherwise not apply if they conducted the same business in their individual capacities.

Ultimately, the shareholders of a corporation, even where they have appointed directors to make certain decisions, remain the true parties to any contract that the corporation enters into as they are the only residual parties that bear the costs of agency risks, thus validating the concept that a corporation is a nexus of contracts.

3.3. The Place of a Corporation in Economic Relationships

It is undeniable that corporations are formed with the purpose of doing business and making profit. Armen Alchian and Harold Demsetz posit that the mark of a capitalistic society is that resources are owned and allocated by non-governmental organizations such as firms and productivity is increased through cooperative specialization.[10] While there is a difference between how a corporation carries on its business and how an individual would conduct the same business, they both occupy the same position in the market, at least from the point of view of the consumers. The individual businessperson is replaced by

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[9] David K. Millon, *Theories of the Corporation* (Washington and Lee University School of Law, 1990).

[10] Armen A. Alchian & Harold Demsetz, *Production, Information Costs and Economic Organization* (The American Economic Review 62(5) 1972). <https://www.jstor.org/stable/1815199> Accessed 26th August 2022.

a corporation, but the difference is that within a corporation there is a team utilization of inputs and a centralized contractual agent.[11]

If shareholders could conduct the business in their individual capacities, they would, but they form a corporation for purposes of some benefits for instance with regard to taxation and also to maximize efficiency with regard to expertise and production, risk allocation and limitation of liability. On the part of consumers or persons who enter into business relations with a corporation, their interests are better protected as compared to if they did business with individuals. This is because the life period of a corporation is not dependent on the founders; a corporation would still exist even where the founding shareholders are deceased, more so where there is a succession plan in place. As such, persons who contract with corporations can still enforce their rights against a corporation despite the death of its shareholders. This is not the case where contracts are entered into with individuals, as performance mostly depends on the individual party being alive.

In essence, a corporation is a special purpose vehicle for contracting and doing business, and its place in economic relationships is critical as it ensures continuity despite the death or incapacitation of the members of a corporation.

4. Criticisms against the Concept

a. Ownership of the Corporation

The concept of corporations as a nexus of contracts does not take into consideration the ownership of the corporation by its shareholders. The relationship is viewed as contractual, where shareholders are viewed as a mere but different group of suppliers to the corporation. This argument cannot be entirely true, as shareholders, by virtue of their ownership of the corporation, bear the costs of agency risks and in case of insolvency, they may be the biggest losers as they rank lowest in distribution of the corporation's assets or proceeds of the sale of those assets. The same applies to when the corporation is performing

[11] Ibid.

optimally, and the shareholders are the biggest beneficiaries in terms of sharing in profits. In fact, according to Milton Friedman, the only responsibility of the (employees) of corporations is to fulfil the wishes of the owners, whatever those wishes may be.[12]

In practice, any person or other corporations may enter into contractual relationships with a corporation, and where there is breach of contract, their redress would be in damages, specific performance, rescission and restitution.[13] On the other hand, shareholders, being the owners of the corporation, would enjoy some remedies against the company which are ordinarily not available to persons who are not shareholders such as the right of minority shareholders to institute unfair prejudice petitions based on conduct of the company that unfairly prejudices them.

Further, shareholders have limited liability (limited to the unpaid amount on the shares they hold), while the liability of contracting parties is based on the obligations outlined in contract. When a corporation is wound up, shareholders would not be prioritised with regard to distribution of assets, while creditors who contracted with the corporation would be prioritized. In essence, ownership by shareholders, which carries significant risks (and benefits) cannot be downplayed in favour of the argument for contract as the basic means of operation by a corporation. According to Jonathan Macey, if the argument that the corporation or the firm is not an entity but a set of contracts is accepted, then the organization is broken down into groups of identifiable participants including managers, employees, suppliers, investors etc. who negotiate among themselves. The consequence of this is to deny that any of these persons have a right to claim ownership of the property in the corporation.

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[12] Richard N. Langlois, "The Corporation is not a nexus of contracts: it's an iPhone" (2016). <https://www.researchgate.net/publication/317997558_The_Corporation_is_Not_a_Nexus_of_Contracts_It's_an_iPhone> Accessed 19th August 2022.

[13] Steven Shavell, "The Design of Contracts and Remedies for Breach" (1984) 99 (1) Quarterly Journal of Economics. <https://www.nber.org/system/files/working_papers/w0727/w0727.pdf> Accessed 28th August 2022.

In addition, parties to a contract must actively be involved in discharging the obligations outlined in the contract. Shareholders of a corporation on the other hand, more so in the modern era where maximisation of value demands the separation of ownership and control, are mostly reduced to passive investors who have trusted professional managers with their economic interests.[14] Whether in this case the passive investor position occupied by shareholders is purely a child of contract is a point for debate.

b. The Corporate Entity as a Right in Rem

A right in *rem* is distinguished from a right in *personam* in that the former surrounds a thing that gives the possessor dominion or authority to exclude an indefinite number of unspecified persons[15] while the latter involves specific obligations between or among specified persons. It therefore goes that contract sits within rights in *personam* while property sits within rights in *rem*. The distinction between a corporate entity that conducts business and other types of entity that conduct business is ownership, limitation of liability and recognition as a legal person with features such as the ability to sue and be sued in its name and entering into contracts in its name. As aforementioned, a corporation is a product of consensus ad idem among persons who agree to incorporate an entity which will act on their behalf. Therefore, while this consensus is characterised by contract, the underlying factor is ownership of that entity. As such, to the extent that the corporation will coordinate various contracts as it conducts business on behalf of the owners, the argument that a corporation is a nexus of contracts is true. However, when one considers the basis of agreement to incorporate, then the issue of property in rem arises. Richard N. Langlois argues that the corporate entity borrows from the concept of property rights and not from the role as a nexus of contracts.[16] As such, while contract

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[14] David K. Millon, *Theories of the Corporation* (Washington and Lee University School of Law, 1990).

[15] Armen Alchian, *Some Economics of Property Rights* (1965) 30 (4) Politico 816. <https://www.sfu.ca/~allen/AlchianPR.pdf> Accessed 26th August 2022.

[16] Richard N. Langlois, *The Corporation is not a nexus of contracts: it's an iPhone* (2016). <https://www.researchgate.net/publication/317997558_The_Corporation_is_Not_a_Nexus_of_Contracts_It's_an_iPhone> Accessed 19th August 2022.

(and contract law) heavily informs the existence and operations of a corporation, a corporation is not purely a nexus of contracts.

c. The Ambiguities of the Concept

Lewis A. Kornhauser argues that the concept of corporations as a nexus of contracts represents ambiguities as it sometimes relies on appeal to legal authority and rules of contract law, other times it relies on moral authority based on the consensual decisions of independent actors, while at times it relies on the theory of utilitarianism, demanding that interpretation and judgment should be based on what best promotes the interests of the parties to the contract.[17] Lewis A. Kornhauser further criticises the concept by positing that the argument, as put by Judge Easterbrook and Professor Fischel, offers three formulations of the rule of construction. One of these instructions is to maximize joint wealth. The other two, which he argues are not clear, include the instruction to duplicate the terms that the parties would have selected in the joint interest if they had contracted explicitly and the instruction to fill gaps with the terms that the parties would have chosen if they wished and if the costs of negotiating were worthwhile in the light of the stakes.[18] He argues that this amounts to a selection of the rules of construction or interpretation that a judge should adopt; in contract law the court should respect the agreement among the parties and respect the terms of a legally enforceable contract. In the context of the corporation or corporate transactions, he argues that the 'agreement' is generally unwritten, and the concept of the contracts approach seeks to construct an agreement out of the interests of the parties concerned, hence the need to select the rule of construction that a court should adopt, which is in any case inconsistent.

[17] Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel* (Columbia Law Review, Vol. 89, No.7, Contractual Freedom in Corporate Law 1989). <https://www.semanticscholar.org/paper/The-Nexus-of-Contracts-Approach-to-Corporations%3A-A-Kornhauser/141ce1855bedebe420f5a288e4e0b1ebe8211299> Accessed 19th August 2022.

[18] Ibid, 1451-1452.

d. The Mandatory Rules of Corporate Law

Several authors have argued that the concept of the corporation as a trust has been replaced by that of the corporation as a nexus of contracts. The law of trusts imposes certain mandatory duties including the fiduciary duties of loyalty and care on the directors of a corporation. In contract law on the other hand, the parties are free to negotiate on the terms of contract, and it is well known that an 'ideal' contract, which presupposes all eventualities, does not exist. As such, the cost of negotiating all the terms is too high, and the parties would desire a set of mandatory rules which protect them in case of unforeseen eventualities. This then implies that the metaphor of the corporation as a trust, based on fiduciary roles for the benefit of the beneficiaries, is still valid, even to the concept of the corporation as a nexus of contracts.[19] While the common law duties of directors (which were heavily based on trusts law) have been codified in most jurisdictions, the common law rules are still heavily cited and relied on in enforcing the duties of directors. Even where the directors have entered into a contract with the corporation, their fiduciary duties are still applicable, and they must perform them even where not expressly provided for in the contracts.

5. Conclusion

In conclusion, the corporation is heavily a product of private negotiations among individuals who agree to incorporate an entity with a separate legal personality to conduct business with a view to making profit. The process of incorporation is grounded on both contract and regulation, and the operations of a corporation are largely based on contract. Further, the main objective of corporate law is to protect the interests of shareholders which is evidenced by numerous provisions including but not limited to providing for the duties of directors, provisions on protection of minority shareholders and provisions on decision making by shareholders. As is evident, such provisions are not concerned with the rights of third parties, who must specifically contract with the corporation where they have interests in order for some of the laws such as laws on insolvency to apply to them.

[19] Ibid, 1457-1460.

However, there are provisions or laws aimed at protecting the public from any harmful business practices of corporations; they cover environmental, social and governance matters. Some of these laws are mandatory for listed entities while others are a matter of good practice to enhance sustainability of business operations. This points to the fact that a corporation is not purely a nexus of contracts as some obligations owed by the corporation to the society are not based on contract.

Additionally, the argument that a corporation is a creation of the state may also hold water when one considers the process of incorporation or the process undertaken when the members or directors of a corporation wish to effect some changes with regard to ownership, directorship or the incorporation documents of the entity. A change of directors must for instance be approved by the state (through the relevant offices) when it comes to both resignation and appointment. A change of shareholding is also regulated by the state, which is the custodian of the register of members of a corporation that is available to the public on payment of prescribed fees. Mandatory rules on shareholding and directorship are also dictated by the state, and a corporation can only come into existence if the state approves its incorporation. Similarly, during liquidation, the state is involved through the courts and a corporation can only be dissolved once the state approves.

Further, while in contractual relations the doctrine of privity of contract is key and persons who are not parties cannot claim, some areas of business laws may rightfully claim from the actions or inactions of corporations which are parties to a contract. A good example is the competition law regulators who have a right to investigate the conduct of corporations with regard to competition, and demand that such corporations subject their operations to approvals from the regulator for purposes of assessment of effects on competition. Where corporations do not adhere to such laws, the regulators impose fines or undertake other punitive actions, and the contracts entered into by these corporations are considered void hence unenforceable. If business was only conducted by individuals, perhaps competition laws would not have been birthed as market forces would easily put in check the business behaviour of these

individual businesspersons. However, the moment they come together to form an entity to conduct business on their behalf, then the state comes in to regulate their behaviour in the market.

In essence, the corporation is a nexus of contracts that incorporates aspects of the law of trust, social responsibility and its nature as a creation of the state cannot be ignored.

Separation of Ownership and Control: A Catalyst for Corporate Failure in Kenya?

Nathan W. Wamalwa*

1.0 Introduction

The term "separation of ownership and control" typically refers to a corporate phenomenon that is attributed to publicly traded business enterprises in which the shareholders, who are frequently referred to as the residual claimants, have little to no direct control over management choices in that enterprise. Separation of ownership and control makes a distinction between those in charge of running the business, the managers, and the financiers, the shareholders or owners. As a fundamental component of corporate governance, this phenomenon has existed at least since Adam Smith's time. In *The Wealth of Nations,*[1] Smith, while writing on joint-stock companies, observed that:

> *The directors of such companies ... being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour and very easily give themselves a dispensation from having it....*[2]

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[1] See Adam Smith, *Wealth of Nations* (1st edn, Methuen & Company Limited 1776), 575.

[2] Ibid.

Jensen and Meckling acknowledge the existence of separation of ownership and control in their work by highlighting the crucial role that separation of ownership and control play in the agency theory and the use of agency cost to address the agency problem brought on by the conflict of interest.[3] The underpinning theory's is primarily the agency problem, which entails the fact that key decision-makers in an organization are protected from taking the higher risk of the decisions they make. In designing, overseeing, and bonding contracts, an organization is seen as a nexus of interconnected contracts from which agency costs emerge. Controlling agency problems during the decision-making process is crucial to preventing decision-makers from making choices that do not benefit risk-takers.[4]

This theory could also be compared with the shareholder theory, which holds that the management of a firm has a fiduciary duty to the shareholders and that they must take the interests of the shareholders into consideration while exercising their authority.

1.1 Ownership Structure

In his book, Zhuang contends that the ownership structure plays a significant role in determining the corporate governance framework of any nation.[5] This is because the ownership structure directly affects how the agency problem is addressed. Specifically, whether the main conflict is between shareholders and managers or between minority and controlling shareholders. Therefore, Zhuang identified concentration and composition as two crucial elements of company ownership structure. He contends that a company's level of ownership concentration determines the balance of power between its shareholders and managers.

[3] Michael C. Jensen, and William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure', (1976) 3 *Journal of Financial Economics*, 305-360.

[4] Eugene F. Fama, and Jensen C. Michael, 'Separation of Ownership and Control', (1983) 26 Journal of Law and Economics, 301-325.

[5] J. Zhuang, (1999). *Some Conceptual Issues of Corporate Governance*. EDRC Briefing Notes Number 13 [Online] Available at: www.adb.org/Documents/Books/Corporate_Governance/Vol1/chapter2.pdf

1.1.1 Dispersed Ownership

Shareholding control is typically weak in dispersed ownership due to inadequate shareholder monitoring. A small shareholder, for example, is unlikely to be interested in monitoring because they would be responsible for all of the costs and only receive a small percentage of the rewards.[6] This raises the question of what might happen if all small shareholders act in this manner. In that case, managerial efforts wouldn't be monitored.

1.1.2 Concentrated Ownership

Large shareholders would be crucial in monitoring the management activities of the company when ownership of the company is concentrated. The main issue with this style of ownership, according to Zhuang, is how minority shareholders would be shielded from abuse by controlling shareholders who might act against their best interests.[7]

Second, ownership composition seeks to define the shareholders and identify those who belong to the controlling groups. On the basis of this, it is largely assumed that better overlap between ownership and control should, in fact, result in fewer conflicts of interest and, as a result, greater corporate value.[8]

1.2 Corporate Control.

Corporate control is defined as the set of rules and policies established by the management of a company to regulate its operations and effectively manage the company's resources in order to increase a company's value and maximize shareholders' returns.[9]

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[6] Ibid.

[7] Ibid.

[8] C. G. Holderness, (2009). The Myth of diffuse ownership in the United States. Review of Financial Studies, 22(4), pp.1377- 1408. doi:10.1093/rfs/hhm069, available at: http://dx.doi.org/10.1093/rfs/hhm069.

[9] K. Keasey, & M. Wright, (1993). Issues in corporate accountability and governance. *Accounting and Business Research*. 23 (91a), 291-303.

Companies with effective corporate control procedures draw more investors, allowing them to optimize their capital structure by securing less expensive financing, hence maximizing returns to shareholders. The separation between control and ownership, according to Berle and Means,[10] is directly proportionate to the size of the organization and inversely related to equity ownership, thus increasing agency costs. This results in agency conflict as management starts to pursue selfish interests contrary to those of shareholders.[11] The management's general inefficiency, theft of funds, and investments in less profitable portfolios are the cause of the agency costs. Through adequate oversight and governance, corporate control practices increase a company's efficiency and effectiveness, reducing agency conflicts and aligning management's interests with those of investors in order to maximize corporate value.[12]

In Kenya, we have seen a number of banks fail, including Chase Bank, Dubai Bank, and Imperial Bank. Similar operational issues have recently occurred at the National Hospital Insurance Board, Uchumi, and Nakumatt Supermarkets, as well as Kenya Airways', continuing huge losses and constant government bailouts of Kenya Airways, among others.

2.0 Challenges of Enforcing a Strict Regime of Separation of Ownership and Control.

2.1 Agency Problem.

Adam Smith considered the separation of ownership and control to be problematic since managers in such businesses would not have the same incentives to run the company as owner-managers, leading to inefficient operations.[13] Following Adam Smith, Jensen and Meckling

[10] A.A. Berle Jr, and C. Gardiner, (1932), *The Modern Corporation and Private Property, New York,* MacMillan.

[11] Ibid (n 3).

[12] A. Shleifer, & R. W. Vishny, 'A Survey of Corporate Governance' (1997) 52 (2) Journal of Finance 737, 783.

[13] Ibid (n 1).

classified the separation of ownership and control as an agency problem.[14] In the agency model, managers are fashioned as agents and shareholders as principals. In this approach, agents seek to maximize personal utility. How to give the agent incentives to encourage behavior that will benefit the principals and shareholders is the problem. Agency analysis examines the costs associated with providing such incentives as well as the costs related to how far agents will still deviate from the principal's interests even in the presence of such incentives. Therefore, the costs associated with the separation of ownership and control are the usual principal-agent costs: the costs associated with monitoring by shareholders, the costs associated with bonding by managers, and the residual loss from the divergence of behavior (even with monitoring and bonding) from the ideal.

2.2 What is an Agency Problem?

In the broadest sense, an "agency problem" occurs whenever the welfare of one party, referred to as the "principal," depends on actions taken by a different party, referred to as the "agent." The challenge is getting the agent to behave in the principal's best interests rather than just their own.[15] When seen in this wide sense, agency problems occur in a variety of situations that go far beyond those that lawyers would expressly classify as agency relationships.[16]

In business firms, three generic agency problems arise. The first is a conflict between the business's owners and its hired managers. In this situation, the managers are the agents and the owners are the principals. The challenge is ensuring that the managers are receptive to the owners' interests rather than pursuing their own personal interests.[17]

[14] Ibid (n 11).

[15] John Armour, Henry Hansmann, and Reinier Kraakman, Agency Problems, Legal Strategies, and Enforcement (Harvard John M. Olin Discussion Paper Series, No. 644, July 2009). Available at: http://www.law.harvard.edu/programs/olin_center/.

[16] Ibid.

[17] Ibid.

The second agency problem involves the conflict between, the majority or controlling owners of the company, on the one hand, and the non-controlling or minority owners, on the other. In this situation, the non-controlling owners can be viewed as the principals and the controlling owners as the agents. The challenge is preventing the expropriation of the former by the latter. While this issue is most evident when there are conflicts between majority and minority shareholders,[18] it also arises whenever a small group of a company's owners has the power to influence choices that have an impact on the class of owners as a whole. In light of this, a species of the second agency problem may arise if minority shareholders have the power to veto specific decisions. Ordinary and preferential shareholders, as well as senior and junior creditors in bankruptcy, may experience similar problems in situations when creditors are the owners of the firm.

The third agency problem entails a conflict between the company's owners and other parties the company contracts with, such as creditors, employees, and clients. The challenge in this situation is ensuring that the firm, acting as an agent, does not act in an opportunistic manner toward these many other principals, such as by expropriating creditors, exploiting employees, or deceiving customers.

In each of the aforementioned agency problems, it is more difficult to guarantee agents' responsiveness when there are several principals, particularly when those principals have divergent objectives. Costs associated with coordination will prevent several principals from engaging in collective action.[19] These will then have two different interactions with agency problems. First, the inability of the principals to coordinate will force them to hand over more of their decision-making to agents.[20] Second, it becomes increasingly difficult to verify

[18] See, Luca Enriques and Paolo Volpin, 'Corporate Governance Reforms in Continental Europe', (2007) 21 Journal of Economic Perspectives 117, 122

[19] James M. Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (University of Michigan Press, 1962), 63-116.

[20] Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law*, (Harvard University Press, 1996), 66.

that the agent does the most appropriate thing.[21] since principals find it harder to coordinate on a single set of objectives for the agent. Agency problems are, therefore, made worse by coordination costs between principals.

When it comes to State-Owned Enterprises (SOEs) that are publicly traded, they often take the shape of a joint-stock corporation. Due to the corporate form, there are two main agency problems that arise: (1) between managers and shareholders (which is more severe if company ownership is dispersed); and (2) between controlling shareholders and non-controlling shareholders (which is more severe if company ownership is concentrated).[22] The relative strength and dimensions of these problems will depend on how the state behaves as an owner, but they do not go away and in fact, get worse when the state holds a significant amount of stock. The state is a distinctive type of owner. It is a political and economic entity unto itself, creating a further level of agency costs that could be referred to as "agency costs of state capitalism."[23]

Listed SOEs may have various problems depending on how the state conducts itself as a shareholder. SOEs may have managerial slack and managerial tunneling if the state who is the owner takes a passive or absentee role (i.e., theft of corporate assets). On the other hand, if the state actively participates as a shareholder, this might theoretically minimize management agency problems at the expense of raising the risk of abuse by the controlling shareholder.[24]

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[21] Hideki Kanda, 'Debtholders and Equity Holders' (1992) 21 Journal of Legal Studies 431, 440; Henry Hansmann, *The Ownership of Enterprise* (Harvard University Press, 1996), 39–44.

[22] Curtis J. Milhaupt & Mariana Pargendler, (2017) "Governance Challenges of Listed State-Owned Enterprises Around the World: National Experiences and a Framework for Reform," (2017) 50 (3) Cornell International Law Journal 473.
50: No. 3, Article 3. Available at: https://scholarship.law.cornell.edu/cilj/vol50/iss3/3

[23] Ronald J. Gilson & Jeffrey N. Gordon, 'The Agency Costs of Agency Capitalism Activist Investors and the Revaluation of Governance Rights' (2013) 113 Colum. L. Rev. 863.

[24] Ibid (n 21).

As a result, while the state's significant shareholder position may help to reduce managerial agency problems, it also provides a platform for corruption, political favoritism, and private benefits of control. The combination of these two layers of agency cost results in instances of alignment and misalignment between the interests of the general public and outside shareholders in listed SOEs.[25]

Shareholders and the public have a common interest in (1) raising management effort, (2) lowering managerial tunneling, and (3) preventing politicians from acting in a rent-seeking manner (from favoritism to outright corruption). However, mixed ownership also generates conflicts of interest between shareholders and citizens with regard to other dimensions, such as; (1) "policy channeling," which is the pursuit of social welfare or other non-financial policy objectives by governments through ownership of SOEs,[26] favouring citizens but not shareholders; (2) The awarding of subsidies to SOEs, which may interfere with the level playing field between SOEs and private businesses and restrain competition by favouring shareholders—not necessarily citizens—who pay for these subsidies; and (3) the state's appropriation of unequal financial benefits (which benefits citizens over shareholders, at least temporarily).

A multi-step process is involved in analysing the costs of the separation of ownership and control, including (1) articulating societal goals, (2) determining how managerial behaviour affects those goals, and (3) assessing institutional arrangements in terms of how they affect managerial behaviour and at what cost. In general, there are two causes for management behaviour that deviates from the ideal. The first is that managers may not be motivated to do so, which is also known as the moral hazard problem. The second is that managers might not be

[25] Ibid.

[26] See Curtis J. Milhaupt & Mariana Pargendler, RPTs in SOEs: *Tunneling, Propping and Policy Channeling, in The Law and Finance of Related Party Transactions Transactions* (Luca Enriques & Tobias Tro¨ger eds., forthcoming), Stanford Law and Economics Olin Working Paper No. 517, Stanford Public Law Working Paper, European Corporate Governance Institute (ECGI) - Law Working Paper No. 386/2018, Available at SSRN: https://ssrn.com/abstract=3119164.

able to do it (that is, managers may be incompetent). This is sometimes called the adverse selection problem.[27]

3.0 The Legal and Regulatory Framework on Corporate Governance in Kenya: An Overview.

In terms of listed firms, security exchanges are essential to corporate regulations that strive to maximize efficiency. In Kenya, the regulatory agency in charge of making sure corporate governance principles are followed is the Nairobi Securities Exchange (NSE), which was established to address any shortcomings that may arise. Although the NSE has largely succeeded in achieving its goals, a number of the NSE-listed companies continue to face fiscal and control difficulties as a result of dispersed ownership structures brought on by the public offering of shares, high debt levels as a result of rising agency costs, and corporate control failures as a consequence of inadequate monitoring.[28]

3.1 The Constitution

The Kenyan Constitution, which is the country's supreme law, contains a number of provisions that support corporate governance in the administration of businesses and other entities. First, good corporate practices are encapsulated in article 10 of the Constitution of Kenya which provides for the national values and principles of governance that are binding to the state corporations and also private entities.[29]

3.2 The Companies Act 2015

This Act, which was signed into law on 11th September 2015 and came into force on diverse dates thereafter, modernizes Kenyan company law. Without a doubt, it is a culmination of years of efforts to transform Kenyan company laws.[30]

[27] Ian, Ayres and Peter, Crampton (1994), 'Relational Investing and Agency Theory', (194) 15 Cardozo Law Review 1033.

[28] R. M. Kiruri, (2013). The effects of ownership structure on bank profitability in Kenya. *European Journal of Management Sciences and Economics,* 1(2), 116-127.

[29] The Constitution of Kenya, 2010, Article 10(2).

[30] The Companies Act No 17 of 2015.

The most notable manner in which the Companies Act 2015 safeguards, shareholders, against the excesses of directors include the strengthening and enhancement of the duties of directors and the enforcement of the same.

3.2.1 General Duties.

These are what were formerly referred to as the common law duties of directors. In other words, these are duties that, before September 11th, 2015, were administered in accordance with English common law.[31]

The first of these duties is the duty to act within powers, which calls for a director to behave in accordance with the company's constitution and to only use their authority for the specific purpose for which it has been granted.[32] The second duty is to promote the firm, which requires directors to behave in a manner they believe to be in the best interests of all shareholders. Third, a director has a duty to prevent instances where their interests can conflict with those of the firm. This is especially important when it comes to the exploitation of any property, information, or opportunities. It does not matter if the business may benefit from the property, information, or opportunity.[33] These duties are legally enforceable, and anyone who violates them can be sued in court.[34]

3.2.2 Specific Duties.

First, directors must ensure that their interests do not conflict with those of the company.[35] This means that if a director has any kind of interest in a transaction or agreement that the company has entered into or is about to enter into, that director has an obligation to disclose that interest to the other directors and, in the case of

[31] They are set out in sections 140 to 150 of the Companies Act 2015.

[32] Companies Act 2015, section 142.

[33] Companies Act 2015, section 146.

[34] Companies Act 2015, section 148.

[35] Companies Act 2015, section 151.

a public company, to the company's shareholders. Second is the duty to obtain shareholders' approval before entering into certain transactions.[36]

3.3 The Capital Markets Act[37]

The Capital Market Act, Cap 485A[38] establishes the Capital Markets Authority (CMA).[39] The Act gives the CMA power to establish regulations aimed at enhancing corporate governance by Kenyan publicly listed companies. These companies are required to observe the CMA Guidelines.

To ensure accountable and responsible business operations among the listed businesses, the Capital Market Authority of Kenya (CMA) has set rules and regulations on governance practices. Although there has been some reasonable acceptance of corporate governance practice due to NSE and CMA's collaboration, it is still not widely used.

3.4 The Code of Corporate Governance Practices for Issuers of Securities to the Public 2015.

For the purpose of ensuring proper management, the code outlines the corporate governance standards for boards of directors. It emphasizes that excellent corporate governance is essential to promoting efficient and effective use of limited resources, improving accountability and performance of those charged with managing corporations.[40]

3.5 Mwongozo- The Code of Governance for State Corporations.

Mwongozo was released in 2015 as part of the parastatals reform agenda with the goal of ensuring the efficient, effective, and sustainable use of public resources while taking into consideration the evolving

[36] Companies Act 2015, section 158.

[37] Cap 485A, Laws of Kenya.

[38] Sections 11(3) (v) and 12.

[39] Chapter 5.

[40] See *The Capital Markets* Act Cap 486A: Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya. Gazette Notice No. 3362.

requirements of society.[41] It was created in order to address challenges with state corporations such as political interference and the Board's incompetence. The Code was created to help in establishing best practices for corporate governance in state corporations. Mwongozo addresses issues relating to the efficacy of the board, good corporate citizenship, accountability, internal controls, risk management, transparency and disclosure, and ethical leadership.[42]

3.6 The Code of Corporate Governance for Listed Companies 2016

This Code does not bind all companies in Kenya, but only those public companies whose shares are listed at an approved securities exchange. In order to increase the value of the shareholders' investment in the company, the Code of Corporate Governance for Listed Companies 2016 provides several recommendations and instructions on how boards of directors of corporations should handle their shareholders.[43] This Code does not, however, bind companies in general, and it is still up for debate as to whether or not shareholders can enforce it in court against irresponsible directors.

3.7 Nairobi Securities Exchange (NSE) Regulations

The Nairobi Securities Exchange (NSE) was initially registered as the Nairobi Stock Exchange under the Societies Act (1954), but later changed its name. The CMA has granted the NSE authorization to provide a trading platform for securities. The oversight of the trading companies is also necessary. It is also required to oversee the trading companies. Even after companies meet the qualifications for listing on the NSE; they are still required to observe some rules and regulations such as the NSE Market Participants (Business Conduct and Enforcement) Rules, 2014.[44]

[41] Mwongozo, The Code of Governance for State Corporations, 2015, 7.

[42] Ibid.

[43] See, Guidelines 2.1.1.(a), (b) and (c).

[44] Nairobi Securities Exchange Market Participants (Business Conduct and Enforcement) Rules.

However, some companies registered at the NSE continue to perform poorly and display fundamental weaknesses. While some of them are on the verge of failing,[45] others have already collapsed. The recent failure of Uchumi Supermarket Imperial Bank, Dubai Bank, and Chase Bank, as well as Kenya Airways' ongoing poor performance, among others, have somewhat undermined the public's confidence in the NSE's ability to regulate corporations. There is active debate as to whether the failure was caused by a lack of control, financial distress, ownership attributes, or a combination of these factors.

4.0 Collapse of Companies in Kenya

4.1 Dubai Bank.

On August 14, 2015, Dubai Bank Kenya Limited (DBKL, "Dubai Bank") was placed under statutory management by the Central Bank of Kenya (CBK), and Kenya Deposit Insurance Corporation (KDIC) was appointed as the receiver-manager in accordance with the 2012 Deposit Insurance Act.[46] Concerns with the bank's functioning had been brought up. The late Jacob Juma, one of its customers, raised several critical issues. Jacob Juma alleged many instances of fraud against Dubai Bank in a letter dated March 17, 2015, and submitted to the CBK. However, its downfall was a progressive one, heavily attributed to egregious violations of the banking laws by its directors.

On August 24, 2015, KDIC presented a report to the CBK on Dubai Bank's financial position, stating that it was beyond recovery and that liquidating the bank was the best practical course of action given its dire conditions.[47] It was revealed that the bank's daily cash reserve ratio was being breached because of its capital and liquidity challenges. Ultimately, the bank was unable to meet its financial obligations as

[45] Dominic, O. O., & Memba, F. (2015). 'Effect of Corporate Governance Practices on the Financial Performance of Public Limited Companies in Kenya' (2015) 3 (1) International Journal of Management and Commerce Innovations 122, 132.

[46] Section 54.

[47] Robert N. Gathaiya; 'An Analysis of Issues Affecting Collapsed Banks in Kenya from year 2015 to 2016' International Journal of Management and Business Studies. Available at <http://www.ijmbs.com/Vol7/73/1-robert- n-gathaiya.pdf> Accessed 16 July 2022.

required by the Banking Act,[48] which forced the CBK to close it down. There were a number of factors contributing to this, including among others, failure to maintain adequate provisions for non-performing loans, and poor corporate governance.

Following the receivership of Dubai Bank, one of the bank's largest depositors, Richardson and David Limited, filed a lawsuit to stop the bank's liquidation, claiming that KDIC's decision to advertise the bank's assets for sale would ultimately harm creditors and depositors because the bank would be left with no assets.

Some of the reasons for Dubai Bank's collapse and which were highlighted in the case of ***Richardson and David Limited -vs- Kenya Deposit Insurance Corporation & another***[49] include the following:

a) The Board of the DBK comprised of three (3) Directors less than the minimum 5 board members as required by the Banking Act.
b) Several unapproved and unsecured loans and other transactions entailing guarantees and overdrafts advanced to the defendants or to companies **linked to the bank's Chairperson, Mr. Zubedi.**
c) Investigations also established that the bank's Chairman, Mr. Zubedi, contravened the provisions of the Banking Act Cap 488, by being both an Executive and a non-executive director of the board and **had absolute control** over the bank's operations and affairs.
d) Suleiman Enterprises Company, M/s Africa Energy Limited, Kemu Salt Parkers Production Company, Kamp General Engineering Company, and Maestro Properties Company, **all associated with Mr. Zubedi, were beneficiaries of large questionable loans and other forms of credit.**

[48] BD Africa.com Reporter, 'Dubai Bank Kenya placed in Receivership for a Year' *Business Daily Africa* (24 August 2015).

[49] [2015] Eklr.

4.1.1 Analysis

From the foregoing, it is evident that the failure of Dubai Bank's management to follow corporate governance principles is viewed to be one of the main reasons for its collapse. The management of the said banks breached both the law governing banking operations and the rules of good corporate governance, including the role of shareholders in corporate governance, openness, and disclosure, as well as shareholder rights and key ownership functions.

The collapse was also a result of the actions of top officials who engaged in shady dealings and flagrant disrespect for the provisions of the law. The bank's board should have swiftly informed the shareholders as soon as it became aware that some of its managers were working together with prominent businessmen to defraud the bank.[50]

4.2 Imperial Bank

Only a few months after placing Dubai Bank under receivership, CBK placed Imperial Bank under statutory management on October 13, 2015, by publishing Gazette Notice Number 7715 in the Kenya Gazette Special Issue Volume CXVII - No 111. This effectively suspended the bank's banking services and prevented it from accepting any deposits or honoring customer requests for withdrawals or access to the deposited funds.[51]

Following the death of Janmohamed on September 15th, 2015, Naeem Shah, then Head of Credit, and James Kaburu, then Chief Finance Officer (CFO), were elevated to the positions of acting managing director and deputy managing director, respectively. The two managers disclosed information to the bank's board accusing the late Janmohamed of fraudulently disbursing loans totaling billions of shillings to close friends and business associates while completely ignoring the institution's internal lending policies and prudential

[50] Jacob Owuor Ogola et al, 'The Effect of Corporate Governance on Occurrence of Fraud in Commercial Banks in Kenya' (2016) 4 (7) The International Journal of Business & Management 1.

[51] Ibid.

guidelines and routinely concealing the transactions in the books of accounts by coercing, intimidating, and threatening the CFO to come up with inventive accounting techniques to avoid the board's scrutiny.[52]

Alnashir Popat, the Chairman of Imperial Bank, called an urgent board meeting on September 25, 2015, in reaction to the Shah and Kaburu's accusations. The bank's board assigned the chairman of the audit committee to conduct an inquiry into the alleged fraud, after which the directors would request a meeting with the Governor of the Central Bank to brief him on their findings. On October 2, 2015, the board also hired an independent external forensic advisor after internal inquiries proved to be very slow and with preliminary findings implicating senior officers of the bank. Therefore, it was only prudent to hire an external investigator.[53]

The forensic auditors from London, FTI Consulting, were engaged on October 5, 2015, and they arrived the following day. The former group managing director and accomplices within and outside the bank, including some employees at CBK, had been operating a scheme of illegal and fraudulent disbursements that was operational for several years and cost the bank approximately 380 million dollars in custodial fees, according to the FTI Consulting audit, which found discrepancies between the actual figures of overdrafts, unsecured loans, deposits, and investments and those previously reported to the bank's board.[54]

The investigations revealed a number of debtors who had defaulted on their loans before Imperial Bank went under. Investigations also revealed that the directors awarded themselves huge dividend payments with complete disregard for the bank's fragile financial status. They failed to first consider the performance of the bank before they paid themselves huge perks.[55]

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[52] Dominic Wabala, *"How Imperial Bank fraud was discovered"* The Star (15 February 2016)

[53] Ibid.

[54] Ibid.

[55] Dominic Wabala, *'CBK, Imperial Bank staff colluded in fraud Report'* The Star (12 February 2016)

4.2.1 Analysis

Poor corporate governance standards led to the collapse of Imperial Bank of Kenya Limited, which resulted in substantial losses for shareholders and the loss of depositors' access to their money as the bank was in receivership. Weak corporate governance was evident in the following areas. Firstly, the board size, composition, and remuneration. The board's effectiveness and growth are dependent on its composition and size, hence the need to have the right size and composition. At the time of its collapse, Dubai bank had only three directors as opposed to the required minimum of five directors thereby compromising its oversight and monitoring role.

Secondly, in both banks, conflict of interest was flagged. The Managing Director of Imperial Bank, the late Janmohamed, was the Founder, the Chairman of the Board as well as the principal shareholder. A position he used to run a plan of fraudulent and unlawful money transfers that affected the bank. The Chairman of the Dubai Bank served as both an executive and a non-executive director of the board. Due to the concentration of power in one person in these situations, possibilities for conflicts of interest are created. In both cases, we see companies' friends and relatives of the two chairmen being the main beneficiaries of large questionable loans and credits and their involvement in conspiracies, fraud, and theft of funds.

4.3 Uchumi Supermarket

The Uchumi supermarket, which had been in business for more than 30 years, was declared bankrupt in June 2006. The board of directors resolved that the company stops operations and was later placed under receivership. In the same vein, the Capital Markets Authority (CMA) suspended the listing of the troubled supermarket on the Nairobi Stock Exchange (NSE). Following a framework agreement between the Kenyan government, suppliers, and holders of debentures, the company was revived and began operating on July 15, 2006, under interim management and a specialized receiver manager (SRM). The

firm hired Dr. Jonathan Ciano, the former CEO of Uchumi Supermarket, as a specialist receiver manager in 2006.

In an effort to turn around the retail chain, restructuring was done and some managers were removed. The company reported profits in each of the next three fiscal years after management and staff put in a lot of effort to turn around the company as a result of restructuring.[56] The lending banks in turn lifted the company's receivership in 2010 and the company was successfully re-listed in the Nairobi Securities Exchange on 31st May 2011. The retail chain enjoyed profits until the year 2015 when it fell sick and was bedridden again.[57]

Apart from having challenges with several of its indebted suppliers, the retailer also engaged in egregious misconduct, conflict of interest, and failed to make payments to its creditors. Indeed, companies would emerge out of nowhere and still be permitted to supply goods to the retail chain without following the due processes, a factor that resulted in having uncompetitive prices.[58]

The board of directors and managers were also accused of making investments that were not profitable and this became one of the premises upon which the directors of Uchumi were charged with the offence of conspiracy to defraud. In ***the Republic versus Chris Kirubi and 13 others*** (unreported), part of the board of directors of Uchumi was charged with the offence of conspiracy to defraud the supermarket chain and a second charge of breach of public trust. The criminal charges were a result of the board's resolution to sell the Aga Khan Walk branch property.[59]

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[56] Green Belt Communications, (2016). Company History - Uchumi Supermarkets. Retrieved July 22, 2022, from Uchumi Supermarkets: http://kenya.uchumicorporate.co.ke/aboutus/history.

[57] M. Karanja, (2016, March 21). Business News. Retrieved July 29, 2022, from Citizentv: http://citizentv.co.ke/business/uchumi-closes-five-more-branches-sacks-253-employees119159/#

[58] IPSOS, Kenya, (2016, July 2). http://www.ipsos.co.ke/NEWBASE_EXPORTS/Nestle/150614_Sunday%20Nation_10_9ab55.Pdf

[59] Ibid.

By the time Uchumi was experiencing governance challenges, the Capital Markets Authority had published and gazetted Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya. The retailer was at the time a public listed company and the guidelines applied to it. The prosecution, however, did not lend any evidence to show that the board flouted these guidelines. Even though the prosecution's case was based on the premise that the supermarket was a parastatal, the evidence produced in court proved otherwise since the government with 26 percent shareholding only held a minority interest in Uchumi. The court, therefore, held that the supermarket chain was not a parastatal and thus the board did not breach the public trust.

4.3.1 Analysis

A common characteristic of public companies, such as Uchumi, is the fact that they have a large number of small owners. In this case, there are two distinct challenges that emerge. First, despite the fact that shareholders often have ultimate residual control rights in the form of votes, they are typically too small and numerous to actively exercise control on a daily basis. As a result, they delegate control to the board of directors, which then delegates it to management. There is, therefore, a separation of ownership and control.

Secondly, as already pointed out dispersed shareholders have little or no incentive to monitor management because of high agency costs. Each shareholder, therefore, joy rides in the hope that other shareholders will do the monitoring. Regrettably, there will be absolutely no monitoring because all shareholders think the same way. Because of the separation of ownership and control and the lack of monitoring, there is a danger that the managers of a public company will pursue their own goals at the expense of those of shareholders. Among other things, managers may overpay and give themselves extravagant perks and may seek to entrench themselves.

5.0 Conclusion.

The collapse of the companies discussed above is firmly ascribed to the failure of corporate governance mechanisms. The failures are illustrative of the fact that managers are usually self-interested, risk-averse, and committed to pursuing their own interests at the expense of those of shareholders. Tighter corporate control mechanisms are needed to sanction managers and reduce agency costs.

Board Evaluations: Why they Matter and How they Should be Conducted

Winny Cheptoo*

Abstract

When board directors take ownership of the board assessment/evaluation process, their meetings proceed more smoothly, they make better decisions, they are able to detect specific deficiencies in the existing board working arrangements, there is enhanced ability to monitor managerial performance, they have greater influence on long-term corporate strategy, and there is improved performance and accountability of the company. However, this can only be achieved upon full comprehension of the entire board evaluation processes.

1. Introduction

Board evaluations have often been viewed as a means of assessing whether the board, as a whole and its individual members, have adequately executed their objectives, responsibilities and duties. Recent developments in board evaluations reveal that evaluations should not only be premised on performance of duties and responsibilities, but also on whether the board's structure, composition, operations and dynamics are well suited for effective performance of board. This is because the effectiveness of a board is hinged on a myriad of factors, such as its structure and composition, the dynamics and operations of the board, its processes, procedures and internal controls.

This paper seeks to highlight and analyse, by giving examples, the various aspects of board evaluations, namely, features of effective board evaluations, evaluation methodology, goals of evaluations, possible outcomes of evaluations, benefits of evaluations and challenges of board evaluations.

2. Justification for Board Evaluations

The need for board effectiveness has been occasioned by factors that have shaped corporate governance over the years, namely, pressure from stakeholders for short-term and long-term corporate performance, board oversight failures, evidenced by recent examples,[1] statutory requirements in certain jurisdictions,[2] and increased risks and opportunities in the business environment that require good governance.

Boards are tasked with various responsibilities such as: providing overall leadership for the company, scrutinizing and approving company policies, financial statements, strategies, investment proposals and budgets and appointing senior executives of the company. These roles and responsibilities can be summarized to three main 'umbrella' roles, that is, it is required to provide strategic direction for the organization, monitor the management of the organization and advise management.[3] The Companies Act, 2015 identifies the most notable duties of directors to be: "to promote the success of the company, to act within the powers prescribed by the Act and company's constitution, to exercise independent judgment, to exercise reasonable care and skill, to avoid and or declare conflicts of interest, to not accept benefits from third parties, not make unauthorized profits and to adhere to confidentiality".[4]

In the governance of State Corporations in Kenya, the Code of Governance for State Corporations (Mwongozo Code) stipulates the functions of the board as a whole and duties of individual board members. The functions of the board identified therein include: to execute their roles collectively, to establish the overall strategy of the organization, evaluate the

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[1] Michael Schlossberg, Three Dramatic Board Failures to Learn from (2022). https://www.thecorporategovernanceinstitute.com/insights/guides/three-dramatic-board-failures-to-learn-from/. Accessed on 25th August, 2022.
The article highlights the case of Sports Direct, Enron and Blockbuster. These companies fell because of a myriad of reasons, however, there is a recurring concern for all the three companies. That is, the training of board directors had been ignored and therefore directors lacked capacity to make sound decisions.

[2] For instance, in India, under their Companies Act 2013, annual board evaluations are mandatory.

[3] Deloitte, *Performance Evaluation of Boards and Directors,* (2014). https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-cg-performance-evaluation-of-boards-and-directors-noexp.pdf. Accessed on 25th August, 2022.

[4] The Companies Act, no 17 of 2015, sections 140-150.

organization's overall performance, approve the organizational structure and annual budget, hire senior executives of the organization amongst other roles.[5] On the other hand, the duties of individual board members under the Code include, *inter alia*, ensure transparency and accountability of the board, exercise confidentiality, independent judgment, duty of care, diligence and skill while discharging their duties, protect and promote the image of the organization.[6]

With the duties and responsibilities of boards and directors outlined in various instruments and policies,[7] board evaluations have been identified as the best approach of assessing board effectiveness.

3. Objectives of Board Evaluations

The evaluation methodology and process is pegged on the specific goals and objectives of board evaluations. Best practices around the world reveal that board evaluations should not just be a measure of whether the Board and directors have fulfilled their duties and responsibilities but should also be an assessment to the environment under which they perform their duties.[8] The evaluation should also examine whether the board's structure and composition, operations and dynamics, are suitable for the effective and efficient performance of the board.[9]

The evaluation of a board structure and composition entails examining at the board and committee charters (if the board has committees), competencies of directors, diversity of the board and board processes.[10] Evaluation of dynamics of the board involves examining the interactions

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[5] Mwongozo- Code of Governance for State Corporations, 2015, 3-4.

[6] Ibid.

[7] Respective company polices and statutory instruments of a country.

[8] Steve Klemash, et,al., Effective Board Evalution (2018). Harvard Law School Forum on Corporate Governance. https://corpgov.law.harvard.edu/2018/10/26/effective-board-evaluation/. Accessed 25th August, 2022.

[9] Deloitte, Performance Evaluation of Boards and Directors, (2014). https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-cg-performance-evaluation-of-boards-and-directors-noexp.pdf. Accessed on 25th August, 2022.

[10] Ibid.

and communication between board members, board members and the chair, the board with management, the board with stakeholders. Board dynamics also comprises the quality of participation of directors in board meetings and cohesiveness of the board as a whole.[11]

Identifying the key areas to evaluate is a necessary step when formulating the specific goals and objectives of board evaluations. For instance, if one of the parameters to be evaluated is board dynamics, then the objective of such an evaluation would be to elicit candid feedback from board members on how they feel about their interactions with fellow board members. The evaluation of board structure and composition might elicit the objective of identifying whether the structure and composition of the board is adequate for the performance of the board or whether their gaps requiring inclusion of certain members or committees. Notwithstanding, the specific areas to be evaluated, there are certain goals of board evaluations that cut across. These include: assessing the director's knowledge on the workings of the organization, examining the sufficiency and balance of skills, experience and knowledge and the board and its committees, pinpointing weaknesses of the board and its members that ought to be remedied and gathering information on the workings and effectiveness of the board for purposes of apprising stakeholders on the corporate governance of the organization.[12]

Additionally, Geoffrey Kiel suggests a 'seven-step framework' of conducting board evaluations. This framework advances seven questions that ought to be answered before the evaluation is done.[13] These are: What are the objectives? Who will be evaluated? What will be evaluated? Who will be asked? What techniques will be used? Who will do the evaluation? And what will be done to the results?[14]

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[11] Ibid.

[12] Business Roundtable, *Principles of Corporate Governance* (2016). Harvard Law School Forum on Corporate Governance. https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/. Accessed on 25th August, 2022.

[13] Geoffrey Kiel et. al., *Board Performance Evaluations that Add Value*. Harvard Law School Forum on Corporate Governance. https://corpgov.law.harvard.edu/2018/05/18/board-performance-evaluations-that-add-value/. Accessed on 25th August, 2022.

[14] Ibid.

4. Evaluation Methodology

Unless prescribed by law, board evaluations are elective. This leaves room for flexibility of the evaluation methodology and process, hence the reason why the process can be tailored to the organization's needs.

Methods of carrying out board evaluations include: having board members fill questionnaires, conducting interviews with directors, assessing skills and competencies by asking questions or through document reviews.[15] It is recommended that evaluation questions should be precise and address the core areas for evaluation. In Kenya for instance, the State Corporations Advisory Committee has formulated a Guide to Self-Evaluation and standardized self-evaluation forms for board members in State Corporations.[16] The questions in the forms range from attendance of meetings, comprehension of roles and responsibilities, exercise of skill, duty of care and diligence, matters on transparency and accountability and leadership of the chairperson.[17] Interestingly, the questions on interactions between members and assessment of members' personalities are not provided for in these forms, leaving a lacuna on evaluation of board dynamics in Kenyan parastatals.

Boards are at liberty to undertake their own board evaluations or may seek the services of a third party for a more objective approach and analysis. In some large global corporations, one of the board committees, the nomination committee, is tasked with the role of conducting board evaluations.[18] While there are no differing opinions on whether board evaluations are important, there are divergent views on evaluation of individual directors. Some governance experts suggest that peer evaluation

[15] NASDAQ, *What is Board Evaluation?* (2022). https://www.nasdaq.com/solutions/governance/board-evaluations/what-is-a-board-evaluation. Accessed on 25th August, 2022.

[16] State Corporations Advisory Committee, Board Evaluation forms: BE1 Board Self Evaluation, BE2 Chairperson of the Board, BE3 Board Self Ev*aluation, BE4 Chief Executive Officer's Performance Evaluation, BE5 Evaluation of the Corporation Secretary, (2015).* https://www.scac.go.ke/2015-02-16-09-56-36/board-evaluation. Accessed on 25th August, 2022.

[17] Ibid.

[18] Deloitte, *Performance Evaluation of Boards and Directors*, (2014). https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-cg-performance-evaluation-of-boards-and-directors-noexp.pdf. Accessed on 25th August, 2022.

of a fellow director by a fellow director can inhibit relations between directors and ultimately impact board dynamics negatively and, therefore, recommend self-evaluation of directors or evaluation by an independent third party.[19] The benefits of involving an independent third party in the evaluation process enhances objectivity and integrity, removes bias and increases confidence in the outcomes of the evaluation process.

Board evaluations best practices vary from country to country. In Argentina, the Code of Good Practices in Corporate Governance requires the board of directors of listed companies to evaluate its performance annually, prior to the annual ordinary shareholders meeting.[20] In Brazil, the Best Practices in Corporate Governance, obliges that board evaluations be conducted annually and that the board assessment method be made in accordance to the circumstances of the organization. The Brazil Code bestows the task of conducting board assessments on the Chairperson of the Board and provides that individual assessments of board members should encompass their attendance of meetings and member's involvement in meetings, as these factors are essential for future re-elections.[21] The OECD Principles of Corporate Governance recommends board evaluations for purposes of establishing whether the board has the correct mix of competencies and backgrounds.[22] In South Africa, the King IV Report on Corporate Governance stipulates that a board should evaluate itself and its board members at least once a year.[23] It adds that the evaluation process should be spearheaded by an independent non-executive member.[24] In

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[19] Ibid.

[20] Corporate Secretaries International Association, *Special Report, Global Board Evaluation Practices and Trends; Lessons for the Corporate Secretary: The Five Key Take Aways* (2016). https://www.chartsec.co.za/documents/members/Global%20board%20evaluation%20practices%20and%20trends.pdf. Accessed on 25th August, 2022.

[21] Corporate Secretaries International Association, *Special Report, Global Board Evaluation Practices and Trends; Lessons for the Corporate Secretary: The Five Key Take Aways* (2016). https://www.chartsec.co.za/documents/members/Global%20board%20evaluation%20practices%20and%20trends.pdf. Accessed on 25th August, 2022.

[22] Ibid.

[23] Ibid.

[24] Ibid.

the United States of America, the New York Exchange (NYSE) Corporate Governance Guidance requires committees of all listed companies to conduct self-evaluations at least once a year.[25] The Indian Companies Act, 2013 provides that board evaluations of committees and individual directors is mandatory.[26] In Kenya, there is no statutory requirement for board evaluations, however, state corporations are required, under the Mwongozo Code, to carry out annual board evaluations. This is expected to be led by the Chairperson using a board evaluation tool, and should assess the board as a whole, its committees, individual members, the corporation secretary and the CEO.[27]

5. Outcomes of Board Evaluations

The Mwongozo Code stipulates that at the end of the annual board evaluation, a report with recommendations for enactment should be made and shared to all stakeholders.[28] The Code further provides that the outcome of the evaluation should inform the re-appointment of a member or the chairperson.[29] This practice is not only evident in state corporations, but also in public and private companies. The outcomes of board evaluations may range from: review of board processes, changes in board composition and committees' compositions, elimination of factors that bring dysfunctionality to the board amongst other outcomes.

Unfortunately, the Mwongozo Code does not provide timelines within which the evaluation report should be made and shared. This poses risks to the relevance of the recommendations because if too much time is taken to prepare and share the evaluation report, then the relevance of the recommendations may diminish. Additionally, the said recommendations will not materialize unless an implementation plan is in place and is timely executed.

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[25] Ibid.

[26] Ibid.

[27] Mwongozo- Code of Governance for State Corporations, 2015, 9-10.

[28] Mwongozo- Code of Governance for State Corporations, 2015, 9-10.

[29] Ibid.

6. Benefits of Board Evaluations

The continual use of board evaluations to assess board effectiveness is attributed to the fact that benefits from these evaluations outweigh the costs and time involved in conducting them. They promote accountability of board members, as it instills a sense of responsibility in the members to fulfill their obligations and ensure short-term and long-term corporate performance. The periodic board evaluations establish and embed an organizational culture where board members, management and stakeholders have high regard for board evaluations and carry on the culture of conducting them. This ensures that a culture of good governance is upheld by board members at all times.

Transparency is vital for building long term stakeholder relationships as it nurtures trust and a good reputation. Board evaluations go a long way in ensuring transparency as they reveals to stakeholders the inner workings of the board. Board evaluations also enable members to know how to better utilize their opportunities, manage risks and take corrective action plans on weak areas. Ultimately, this enables the board to effectively execute their oversight roles and be better at decision making.

Prior to the formulation of the Mwongozo Code, boards of parastatals used to operate without structure and direction, which had a negative impact on their overall performance of these organizations. This narrative has changed and public entities now have more efficient boards.[30]

7. Challenges of Board Evaluations

As seen above, most jurisdictions recommend that the Chairperson should spearhead the evaluation process. However, more often than not, the Chairperson might not be a governance expert. This may affect the outcome of the evaluation process negatively and, therefore, calls for a need to engage a governance expert in evaluation of Boards.[31]

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[30] Juliet Nyanga'i, *Tackling Institutionalised Corruption: The Contribution of the Mwongozo Code of Corporate Governance (2020).* https://www.linkedin.com/pulse/tackling-institutionalised-corruption-contribution-code-nyang-ai/?trk=articles_directory. Accessed 25th August 2022.

[31] NASDAQ, *What is Board Evaluation?* (2022). https://www.nasdaq.com/solutions/governance/board-evaluations/what-is-a-board-evaluation. Accessed on 25th August, 2022.

The criteria used in board evaluations examine aspects such as quorum, number of meetings attended, board composition and committee compositions. While assessing these factors is important, they might not translate to better performance of the board. Therefore, more emphasis should be given to those factors that drive increased board effectiveness.[32] These factors include: assessing skills, experience and competencies of board members, and providing the requisite training and development where gaps have been identified.

Where third parties are engaged to conduct board evaluations, the risk of lack of independence looms, as the third party may be comprised by the board members. Measures ought to be put in place to counter this.

Due to their consequences, board members may not wholly embrace board evaluations. As such, it is important that the organization's leadership communicates effectively with board members on the subject and sensitizes them on the importance of evaluation.

8. Conclusion

Board evaluations come with their own fair of challenges. Careful consideration has to be made on the specific goals of the evaluation, the methodology to be used has to be formulated based on best practices in corporate governance and it should endeavor to meet the identified goals of evaluation. Once evaluation is completed, a report with recommendations ought to be made soon thereafter and shared with stakeholders. Timely implementation of the recommendations is key or else the entire process might turn out to be an effort in futility. Finally, the effectiveness of board evaluations hinges on leadership. Good leadership is key in ensuring that evaluations are conducted periodically by competent persons and that recommendations are fully implemented.

[32] Business Roundtable, *Principles of Corporate Governance (2016)*. Harvard Law School Forum on Corporate Governance. https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/. Accessed on 25th August, 2022.

Is the Only Social Responsibility of a Business to Increase Its Profit?

Jessica Mwenje*

1. Introduction

A proper understanding of social responsibility is not possible without first properly dissecting the nature, purpose, and scope of business. It is crucial to note that the individual is the basic unit of society, and that the coming together of individuals and their interactions determine what type of a society emerges. Individuals have some defined needs that they cannot do without thus driving them to engage in activities that are required by others, in exchange for economic gains. These interactions are well coordinated through organized and systematic activities. The collective of these activities is called a business.

A business provides an interaction for meeting diverse needs and wants with the intention of earning a profit. Thus, the risk taker earns some reward. As a result, the primary objective of the formation and operation of a business is the coordination of resources to create value and make profits for the owners. Many scholars have supported Milton Friedman[1] assertion in the 1970s that the main goal behind business is to maximize profits. Friedman was an American economist and statistician who received the 1976 Nobel Memorial Prize in Economic Sciences for his research on consumption analysis, monetary history and the complexity of stabilization policy. Friedman opined that a company's profit and its social responsibility are separable. He argued that corporate boards should only think about dividends to their shareholders and let the shareholders do the charitable activities directly.

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[1] Tepper, 'Milton Friedman on the Social Responsibility of Business, 50 Years Later' (Forbes Advisor, 2020) <https://www.forbes.com/advisor/investing/milton-friedman-social-responsibility-of-business/> accessed 19/09/2022.

Sundaram and Inkpen (2004) in "The Corporate Objective Revisited." state that *"governing the corporation requires purposeful activity. All purposeful activity, in turn, requires goals."* They argue that the main goal for managers is "maximizing shareholder value."[2] This has, however, been counter-argued by many scholars who deem that profitability of a business and its social responsibility are inextricably linked. Businesses also have other contracts with other stakeholders such as regulatory agencies that ensure they operate within the law as well as protecting the interests of other parties. Businesses, therefore, have additional responsibilities outside achieving profits that are social in nature since they are related to the environment within which they exist and operate. Accordingly, and as argued by by Hart and Zingales *"the fiduciary duty a board has to a company's shareholders is to maximize their welfare, not just the value of their pocketbook.*[3] Merrick Dodd contended that the managers have a fiduciary duty to the whole community. A corporation has both a social and a profit-making function. Managers ought to take into consideration as many stakeholders as possible.

1.1 Stakeholder Theory

R. Edward Freeman is credited for the modern stakeholder theory promulgated in his book, Strategic Management: A Stakeholder Approach, published in 1984. The theory tries to explain the purpose of a company and the fact that the existence of the company is inextricably linked with other players who are the stakeholders. It argues that there can be no clear separation between the business and ethics of running the business. The theory's main focus is on promoting the contribution of all towards the success of the corporation. It fosters the idea of working together for a common goal.[4]

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[2] Sundaram & Inkpen, 'Stakeholder Theory and "The Corporate Objective Revisited": A Reply' (2004) OS 15.

[3] Hart & Oliver, 'Serving Shareholders Doesn't Mean Putting Profit Above All Else' (2017) HBR 3. <https://www.arrunada.org/files/t/uom/Hart%20Zingales%202017%20Serving%20Shareholders%20HBR.pdf> accessed 20/12/2022.

[4] Janice D, *Directing Public Companies* (Cavendish, 2001), 94.

One of the questions that arises is exactly who is a stakeholder and what value do they want from the corporation. The Black's Law Dictionary 11th Edition defines stakeholders as individuals with interests in a company. They include managers, shareholders, directors, the government, suppliers, consumers, employees and the general community. The stakeholder theory provides that shareholders are among the varied groups that have a direct impact and interest in the business of the corporation. Accordingly, it argues for an all-encompassing approach towards all of them.

The stakeholder theory has three facets: normative, descriptive, and instrumental. The normative aspect explains why stakeholders should be treated as fundamental to the success of the corporation and therefore are very valuable to a company. This is in clear contradiction to the supremacy of the shareholder and the notion that the corporation's managers should have the shareholders' interests as their primary concern.

The descriptive prong of the theory explains the reason behind the corporate behavior while the instrumental aspect provides a framework for assessing the connection between stakeholder management and a corporation's performance. It looks at how stakeholders improve the success of a corporation.

The biggest criticism of this theory is the fact that there are a myriad number of stakeholders and the corporation has limited resources. Therefore, there is the challenge of how the corporation should apply the limited resources to satisfy all the stakeholders and to what extent should the corporation do so. For instance, how does a corporation legitimately prioritise one group of stakeholders over another group. Shareholder primacy theorists argue that shareholders' interests have to be given first priority and must be preferred or the corporation will not prosper. Another criticism is that it undermines the right to property by the shareholders as well as the agency relationship between the agent (managers in a corporation) and the principals who are the shareholders.

2. A Case for Business Social Responsibility

Understanding the fundamentals of social responsibility for business requires a critical review of the stakeholder theory as above and its relation to the fundamental principle of making profits and customary corporate law.[5] Stakeholder theory traces its roots to the development of modern management practices where businesses desired managers that are more capable of anticipating and solving diverse problems.[6] The main problems identified were value creation and trade, ethics of capitalism and the issue of managerial mind-set.

The problem associated with value creation and trade seeks to provide solutions to challenges that businesses face with regards to operating sustainably in a rapidly changing business environment.[7] This problem is essential since it defines the relationship between the business and the stakeholders that affect its value chain.

The ethics of capitalism problem affects all the stakeholders that are affected by or that affect the operations of the business. More often than not, the objectives of capitalism and ethics find themselves at the opposing ends.[8] The main reason for this occurrence is that the maximization of profits requires tight controls on spending while operating ethically often requires additional spending. A simple example of this is in the payment of wages.

One of the main reasons why China and Asia are preferred locations of manufacturing plants for many international companies is due to the availability of cheap labour. The cheap labour arises from loose labour regulations that have resulted in reports of violations of ethical employment relations. Some of the most common violations include payment of low wages, subjecting workers to excessive overtime hours, provision of

[5] Chukwuemeka G, 'Customary Corporate Law in Common Law Africa' (2018) AJCL 66.

[6] Sundaram & Inkpen (n 2).

[7] Ibid.

[8] Ibid.

substandard health and safety measures, and deplorable living conditions at the workers' quarters. Improving these standards would require the use of additional financial resources that would affect the profitability of these businesses.

The problem of managerial mind-set is a complex combination of factors that affect the operations of the business. A critical review of this problem may lead one to believe that this is the reason why companies hire managers. Resolving this problem defines solutions to two important challenges that cover the broadest aspects of a business's operations. The first challenge is how the business can create better value and the second challenge is how to correlate ethics and business profits.

The stakeholder theory proposes that businesses that find solutions to their problems based on the relation that it has with its stakeholders are more effective in dealing with these two challenges. This is in sharp contrast with the interest of the shareholders, which is to maximize the share price through maximization of profits.[9] Businesses that focus on maximizing profits as the only goal often run into a number of problems before they are able to find the equilibrium point of their operations. The main challenge for these businesses is the minimization of inputs and maximization of output.[10] However, the relationship between input and output is not linear or lateral and requires critical thinking.

Take a business that is looking to produce the maximum number of items of a specific product at the lowest cost possible. This business will most likely procure the cheapest raw material available, use the shortest production process possible, and hire the cheapest labour that is available. Due to the use of low-quality material, substandard production processes, and low skilled labour, the business will end up with a product that consumers are not willing to buy. As a result, the business produces goods that do not have value since value is the satisfaction that consumers draw from the product or the amount of money, they are willing to pay for it.

[9] Malik & Yadav, 'Sustainability Ratings and Corporate Control: Debacle of Shareholder over Stakeholder Theory' (2020) 18 COC 408.

[10] Ibid.

A different company might manufacture the same product but use high quality raw material, use superior manufacturing processes, and hire better skilled labour. This business will end up with a better product than the former company and therefore create better value. Customers will draw more satisfaction from the product since it will meet their expectations, it will be durable and overall better than the one developed by the cost cutting company. This satisfaction makes the customers prefer the better product thus giving it more value. However, it is important to balance the cost elements since a product is only worth what customers are willing to pay for it. In case the business invests in all the resources required to make the product as good as it can be but it ends up being so expensive that customers are not willing or able to pay for it, and then it lacks the ability to create value for the company.

The role of business managers is to manage the relationship between the business and its stakeholders such that it creates as much value as possible sustainably. Sustainability means that businesses should operate in a manner that meets the needs of the current generation and does not compromise the prospects for future generations.[11] While the law strives to develop a legal framework for sustainable coexistence, it is not exhaustive and often leaves many gaps that businesses could exploit for their advantage but at the detriment of others.

Sustainability has got three main foundations. These foundations are the economy, the society, and the environment. Businesses operate within an economy, exist in an environment and even rely on resources from the environment, and have an effect on the societies that they interact with. Sustainability is the main reason why businesses have social responsibility.[12] The responsibility of a business is to create value, not to exploit value. Exploitation leads to depletion, while creating value results in continuity.[13] Businesses have social responsibilities because they need

[11] Greenfield, 'Saving the World with Corporate Law?' (2007) 57 ELJ 1.

[12] Malik & Yadav (n 9).

[13] K Mwaura, 'Constitutionalism of Environmental Governance: Towards Sustainable Corporate Responses to Environmental Degradation' (2018) 27 JKUATLJ 27.

to ensure a balance between economic growth, environmental impact, and social well being.

3. Profits as Part of a Business' Social Responsibilities

3.1 Creation of Rewards for Factors of Production

Production, or creation of value, depends on four main economic resources. These economic resources are land/natural resources, labour, capital, and entrepreneurship. The economic sense of applying each of these resources is that they draw different rewards from their utilization while each of them is important to start a business. Entrepreneurship is critical in its continued operations. While the rewards arising from these factors of production are economic in nature, they play an important role in enhancing social welfare for the recipient of the rewards. All these factors have a claim in the 'property' of the corporation as they have invested in the corporation and therefore have a right as to the profit.

One of the most common examples of the application of land as a factor of production is the creation of industrial spaces, commercial properties, and residential properties that earn rental income for the landlords. However, land also has economic value where it is used for farming, or mining of natural resources such as precious metals, precious stones, and oil.[14] The application of labour allows the employees to earn salaries and wages in exchange for the skills and services offered to businesses while capital earns interest. The reward for entrepreneurship is the profit that a business realizes after it has accounted for its revenues and deducted all expenses.

This means that businesses fulfil their social responsibility by bringing together factors of production that result in value creation and improved lifestyles.[15] Looking at this from an investment perspective, the rewards accrued by the landlords; the holders of capital, and the providers of labour are a cost to the entrepreneur who brings these

[14] Ibid.

[15] Doreen McBarnet, 'Corporate Social Responsibility Beyond Law, Through Law, For Law' (2009) EJ 1.

other factors together for productivity. However, the entrepreneur often ends up accruing most of the benefits especially for businesses that are profitable. The risk for the entrepreneur is the possible loss of the investment but the reward is the creation of an entity that could potentially generate income for future generations through profits.

3.2 Environmental Responsibility

Environmental responsibility is a common form of social responsibility that is exercised by businesses today. Increasing concerns over the effect of human activities on the environment have led to the emergence of sustainability drives to ensure that all stakeholders play their part in taking care of the environment.[16] The nature of a business's operations often informs the strategies that it employs to ensure that it is environmentally sustainable.

3.2.1 Reducing Pollution

Looking at the transport industry as an example, stakeholders in the industry are actively developing strategies that help reduce emissions from motor vehicles. Transportation is one of the leading sources of greenhouse gas populations in the world. This is a common problem across all countries and emissions are expected to increase significantly unless serious interventions kick in or a disruptive technology is adopted on a large scale. A serious concern related to emissions in transportation is the observation that the last mile end of distribution causes more pollution than the bulk transportation that takes place using cargo ships and cargo planes.[17] Road freight emits more than one hundred times as much carbon dioxide as a cargo ship carrying the same amount of cargo. This act is a concern because the last mile distribution networks are expected to keep growing as e-commerce continues to demonstrate resilient growth.

[16] Ireland, 'Corporate Governance, Stakeholding, and the Company: Towards a Less Degenerate Capitalism?' (1996) 23 JLS 287.

[17] Massachusetts Institute of Technology, 'How Can Carbon Emissions from Freight Be Reduced?' (*MI*, 2022) <https://climate.mit.edu/ask-mit/how-can-carbon-emissions-freight-be-reduced> accessed 22 July 2022.

The hope in reducing road pollution is that the small trucks and vans that are responsible for most of this pollution are good candidates for the use of green technologies in transportation. However, this is a long-term solution that will take decades to roll out fully even for developed countries. In the short term, governments are working closely with car manufacturers and logistics companies to develop multifaceted solutions for the emissions coming from the transport industry.

Car manufacturers have been developing engines that burn less fuel per distance covered thus reducing the emissions released into the environment. They are also working on improving engine efficiency so that engines can combust the fuels properly since improperly burnt fuel releases poisonous gasses such as carbon monoxide into the environment. The leading car manufacturers are all working on electric vehicles that are expected to result in greener cars for the future.[18] General Motors has committed to delivering at least twenty new electric vehicles to consumers by the end of 2023. Hyundai has also stated that consumers can expect twenty-five electric vehicle models to be available in their showrooms by 2025.[19] The increased models of electric vehicles are expected to increase the options available for consumers since the limited number of options could be a reason for consumer apathy.

Logistics companies are also playing a role in developing solutions that reduce emissions or prevent a drastic increase of the same. Route scheduling and optimization is one of the strategies that these companies are using to operate more efficiently. In the past, these companies provided services for their customers on demand. Meaning that they focused on servicing the needs of individual customers. While the model supports accelerated growth for the companies as they are able to make deliveries faster, it is also costly

[18] Ibid.

[19] Ibid.

for the customer, the company and for the environment.[20] These deliveries would more likely than not result in an empty return trip with the expense transferred to the customer or absorbed by the company and increased pollution of the environment through emissions.

By having scheduled deliveries and properly mapped routes, companies have reduced the number of miles required to make the same number of deliveries. They have also established the optimal speeds that truck drivers should drive to achieve the best fuel economy and minimize emissions. Large logistics companies have also enhanced their operations by developing hubs that help increase the efficiency of these route plans. By doing so, they are able to apply cleaner transportation options such as bicycles, electric scooters, or electric vans for last mile deliveries.

3.2.2 Increasing Reliance on Renewable Energy

The world's reliance on fossil and nuclear fuels is one of the largest sources of environmental pollution since energy is required to drive machines and activities across the world. However, governments have made concerted efforts to move towards renewable energy sources through policy and incentives offered to players in different industries. While companies are not required to generate the energy that they need to run their operations, some companies have taken the social responsibility of accelerating their use of renewable energy by developing their own generation capacities.

Apple Inc. is one of the world's most popular and recognized brands. The company serves a worldwide market through over five hundred retails stores that are spread out in strategic locations. Given the size of the firm's operations and the size of its supply chain, it has implemented a renewable energy plan that has seen it increase its reliance on renewable energies and reduced its environmental

[20] Ibid.

footprint. On April 9, 2018, Apple announced that it had achieved one hundred per cent reliance on renewable energy in all its facilities.[21] The company stated that it was able to achieve this milestone due to its commitment to leave the world better than it found it.

Apple has continuously built renewable energy facilities across the world and it is driving its suppliers to assume similar responsibilities so that it can achieve a supply chain that is fuelled by clean energy. The company has twenty-five renewable energy projects across the globe that are fully operational and have a capacity to generate six hundred and twenty-six megawatts of electricity. Fifteen other projects are on going and the company's renewable energy grid is expected to inject one thousand four hundred megawatts of electricity into the grid once they are completed.[22] Apple is not the only company that has taken on the social responsibility of caring for the environment, there are thousands of companies across the world that are committed to operating sustainably and caring for the environment. They are committed to sustainability and leaving the environment better than they found it.

3.3 Ethical Responsibility

Ethical responsibility differs from the other forms of social responsibilities since it is mostly concerned with the treatment of internal stakeholders while the other forms of social responsibility are mostly concerned with the treatment of external stakeholders.[23] The question arises on what level of ethics should a business have? It is generally agreed that business ethics should be less stringent than that generally expected of individuals in a society.

[21] Apple Inc., 'Apple Now Globally Powered By 100 Percent Renewable Energy' (*Apple Newsroom*, 2022) <https://www.apple.com/ke/newsroom/2018/04/apple-now-globally-powered-by-100-percent-renewable-energy/> accessed 22 July 2022.

[22] Ibid.

[23] McBarnet (n 15).

There are multiple angles to ethical responsibility and this paper will give some examples to cover a few of these angles. The most common strategy to ethical responsibility adopted by business is ensuring that raw material used to manufacture their brands come from an ethical supply chain. This is of particular interest to these companies and to the consumers because the supply chain is often characterized by unethical practices such as forced labour, child labour, unsafe working conditions, discrimination in workplaces, harassment in workplaces, corruption, and environmental degradation.

Ethical sourcing is an integral part of a company's social responsibility and some global firms have provided workable solutions for ethical sourcing that are driving sustainability. One of the leading companies on this front is Starbucks with its Coffee and Farmer Equity Practices policy. The company's C.A.F.E program ensures sustainable sourcing by creating verification stages where the suppliers' practices are vetted on the basis of their economic, social, and environmental impacts.[24] The verification process ensures that the farmers operate in transparent and profitable manners. The program also ensures that the company's coffee suppliers promote the wellbeing of the coffee farmers, workers, and their families. The program contains over two hundred indicators that include financial metrics, protection of farmers and workers' rights measures, and environment preservation. The measures are then reviewed by SCS Global Services, a company that is responsible for verifying the quality and integrity of audits.[25]

In the midst of reports of human right abuses in the apparel industry's supply chain. H&M took up the ethical responsibility of committing to a transparent supply chain.[26] This is part of the company's efforts directed towards fulfilling its ethical responsibility. This undertaking

[24] Starbucks Coffee Company, 'ESG Resources: Starbucks Coffee Company' (*Starbucks.com*, 2022) <https://www.starbucks.com/responsibility/reporting-hub/> accessed 22 July 2022.

[25] Ibid.

[26] H&M Group, 'Transparency' (*hmgroup.com*, 2022) <https://hmgroup.com/sustainability/leading-the-change/transparency/> accessed 22 July 2022.

operates in a simple way but it passes a very important message to the suppliers and to the customers. H&M's supply chain transparency program involves publishing a list of their suppliers on their website and updating this list on a quarterly basis.[27] This approach grants the public access to information on the company's suppliers thus allowing them to report any cases of ethical behaviour by the suppliers to H&M. The apparel industry is considered one of the worst in terms of ethical sourcing and a leading company in this industry allowing the public to audit its supply chain is a significant step in ensuring that companies fulfil their ethical responsibility.

An example that is closer home is the recent decision by Villa Rosa Kempinski in Kenya not to buy chicken reared in cages. This is due to the ethical considerations based on the fact that battery cage method violates animal rights and use large quantities of drugs during rearing.[28]

3.4 Philanthropic Responsibility

Philanthropic responsibility remains a grey area in modern business management fundamentally due to the definition of the term. Philanthropy is the desire to improve the welfare of others through charitable donations and contributions. While some businesses participate in such courses, it is difficult to reinforce this as a responsibility for businesses since they have little control over these activities. These are programs that are organized and implemented outside of the organization's operations and they have no or no direct effects on its performance.

It is also difficult to hold a business accountable based on the level or amount of philanthropy that it demonstrates. However, it is possible to hold a firm accountable on the basis of its mission and vision statement. If the company has the improvement of the lives of whole communities, or other external stakeholders, then it is possible

[27] Ibid.

[28] <https://www.standardmedia.co.ke/farmkenya/article/2001445668/why-kempinski-will-no-longer-buy-chicken-products-reared-under-cages> accessed 20/10/2022.

to hold the firm accountable since it has expressed commitment to make improvements outside its scope of philanthropy. In modern times, philanthropy has morphed from random acts of kindness so as to speak from the corporation to more structured corporate social responsibility structures that are quantifiable.

3.5 Economic Responsibility

Economic responsibility could be seen as a combination of all the above or a control to the economic activities of a business. Economic responsibility of a business is the consideration of all the effects of its business decisions. This helps the firm determine whether the firm has got negative effects on its stakeholders in the course of doing business.[29] The element of economic responsibility is best demonstrated using active examples. For example, take a company that manufactures weaponry. Since more volumes translate to more revenue and enhance the firm's profitability, the firm is driven to push as much sales as possible. However, the company's products could be used to cause harm to innocent people through acts of violence. The firm cannot, therefore, blatantly push for increased sales volumes with considering the controls to how the buyers will use its products.

Other examples of economic responsibility are the sale of products that are voluntarily consumed and could cause harm to the consumer. These products include alcohol and cigarettes that are linked to terminal illnesses. The managers in these companies have the social responsibility of generating profits for the investors.[30] However, they also have the economic responsibility of informing the public that consuming these products could affect their judgment or their health.[31] Economic responsibility is one of the least implemented forms of social responsibility since its effective implementation would result in

[29] Ireland (n 16).

[30] Sundaram & Inkpen, (n 2).

[31] Chukwuemeka (n 5).

some companies losing most if not all of their revenue streams. These companies often compensate for this by participating in other forms of social responsibility such as environmental and ethical responsibility.

The examples used to demonstrate social responsibility for Apple and Starbucks have elements of economic responsibility in them. In Apple's case, the development of these renewable energy facilities reduces the company's reliance on purchased energy thus resulting in long term costs savings, which benefits the company in the long term. In Starbucks' example, its practices ensure that the suppliers operate sustainably thus securing its supply chain. The program ensures that the company does not suffer from supply chain interruptions resulting from lack of raw material or supply of substandard raw material by the farmers.

4. Conclusion

Apple is not the only company that has taken on the social responsibility of caring for the environment, there are thousands of companies across the world that are committed to operating sustainably and caring for the environment. They are committed to sustainability and leaving the environment better than they found it. Controlling pollution is not the only approach to caring for the environment. Companies are taking on this responsibility through other initiatives such as recycling and reclaiming natural resources, such as forests and water bodies. The findings of this research indicate that businesses have the social responsibilities of maximizing shareholder value. However, this is not the only social responsibility for these businesses. Everyone has the responsibility of making the world a better place and businesses fulfil this responsibility to the investors by providing them with profits. They also have the responsibility of ensuring continuity and sustainability, which they can only achieve by acting on their environmental, ethical, philanthropic and economic responsibilities. Ultimately, when managers create value for all stakeholders then the shareholder's value is also maximised.

The Corporate Veil: A Catalyst for Soulless Foreign Investments and Human Rights Abuses

Husnah Julius

Abstract

The need for investments that promote human rights has been at the core of the current discourse on international investments reforms. There has been public outrage on the importance of aligning investments with sustainable development. This includes tying the benefits that accrue to investors with the duty and responsibility of investors to act in a manner that protects and promotes human rights. This paper interrogates the concept of the corporate veil under the international investment regime; whether it has incentivized foreign corporate investors to ignore human rights concerns and what can be done to remedy the situation.

1. Introduction

Despite the popularity and recommendation of foreign investment over the years, the current state of foreign investments has suffered major drawbacks. One of the major drawbacks is the prioritization of foreign investor protection at the expense of human rights protection in host states. Human rights in need of protection include civil and political rights as well as economic, social, cultural and environmental rights.

It is against this backdrop that this paper seeks to interrogate foreign corporate investor protection vis a vis human rights protection through the lens of corporate governance. The paper argues that the international investment regime's augmentation and institutionalization of the corporate veil has had negative effects. This is because in addition to the concept of the corporate veil, International Investment Law accords foreign investors protections that make lifting of the corporate veil even harder. Some of

these foreign investor protections include: national treatment; most favored nation treatment; fair and equitable treatment; international minimum standard of treatment; full protection and security; prohibition against expropriation; and prompt, adequate and effective compensation for expropriation and nationalization.

The current Investor-State Dispute Settlement (ISDS) system has been argued to be biased towards over protecting foreign investors and under protecting the host states.[1] This is because it gives leeway to foreign corporate investors to access justice with unclean hands and seek redress for alleged violation of their rights by host states even in the face of gross misconduct, such as human right abuses.[2] Jean Ho argues that the current elusive foreign investor responsibility, particularly corporate investor responsibility, was created by omission.[3]

This omission can be traced back to the Nuremberg trial where the Nazi leaders were convicted but the German Corporations that were involved in financing the autocracies were not charged because corporate liability for misconduct, at the time, was not an established area under International Law.[4] The drafters of the Rome Statute of the International Criminal Court also focused on criminal conduct of individuals and avoided incorporating the underdeveloped concept of corporate misconduct.[5]

Sornarajah notes that foreign investors, especially Multinational Corporations (MNCs), have immense financial resources that could greatly destabilize the economies of weak host states in case they decided to relocate their investments.[6] Hence, capital importing countries often

[1] Jean Ho, 'The Creation of Elusive Investor Responsibility' (2019) 113 American Journal of International Law <https://www.cambridge.org/core/journals/american-journal-of-international-law/article/creation-of-elusive-investor-responsibility/66BEA419EB40F67433A1E9DED4EBDD7E> accessed 20 July 2022.

[2] Ibid.

[3] Ibid.

[4] Ibid.

[5] Ibid.

[6] M. Sornarajah, *The International Law on Foreign Investment* (2010, 3rd edn, Cambridge University Press 2012).

feel the need to relax their human rights and corporate governance laws in order to attract investments from capital exporting countries at the expense of public interest protection. Even though efforts are underway to reform the current international investment regime, this remains to be the biggest challenge.

Incorporation is important to foreign investors because, firstly, through the corporate veil they enjoy protection from personal liability over any violations committed by the company. Secondly, incorporation gives foreign corporate investors immense power which they then use to dictate the regulatory and policy framework that should govern their investments in host states. This paper thus interrogates the concept of the corporate veil under the International Investment regime; whether it has incentivized foreign corporate investors to ignore human rights concerns and what can be done to remedy the situation.

2. Theoretical Framework

This part of the paper briefly discusses some of the corporate governance theories that support and criticize human rights protection, as a means of achieving sustainable investment and corporate governance.

2.1 The Communitarianism Theory

This theory is argued to be the backbone of Corporate Social Responsibility (CSR). It is a socio-political theory that discredits the ideas of individualism and individual liberties as propounded by John Rawls and Robert Nozick.[7] Accordingly, proponents of the communitarianism theory argue that the interests of society should take precedence over individual interests.[8] Some of the proponents of this theory are: Alasdair MacIntyre, Michael Sandel, Charles Taylor and Michael Walzer.[9] Ubuntu is the African manifestation of the communitarianism theory.

[7] Daniel Bell, 'Communitarianism' (Fall 2020 Edition), The Stanford Encyclopedia of Philosophy, Edward N. Zalta (ed.) <https://plato.stanford.edu/entries/communitarianism/#pagetopright> accessed 20 July 2022

[8] Ibid.

[9] Ibid.

It thus follows that since corporations do not operate in a vacuum, they have a moral obligation to protect and promote the wellbeing of the particular communities that they operate in. This includes ensuring that corporations respect all the human rights and fundamental freedoms of these communities. Contrarily, the Contractarianism Theory and the Friedman Doctrine hold that corporations have no moral obligations towards society as a whole. The Friedman Doctrine, as put forward by Milton Friedman in 1970, states that the only social responsibility corporations have is to make profits.[10] Therefore, it is not the responsibility of corporations to promote human rights; that is the responsibility of the State.

The Contractarianism Theory or the Nexus of Contracts Theory on the other hand is premised on the notion that (moral) obligations are derived from contracts or mutual agreements.[11] For that reason, proponents of this theory argue that corporations are a nexus of contracts and thus are only obligated to those they are in contract with namely: shareholders, directors, employees, suppliers and creditors among others. Therefore, the corporation has no obligations to the society as whole as it has no contract with it. This theory can be traced back to historical Social Contract theorists; Hobbes, Locke, Kant, and Rousseau.[12] Modern economists that have contributed to the development of the theory include: Ronald Coase, William H. Meckling, Michael C. Jensen, Armen A. Alchian, and Harold Demsetz.[13]

[10] Milton Friedman, 'A Friedman Doctrine - The Social Responsibility Of Business Is to Increase Its Profits' *The New York Times* (13 September 1970) <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> accessed 20 July 2022.

[11] Ann Cudd and Seena Eftekhari, 'Contractarianism' (Winter 2021 Edition), The Stanford Encyclopedia of Philosophy, Edward N. Zalta (ed.) <https://plato.stanford.edu/cgi-bin/encyclopedia/archinfo.cgi?entry=contractarianism> accessed 20 July 2022.

[12] Ibid.

[13] William W. Bratton, 'The "Nexus of Contracts" Corporation: A Critical Appraisal' (1989) Faculty Scholarship at Penn Law <https://scholarship.law.upenn.edu/faculty_scholarship/839> accessed 20 July 2022.

This paper argues that in light of globalization and in the wake of good corporate governance practices, the Contractarianism Theory and the Friedman Doctrine can no longer hold in the current international economic order. This is because human rights are no longer at the periphery of business operations. Corporations are now required to embrace the 3 Ps of sustainability: people, planet and profits as the pillars of their operations and governance. As such, profits are no longer the only pillar.

2.2 The Stakeholder Theory

This theory is based on the proposition that a corporation should protect the interests of all its stakeholders by forging alliances that ensure effective stakeholder engagement.[14] These stakeholders include: employees, shareholders (investors), the community, customers, the government, suppliers, and creditors.[15] Respecting the human rights and freedoms of all stakeholders, including the society as a whole, during their operations then becomes imperative. Opposed to this theory is the Shareholder Theory that argues, the corporation should only safeguard the interests of the shareholders; who are the principals.[16] This was posited by economist Milton Friedman when he published the Friedman Doctrine discussed earlier; a theory on business ethics.[17]

This paper disagrees with the Shareholder Theory and instead relies on the Stakeholder Theory to assert its position that, indeed corporations have an obligation to promote the interests of all parties that may be affected by their operations. Their obligations do not start and end with maximizing their shareholders' value.

[14] Sneha Gaonkar and Priya Chetty, 'The Stakeholder Theory of Corporate Social Responsibility' <https://www.projectguru.in/the-stakeholder-theory-of-corporate-social-responsibility/> accessed 20 July 2022 .

[15] Ibid.

[16] Milton Friedman, supra. n 10.

[17] Ibid.

3. Conceptual Framework: The Foreign Corporate Investor-Human Rights Dichotomy Through the Lens of the Corporate Veil

This part delves into an in-depth discussion of the subject matter. It defines the relevant foreign investment concepts (variables) and interrogates how these concepts relate to human rights abuses. Particular focus is paid to the correlation between the corporate veil and human rights abuses. This analysis highlights the glaring and daunting role of International Investment Law and Corporate Law in promoting human rights abuses.

3.1 The Correlation Between Foreign Investment Concepts and Human Rights Abuses

This paper finds that there is a positive correlation between foreign investment concepts that protect foreign corporate investors and an increase in human rights abuses. This is because when the standards of foreign investment protection are raised, to become more favorable to foreign investors, the probability of human rights abuses also rises. The protection of human rights is often curtailed by various investment concepts such as: stabilization clauses, foreign investors' legitimate expectation and regulatory chills. These concepts are discussed below.

3.1.1 Stabilization Clauses

These are clauses that essentially freeze laws and regulations, some or all, by limiting the application of new laws and regulations to a foreign investment throughout its life.[18] Stabilization clauses are often drafted in a way that either excuses foreign investors from complying with new laws and regulations or in case of compliance, the host state is required to pay the foreign investor compliance costs.[19] Hence, the clauses negatively affect the host state's duty to meet its international obligations especially on protection of human rights without undue costs and hardships.

[18] Andrea Shemberg, 'Stabilization Clauses and Human Rights' 2009 International Financial Corporation <https://www.ifc.org/wps/wcm/connect/0883d81a-e00a-4551-b2b9-46641e5a9bba/Stabilization%2BPaper.pdf?MOD=AJPERES&CACHEID=ROOTWORKSPACE-0883d81a-e00a-4551-b2b9-46641e5a9bba-jqeww2e> accessed 20 July 2022.

[19] Howard Mann, 'International Investment Agreements, Business and Human Rights: Key Issues and Opportunities' 2008 International Institute for Sustainable Development <https://www.iisd.org/system/files/publications/iia_business_human_rights.pdf > accessed 20 July 2022.

3.1.2 Foreign Investors' Legitimate Expectation

When a foreign investor establishes an investment in a host state, it is their expectation that the host state will be transparent in its dealing. This includes: full disclosure, clarity, promulgation and consistent application of the laws and procedures relevant to the investment. This concept of foreign investor's legitimate expectation has however been critiqued by various scholars. One such scholar is Jean Ho who argues that a foreign investor should also have a legitimate expectation that laws will change.[20]

3.1.3 Regulatory Chills

Regulatory Chills occur when host states are hesitant to regulate foreign investors for various reasons.[21] This fear arises from the host state's concern that in case they enact new laws to protect human rights, the foreign investor may pull out their investment and take it to another country with no human rights obligations; leading to loss of investment.

Mann notes that the right of the host state to regulate is two-fold: the duty to protect and promote human rights; and the power to enforce sanctions and punishment against violators.[22] The right of the host state to regulate has not been accepted as an international customary practice hence for it to be effective, it should be expressly recognized in IIAs.[23] Otherwise, regulatory chills will continue to act as a catalyst for human rights violations by foreign corporate investors.

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[20] Jean Ho, supra. n 1.

[21] United Nations General Assembly, 'Human Rights-Compatible International Investment Agreements' <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N21/208/09/PDF/N2120809.pdf?OpenElement> accessed 20 July 2022.

[22] Howard Mann, supra. n 19.

[23] Ibid.

3.2 The Correlation Between the Corporate Veil and Human Rights Abuses

The corporate veil is one of the sacrosanct legal concepts entrenched in corporate law. The concept was first addressed in the *Sutton's Hospital Case (1612).*[24] However, it was formally established in the *locus classicus case of Salomon v Salomon & Co Ltd*[25] where the House of Lords upheld the principle of limited liability. The principle holds that the company is a separate legal entity from its members, hence members cannot be held liable for the actions or inactions of the company and vice versa.[26] This principle subsequently birthed the corporate veil doctrine which shields the members of a company from any liability relating to the company's actions; mostly the shareholders, directors and senior members with authority.

The corporate veil has incentivized foreign corporate investors to violate human rights without any sanction by the host state or the international community. This is because economically, the corporate veil creates a moral hazard. A moral hazard is an incentive to increase one's exposure to risk because one has legal or economic protection.[27] This is one of the problems of the principal-agent relationship in corporations. To illustrate this, this paper analyses some of the corporate governance variables from a law and economics perspective. An economic analysis of these concepts helps interrogate the unintended and often overlooked economic and social consequences of the corporate veil.

In making the assertions that this paper makes, it is important to note that the instant paper acknowledges the importance of the corporate veil in the operations of corporations. Therefore, it appreciates that the concept plays an important role in incorporation and it should

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[24] *Sutton's Hospital Case* (1612), 10 Coke Reports, 1a-35a ER 77 937-976.

[25] *Salomon v Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22.

[26] Ibid.

[27] J. A. Mirrlees, 'The Theory of Moral Hazard and Unobservable Behaviour: Part I' (1999) 66 (1) The Review of Economic Studies <https://doi.org/10.1111/1467-937X.00075 3 - 21> accessed 21 July 2022 3-21.

only be lifted in serious occasions. One such serious occasion is when corporations abuse human rights and fundamental freedoms. Violation of human rights is not a risk corporations should be allowed to take because the social costs of the same by far outweigh any envisioned benefits.

3.2.1 The Law and Economics of Agency Law and the Corporate Veil

The law of agency can be traced in the nexus of contracts theory or the contractarianism theory. The theory, as discussed earlier, holds that since corporations are not natural persons they have no minds, bodies or souls; they are merely creatures of the law and the company's contracts. The economics of agency law is therefore to ensure that corporations can operate efficiently by creating a principal (shareholders) and agents (directors and managers).[28] This way there are natural persons that give the corporation a mind, body and soul.

Similarly, the corporate veil ensures the agents carry out their mandate at optimum levels without any interferences, such as being held liable for any decisions made on behalf of the corporation, positive or negative. This is why courts are always reluctant to lift the corporate veil by ignoring the agency relationships within a corporation unless provided for under statutory law or common law. In Kenya, the corporate veil may be lifted under the Companies Act 2015 in cases involving: fraudulent trading; a sham company; an alien/enemy company; reduction or increase in statutorily required number of members; deliberate evasion of contractual and statutory obligations, such as payment of tax; holding and subsidiary companies; and misdescription of the company.[29]

[28] George M. Cohen, 'Law and Economics of Agency and Partnership' (2018). Oxford Handbook of Law and Economics, Forthcoming, Virginia Law and Economics Research Paper No. 2018-11, <https://ssrn.com/abstract=3208640> accessed 21 July 2022.

[29] The Companies Act No. 17 of 2015.

From an economics perspective, lifting the corporate veil for some corporations, such as publicly traded companies that have large numbers of shareholders, may not be effective.[30] This is because these shareholders have the financial muscle to diversify and absorb the risk of liability, hence the severity of the liability will not be felt. The same can be said about foreign corporate investors. Therefore, alternatives to lifting the corporate veil may be needed to ensure members of corporations are held liable for human rights abuses.

3.2.2 The Law and Economics of Ethical Conduct, Due Care and Risk Management

An economic analysis of tort law involves analyzing non-market behaviors such as ethical conduct, due care and risk management. Robert Cooter and Thomas Ulen note that the law on torts seeks to govern injuries that do not arise from a breach of contract.[31] Tortious liability arises when there is a breach of duty primarily fixed by the law; such duty being towards all persons generally.[32] Based on this, a logical argument can be made that promotion of human rights, especially those that fall under tort law, is a duty owed by corporations to the society.

The economic purpose of tort law is to induce injurers to internalize the costs of harm by making them compensate victims for harm caused.[33] Internalization of harm therefore acts as incentive to invest in safety at the most efficient level.[34] Going by the Coase Theorem, the cost of bargaining in tort is high because tort claims are private claims.[35] Bargaining would thus require every human to individually

[30] Philip Örn, 'Piercing the Corporate Veil - A Law and Economics Analysis' (Master Thesis, University of Lund 2009) <https://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1563314&fileOId=1566244> accessed 21 July 2022.

[31] Ibid.

[32] Ibid.

[33] Ibid.

[34] Ibid.

[35] Ibid.

bargain with another human on how to deal with tort matters.[36] A good illustration of this is the case of faulty products where each manufacturer would be required to negotiate with each consumer on how to allocate the cost of any accident that may occur. Thus economically, tort liability is one of the ways of optimally deterring risk by inducing optimal precautions by both the injurers and the victims.

When corporations commit torts because they: (a) failed to act ethically, (b) disregarded due care, or (c) did not effectively manage their risks, those affected are innocent by standers who are not privy to their operations. Unlike creditors of a company who assume the risks/externalities of the company's operations, tort victims do not consent to these risks.[37] Accordingly, it is argued that for acts of tort, the standard for lifting the corporate veil should therefore be lower.[38] This will aid in achieving a fair and effective allocation of blame and costs because costs are internalized by the party better equipped to do so, economically or otherwise.[39] In this case, corporations especially foreign corporate investors are better placed to internalize the costs of protecting human rights.

4. Jurisprudence: The Prevalence of Human Rights Abuses by Foreign Corporate Investors

Traditionally, the purpose of lifting the corporate veil was to hold members of a company personally liable for wrongs 'done by the company'. Lifting the corporate veil is particularly difficult when trying to hold a parent company liable for the wrongs done by its subsidiary because legally the two entities are separate and independent. Hence, it is always difficult to prove that the parent company was in control of the subsidiary's actions and the burden of proof is on the host state to prove

[36] Ibid.

[37] Philip Örn, supra. n 30.

[38] Ibid.

[39] Ibid.

control. The corporate veil acts as a shield because it is used as a means of defence against personal liability.

However, in Investor-State Disputes the inverse happens and the burden of proof shifts to the foreign corporate investor to prove that they had an investment in the host state. To do this, the parent company has to ascertain that they had control over the subsidiary in a manner that indicates that the parent company and the subsidiary company are one entity deserving of protection. This is important because for the parent company to establish that it has locus standi to bring an Investor-State Dispute against the host state, it has to show connection to the subsidiary company; the corporate veil then becomes a sword that investors use to seek damages from host states.

This part of the paper highlights some international and local cases to illustrate how frequent corporate human rights violations are; and how corporations have used the corporate veil to maneuver liability.

4.1 S. D Meyers Inc. v Government of Canada[40]

S.D. Myers Inc. registered in the United States (the parent company) incorporated S.D. Myers (Canada) Inc. (the subsidiary company) to obtain polychlorinated biphenyl (PCB) waste from Canada for treatment in its facility in the United States. In 1998, the parent company brought an arbitration claim against Canada under Chapter 11 of the North American Free Trade Agreement (NAFTA)[41] because Canada banned the use of polychlorinated biphenyl (PBC), which was the object of their business. The parent company thus claimed that the ban affected its investment and further that it violated the foreign investment principles on national treatment, minimum standard of treatment, performance requirements and expropriation.[42]

[40] *Myers* (S. D.) v. Canada [2002] NAFTA/UNCITRAL Tribunal

[41] Government of Canada, 'NAFTA - Chapter 11 – Investment' <https://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/SDM.aspx?lang=eng> accessed 22 July 2022.

[42] Ibid.

Canada on the other hand argued that the parent company did not have any investment in Canada because the subsidiary company incorporated in Canada was a separate independent entity hence it did not have standing to bring the suit. Further, that their decision to ban PBC was necessary for environmental protection.[43] The tribunal, however, found that the subsidiary company was an investment because the parent company proved substantial control over the subsidiary. It also held that the ban was discriminatory because it was intended to favor Canadian PCB waste disposal companies hence it was not an environmental protection measure.[44] Accordingly, the tribunal proceeded to award the claimant $6.9 Million Canadian Dollars for the direct loss of profits caused by Canada's action.[45]

In the above judgment, the tribunal re-emphasized that the right to regulate should not violate the minimum standard of treatment and the national treatment principle. However, a reading of the award illustrates that the tribunal was largely concerned with whether the rights of the investor had been violated and failed to consider that there was an actual environmental concern worth addressing.

4.2 The Johnson & Johnson Talc Powder Cases

The American multinational pharmaceutical corporation founded in 1886[46] has been involved in a series of law suits including class actions with regards to its famous baby powder for containing high levels of asbestos, a mineral ingredient that causes cancer.[47] The pharmaceutical has been aware of the ingredient and the grievous effects (health complications and death) for decades but it chose to ignore the same; violating consumer rights.[48]

[43] Ibid.

[44] Ibid.

[45] Ibid.

[46] Johnson & Johnson, 'About Johnson & Johnson' <https://www.jnj.com/about-jnj> accessed 22 July 2022.

[47] Lisa Girion, 'Johnson & Johnson Knew for Decades that Asbestos Lurked in its Baby Powder' *Reuters Investigation* (14 December 2018) <https://www.reuters.com/investigates/special-report/johnsonandjohnson-cancer/> accessed 22 July 2022.

[48] Ibid.

Several victims got favorable court orders against company for damages. To avoid settling claims, the company adopted the court sanctioned Texas two-step law on bankruptcy.[49] Under this law, the first step is to incorporate a separate company and then transfer all the company's liabilities to it[50] (the award orders in favor of the victims). The second step is to file for bankruptcy so that the court issues a moratorium indicating creditors are not to be paid until the unprofitable company holding the liabilities goes through the bankruptcy process.[51] This way the original company (Johnson & Johnson) remains with the assets, the profitable business.

This concept of separation of a company based on its assets and liabilities is entrenched on the concept of the corporate veil because the two companies (the on holding the assets and the one holding the liabilities) become two distinct legal entities. This allows the profitable half of the company to run as usual because there is no moratorium against it while the other unprofitable half is subjected to bankruptcy. The company holding the assets is therefore relieved from the pressure of settling claims; robbing victims of justice by leaving them uncompensated and in limbo not knowing if their awards will ever be enforced.

4.3 Human Rights Abuses at Kakuzi PLC

It was not until August 2019 that allegations of human rights abuses at the Kenyan agricultural company came to light.[52] The company is a subsidiary of Camellia Plc, a company incorporated in the United Kingdom.[53] The human rights allegations included: rape, arbitrary

[49] Brian Mann, 'J&J is Using a Bankruptcy Maneuver to Block Lawsuits over Baby Powder Cancer Claims' NPR 21 October 2022 <https://www.npr.org/2021/10/21/1047828535/baby-powder-cancer-johnson-johnson-bankruptcy> accessed 22 July 2022.

[50] Ibid.

[51] Ibid.

[52] Kenya Human Rights Commission, 'Heavy Price for Kakuzi's Egregious Human Rights Violations' <https://www.khrc.or.ke/2015-03-04-10-37-01/press-releases/737-heavy-price-for-kakuzi-s-egregious-human-rights-violations.html> accessed 23 July 2022.

[53] Ibid.

detention, assault, labor injustices, beating to death of alleged avocado thieves, and unsettled land claims.[54] It took the Kenya Human Rights Commission years of advocacy to seek redress for the victims and affected communities through a suit filed in the English courts against Camellia Plc for the egregious human rights violations.[55]

Camellia Plc (the parent company) agreed to pay and settle the claims but again, the actual perpetrators were not personally held liable or even publicly disclosed due to the concept of the corporate veil. Additionally, when parent companies located miles away settle the claims instead of the subsidiary companies in the host states, there is a sense of robbed justice. This is because these corporate foreign investors are allowed to by-pass national domestic laws and prosecution by domestic courts. Hence, host states and the local communities that are the direct victims of the abuses cannot litigate the abuses in their domestic courts; the sense of justice is thus detached from them because they cannot directly confront their abusers.

4.4 The Owino Uhuru Lead Pollution Case

In 2007, a company called Metal Refinery (EPZ) opened a plant to recycle used lead-acid batteries in Owino Uhuru Settlement in Mombasa, Kenya.[56] Shortly thereafter, the local community lodged complaints alleging lead poisoning in their soil and water as a result of poor waste management.[57] The lead poisoning has had negative environmental and health complications, including deaths and respiratory diseases.[58]

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[54] Ibid.

[55] Ibid.

[56] Business and Human Rights Resource Centre, 'Metal Refinery (EPZ) Lawsuit (Re Lead Pollution in Kenya)' <https://www.business-humanrights.org/en/latest-news/metal-refinery-epz-lawsuit-re-lead-pollution-in-kenya/#:~:text=In%202007%2C%20the%20Metal%20Refinery,result%20of%20poor%20waste%20management.> accessed 23 July 2022.

[57] Ibid.

[58] Ibid.

The Centre for Justice Governance and Environmental Action, an NGO, brought a class action lawsuit on behalf of the Owino Uhuru community in 2016.[59] The Land and Environment Court sitting at Mombasa in 2020 declared that the residents of Owino Uhuru Settlement had a right to a clean and healthy environment and that Metal Refinery had violated this fundamental environmental right.[60] The court directed the government and some local companies to pay the three thousand (3000) victims Kshs.1.3 billion.[61]

It is noteworthy that the Court found various non-state and actors and state actors negligent and liable for not protecting the Community's right to a clean and healthy environment. One such state actor is the national environmental regulator, National Environmental Management Authority (NEMA). Despite being aware of the lead poisoning, the regulator chose not to act.[62] This highlights the problem associated with various relevant parties becoming gatekeepers in aiding and abetting corporate human rights abuses; one of the biggest challenges in implementing good corporate governance practices and responsible behavior within corporations.

4.5 Human Rights Violations in the Extractive Sector in Taita Taveta

The Kenya National Commission on Human Rights (KNCHR) through a public inquiry done in 2016 unveiled various human rights abuses by corporations in the mining sector at Taita Taveta.[63] Some of the reported human rights abuses were: loss of entitlement to land by the communities due to irregular title allocation practices; exposure to environmental health and safety risks arising from mining activities; land degradation; child labour; violation of labor rights, including

[59] Ibid.

[60] Ibid.

[61] Ibid.

[62] Africa Uncensored, 'Lead Poisoning in Owino Uhuru, Mombasa' <https://www.youtube.com/watch?v=SWU6AsfhYs0&ab_channel=AfricaUncensored> accessed 23 July 2022

[63] Kenya National Commission on Human Rights, 'Public Inquiry Report On Mining And Impact On Human Rights: Taita Taveta County, 2016' <https://www.knchr.org/Portals/0/EcosocReports/Taita-Taveta-Inquiry.pdf?ver=2013-02-21-141554-053> accessed 23 July 2022.

denial of leave days and failure to remit statutory deductions.[64] Only a few of these cases have been filed in court for redress. This is because of the complexities presented by the corporate veil when trying to find the specific actors personally liable.

5. Conclusion and Way Forward: The Road Towards Investments with Souls

This paper analyzed the concept of the corporate veil under the international investment regime. It found the concept to be problematic. This is because under the international investment regime the corporate veil is used as a sword against the host state. Once a parent company establishes that a subsidiary company is an investment in the host state, it automatically has standing to bring a claim against the host state for alleged violations; even if they have committed human rights violations.
The paper makes the following recommendations as solutions to the gaps and challenges highlighted throughout the paper:

1. Stakeholders, especially internal stakeholders, sometimes aid and abet the commission of human rights abuses because they have protection under the corporate veil. Subsequently, corporations are held liable for the actions of its personnel (directors and shareholders) and company resources are used to settle claims. The resources used could have otherwise been spent in capital expenditure (investments), payment of recurrent expenditure, operational bills, loan repayments, payment to suppliers and creditors, and payment of dividends. This has in some circumstances led to the failure, collapse and bankruptcy of some corporations.

   Members of the company should use their derivative rights to bring claims against the individuals committing human rights abuses; directors as strategic leaders should promote human rights as part of the business strategy; and shareholders should use their voting rights to vote out directors not making decisions that align with CSR and ESG.

[64] Ibid.

2. IIAs should integrate human rights protection by expressly assigning human rights obligations to foreign investors. Additionally, IIAs should not have precedence over international and domestic human rights obligations. There needs to be an express condition indicating that any breach or violation of human rights by foreign corporate investors will lead to a revocation of the investment certificate and a repudiation of the IIA.
3. Stabilization clauses should not be used to override host states right to regulate and protect its citizens from human right abuses by foreign corporate investors. Similarly, host states should not use their powers to regulate in an arbitrary and discriminatory manner, as this may lead to direct and indirect expropriation. If regulation is done in the public interest, no compensation should accrue. Instead, investors should foresee and assume the risk of changes in law. Further, investors who have committed human rights abuses should not be allowed to approach tribunals and courts with unclean hands.
4. Once found guilty of human rights violations, tribunals should decline to grant foreign corporate investors any remedy for loses suffered as a result of laws or regulations passed by the host state in the public interest.
5. There should be an authoritative, binding and mandatory multilateral international corporate governance regime with a centralized international institution to oversee and monitor the compliance of corporate governance principles. This proposed regime should adopt the international law principles of universal jurisdiction; obligations *erga omnes;* and obligations *erga omnes* partes. Incorporation of these principles will solve the challenge of *forum non conveniens* because States will have universal standing and jurisdiction to prosecute multinational corporations for human rights violations.

Assessing the Level of Awareness of the CS Profession in Kenya

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Abstract

The robust evolution of the Certified Secretaries (CS) profession in both concept and practice across jurisdictions is undeniable. It has occasioned a change in the conception to what is now a considered, properly so, a governance profession rather than one of minute takers-cum-compliance experts. Amid this evolution, however, are worrying levels of awareness and acceptance among prospective practitioners and potential users who are critical for the growth and sustainability of the profession. The evolution has seen the advent of new expectations on the part of a CS to, among other things, facilitate board development and guarantee sustainable governance. This must surely evoke stakeholders to reconsider their approach to promoting awareness of the profession. This paper demonstrates why the levels of awareness are a concern that ought to be addressed urgently. Specifically, it finds that a misconception persists as to what the profession entails, with little knowledge of the value the profession presents among prospective practitioners and potential users. Moreover, there exists a worrying trend of non-compliance with statutory and policy requirements. The statutory requirements, however, have gaps which adversely affect integration and mainstreaming of the profession into both the private and public sectors which are in dire need of good governance. In essence, the paper concludes that even though a commendable bit has been done, a lot of deliberate effort is required. Key among the interventions recommended is legislative reforms, and more proactivity by stakeholders in leveraging existing diverse resources and capabilities to promote awareness.

1. Introduction

The role of a Certified Secretary (CS) evolves alongside the dynamics of corporate governance. Previously, the role was viewed as largely administrative and clerical and often times exclusively within a company setting. However, the profession has experienced robust development and expansion. As a consequence, CSs are beginning to be viewed as individuals who are pivotal in the implementation of effective governance practices within an organisation and the development of highly effective and functional boards.

Presently, chairpersons of boards look to CSs not only for advice on compliance, but also for recommendations on how to ensure that sound governance practices are embedded in the organisational culture and structure. This is particularly so since governance within any organisation should be owned by all board members and buttressed by the CS, rather than merely be delegated to the latter. Given that the role of the CS is gaining more prominence globally, it is necessary that both users and practitioners (actual and prospective) have the necessary information concerning the evident value they can provide. Equally, it is incumbent upon stakeholders in the profession to take up the role of creating this awareness as a means of facilitating acceptance and eventual integration of the profession across multiple sectors where governance is key, which is technically every sector.

Currently, such is not the case. Owing to the fact that there exists little to no literature documenting the level of awareness and what can be done to improve it, this paper attempts to survey the same. It is hoped that target intervention can be pursued in order to influence improvement in the profession, ultimately enhancing governance. The first section of the paper explains the evolution of the concept and role of the CS. The second describes the context within which CSs operate, in terms of the legal and institutional framework. The third assesses the level of awareness of the CS profession among its users and prospective practitioners. The fourth examines how stakeholders can contribute to enhance the level of awareness, based on best practices in other jurisdictions (United Kingdom

and Malaysia) and professions (supplies and legal). The fifth gives general and specific recommendations for interventions by appropriate stakeholders.

2. Evolution in the Role of a CS

The role and position of the CS is fast evolving globally and quickly moving beyond the traditional role of "minute taker" into a compliance and governance leader.[1] What constitutes the role of a CS varies according to a country's peculiar and specific legal framework and conditions.[2] The traditional role of a CS included [a] ensuring compliance with corporate laws and regulations, [b] maintaining the register of members of a corporate outfit, [c] filing returns e.g., annual returns and certain fundamental changes such as those made concerning share capital and company officials.

Conversely, as a consequence of the evolution alluded to, a CS also has a role to play as the conscience of the board on governance issues, promotion of sustainable governance and stewardship in the climate agenda. First, there is a departure in both conception and practice. The emerging role of a CS conceives them as 'governance professionals'[3] and, in practice, CSs are now not only concerned with compliance, but have become the conscience of the board.[4] The evolution is attributable to factors such as a change in boardroom dynamics. The dynamics in the boardroom are changing and as a result, boards are realising that they need technical know-how in the area of governance.[5]

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[1] T Hartin, S Dabski and R Saffron , 'The Dynamic Company Secretary in the Post-GFC Landscape' (2014) 66 (10) Governance Directions, 602.

[2] Joanne Whelan and Mary Shier, 'The Changing Role of the Company Secretary' *(Deloitte Ireland)* <https://www2.deloitte.com/ie/en/pages/legal/articles/changing-role-secretary.html> accessed 12 January 2023.

[3] International Finance Corporation, *The Corporate Secretary: The Governance Professional* (International Finance Corporation, Washington, DC 2016) <https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+CG/Resources/Toolkits+and+Manuals/The+Corporate+Secretary+The+Governance+Professional> accessed 12 January 2023.

[4] PwC, *Climate Change and The Corporate Secretary: Influencer or Implementer?* (PwC, 2021) <https://www.pwc.co.za/en/assets/pdf/csia-pwc-climate-change-survey.pdf>

[5] C Hodge, 'ESG in the Age of Activism' *(Chartered Governance Institute UK & Ireland, 2021)* <https://www.cgi.org.uk/blog/esg-in-the-age-of-activism> accessed 12 January 2023.

For instance, CSs are crucial to the process of board development due to their involvement in board evaluation, training and induction.[6] Moreover, they act as an important interface between boards and management, ensuring effective communication between all parties including investors. They are now also required to do governance reporting in the wake of increased emphasis on the quality of corporate governance and transparency in compliance with regulatory and listing requirements.

Remarkably, there is a new expectation that boards guarantee sustainable governance— an organisation's ability to deliver long-term value to investors and the society at large, ethically, financially, socially, and environmentally.[7] Board awareness on corporate sustainability largely pertains to the opportunities and risks that arise from sustainability trends and its effect on customer expectations, organisational value and regulatory requirements. CSs are positioned to promote sustainability by leveraging their relationships with boards and committee chairs to introduce the topic as an emerging governance trend.

Additionally, a CS's role has evolved to one of stewardship in the climate change agenda with the mandate to educate and advise the board to align their strategic objectives with the global vision relating to climate change, as embodied in the Sustainable Development Goals.[8] Climate change is gaining increased attention from investors, stakeholders and regulators, providing an opportunity for organisations to reconsider capacity of existing dynamics to address the effect of climate change on organisations. Overall, that there is a shift cannot be denied. However, in view of the global shift which has begun being witnessed in Kenya, the low level of awareness of both comprehensive traditional role of the CS and developments thereto is concerning.

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6 T Hartin, S Dabski & R Saffron (2014) (n1).

7 Muhammad Zahid, Haseeb Rehman and Muhammad Khan, 'ESG in Focus: The Malaysian Evidence' (2019) 9 City University Research Journal 72 <https://www.researchgate.net/figure/Years-wise-trend-of-ESG-practices_fig1_341479990>.

8 Joanne Whelan and Mary Shier, 'The Changing Role of the Company Secretary' (*Deloitte Ireland*) <https://www2.deloitte.com/ie/en/pages/legal/articles/changing-role-secretary.html> accessed 12 January 2023.

3. Legal and Institutional Framework Governing CSs in Kenya

It is pertinent to look at the Legal and Institutional Framework within which CSs operate. The Certified Public Secretaries Kenya Act (CPSK Act), Cap 534 Laws of Kenya establishes the CS profession in Kenya, the Registration of Certified Public Secretaries Board (RCPSB), and the Institute of Certified Public Secretaries of Kenya (ICS).[9] The global umbrella body is the Corporate Secretaries International Association (CSIA) which has a membership of 14 professional associations, including Kenya.[10]

The role of the ICS is to regulate, promote, and develop the CS profession in Kenya (Institute of Certified Secretaries, 2021b).[11] The Institute also has membership in the Association of Professional Societies in East Africa (APSEA) and currently has 3800 registered members.

4. The Level of Awareness of the CS Profession in Kenya

As mentioned, lack of awareness and acceptance is one of the key challenges facing the CS profession in Kenya. To draw a clear picture of this, we will explore the situation as regards knowledge and understanding of the value of the profession, integration into sectors in the public/private divide, and the problem of compliance. Although raising the profile of the CS profession has been a topical issue in Kenya for a long time, misconceptions as to what it entails to be a CS persist. The persistent idea of a CS conceives them as a traditional secretary who is only involved in managing diaries, booking meeting rooms and note-taking in the board meetings. They are perceived to be people performing secretarial work within the context of a company.

Their involvement in the legal, compliance and governance aspects of the organisation is not appreciated. Consequently, prospective practitioners may not pursue this professional path, while on the other hand, prospective users see neither the value nor the need of employing a

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[9] Benjamin Mwanzia Mulili and Peter Wong, 'Corporate Governance Practices in Developing Countries: The Case for Kenya' (2011) 2 International Journal of Business Administration, 14 <http://www.sciedu.ca/journal/index.php/ijba/article/view/37> accessed 12 January 2023.

[10] Institute of Certified Secretaries (ICS), 'A Report on Review of CPSK Act CAP 534 of the Laws of Kenya' (2021).

[11] Ibid.

CS in their entities and yet good governance is critical in any organisation. Among prospective entrants at the university level, there are low levels of awareness leading to a significant number of tertiary students failing to consider pursuing it as a career option. While there is a high demand for governance professionals, there is little effort in raising awareness of the role of a CS. Its formal integration in the university curricula as well as strategic market campaigns could go a long way towards promoting its acceptance.

Additionally, statutory gaps regarding how the CS is to be integrated into key sectors present a major shortcoming. In the private sector, a statutory gap exists in the Companies Act 2015. It provides that a only a private company with a paid-up capital of five million shillings or more is required to have a secretary, leaving out the SMEs which may fall below the required share capital, but which would still require the services of a CS. In the public sector, there lacks legislative provisions requiring state corporations to hire a CS. For instance, key organs in the education sector are not mandated by their establishing statutes to have a CS. Similarly, the levels of integration in the Public Service and national constitutional/ statutory Commissions is extremely low.

This illustrates that while the law recognises the importance of corporate governance in relation to these organs and bodies, it is relatively silent on how this can be done. The result is that the potential value that CSs can add has gone unrealised. However, regulators in some sectors in the public realm find it necessary to employ a CS given the nature of their mandate. As regards compliance, a worrying majority of public sector entities fail to engage CSs, despite legal or policy requirements that require them to.[12] Entities that tend to comply with the legal requirements are mostly state corporations, which is attributable to the implementation of the Mwongozo Code of Ethics.[13]

[12] Public companies are required to have at least one company secretary under s244 of the Companies Act. 2015.

[13] Public Service Commission (PSC) & State Corporations Advisory Committee (SCAC), 'Mwongozo Code of Governance for State Corporations' https://wasreb.go.ke/downloads/MWONGOZOCODEOFGOVERNANCE.pdf.

General non-compliance has tried to be excused by the inability to afford the services of both CSs and legal officers. In addition, the absence of sanctions for non-compliance and the reluctance to enforce sanctions hinders effective integration of CS in the public sector. Although the Mwongozo Code offers good guidance around the role of the CS, it lacks statutory force, leaving implementation of the good governance standards set out therein to good will.

In view of the observations made above, it is incumbent upon all the shareholders to strategize and come up with an effective plan to improve the situation. The recommendations set out below will be useful in providing guidance on where more focus is required.

5. Promoting Awareness: Borrowing from Best Practices

Having considered the Kenyan position, it is pertinent to evaluate the situation elsewhere, and what can be borrowed both from other jurisdictions and professions.

5.1. Other Jurisdictions

We consider the situation in India, Malaysia and the United Kingdom, which may be argued to represent among the best practices world over. We explore this along the lines of conception of the profession, levels of awareness among beneficiaries, integration into various sectors in the public private divide and compliance with requirements to engage a CS.

5.1.1. India

The CS profession is one of the most respectable and lucrative professions in India. The level of awareness is impressive, as there is high demand for CSs both in employment and practice. This is attributable to organizations increasingly giving more importance to compliance and governance. There is notable growth influenced by the shift in the profession from secretarial work, to compliance and advisory roles. This has led to emergence of practicing firms that are regularly consulted by the various organizations regarding governance and compliance. Additionally, the Institute of Corporate

Secretaries of India (ICSI) is keen on creating awareness through diverse activities, such as signing of strategic MOUs with key stakeholders; scaling up its outreach in the semi-urban and rural parts of India; making it possible for students in remote areas to be included by facilitating distance learning courses and providing online study materials.

Additionally, the compliance level is also commendable. A CS is listed as a Key Managerial Personnel (KMP). The following categories of companies are thus obligated to ensure that a KMP is on-board: all listed companies, public and private companies that have Rs.10, 000,000 or more paid-up share capital. Compliance has been attained through the imposition of offences under the Company Act.

5.1.2. United Kingdom

In the United Kingdom[14], the CS profession is well known by the users together with the students who are prospective practitioners. In fact, it is a viable and common career path for most students, in particular law students. CS professionals are held in very high esteem and their role fairly well understood and appreciated in terms of remuneration by most users. Further, there are varying degrees of compliance with the requirement to have a CS. There is no longer a requirement for private companies to appoint CS practitioners[15] and this has led to a reduction in the number of limited companies appointing CSs.[16] However, public companies are obligated to have a CS under the Companies Act, leading to streamlining of the profession in various spheres of the public service.

[14] The primary instrument regulating the CS profession in the UK is the Royal Charter as amended in 1966 granted to the Institute of Secretaries of Joint Stock Companies in 1902, which is the institute in charge.

[15] The Companies Act 2006 (Commencement No. 6, saving and Commencement Nos. 3 and 5 (Amendment)) Order 2008 removed the requirement of limited companies to appoint CS practitioners.

[16] Joe Bedford, 'Duties of a Company Secretary' (*Stevens & Bolton LLP*, 27 August 2019) <https://www.stevens-bolton.com/site/insights/briefing-notes/duties-of-a-company-secretary> accessed 12 January 2023.

The Institute collaborates with various stakeholders to ensure the robust development of the CS profession. These include higher education institutions, research institutions,[17] membership organisations,[18] and the law society. To adapt to the evolving needs of the profession, CSs have had to take up unique roles in the management of their organisations. For instance, CSs have had to create a platform for discourse between companies and stakeholders through effective communication amid the changing trends.[19]

5.1.3. Malaysia

In Malaysia, the Tunku Abdul Rahman University College (TAR UC) in collaboration with the Malaysian Association of Company Secretaries built a strategic partnership to promote the CS profession and produce professionally qualified CS practitioners. Separately, TAR UC has also been undertaking virtual campaign activities to raise awareness on the importance of the CS profession. In Malaysia, the level of compliance with the requirement to employ CSs[20] is arguably robust.[21] This is demonstrated by the elaborate institutional arrangements put in place to realize this, mainly through the (Companies Commission of Malaysia Act (CCMA). Specifically, the 'Secretary Surveillance Unit' is the wing that ensures compliance by CS with the provisions of the Company Act.

CS practitioners have been designated to play a very pivotal role in enhancing corporate governance.[22] This is evidenced by among other things, the elaborate statutory requirements prescribing their

[17] Such as the Henley Business School.

[18] Such as CSIA.

[19] Joanne Whelan and Mary Shier, 'The Changing Role of the Company Secretary' (*Deloitte Ireland*) <https://www2.deloitte.com/ie/en/pages/legal/articles/changing-role-secretary.html> accessed 12 January 2023.

[20] Under section 235 of the Companies Act, it is prescribed that a company (whether public or private) must have at least one company secretary.

[21] Company Secretary, 'Corporate Governance Guide: Guidance on Board Leadership and Effectiveness' (n.d) <https://bursa-malaysia.s3.amazonaws.com/reports/Pullout-I-8-Practice-1-4.pdf>.

[22] Sharifah Fuzi, Syahrina H Khudzari & Nor E Yussoff, 'Comparative Analysis on the Requirement, Qualification and Responsibility of Company Secretaries in United Kingdom, Malaysia and India' (2019) 16 Journal of Administrative Science 118 https://jas.uitm.edu.my/images/2019_JUNE/JAS7.pdf.

appointment as well as the thorough educational and professional qualifications, which precede their appointment and how their membership in the various professional bodies is regulated. That said, the level of compliance with the requirement to employ CSs is arguably robust in Malaysia. This is demonstrated by the elaborate institutional arrangements.[23] The Companies Commission of Malaysia (CCM) has a corporate compliance division whose main objective is to raise the corporate compliance rate by implementing a continual education campaign as well as strong monitoring and enforcement.[24]

This level of compliance was hailed by the United Nations Office on Drugs and Crime (UNODC) as a significant step in reducing corruption.[25] This enforcement and activism has raised awareness on the part of companies to ensure that they hire a CS.

5.2. Other Professions

A discussion on the current state of CS profession in Kenya ought to be done in comparison to other professions which mirror its core characteristics, particularly on matters relating to entry requirements, training, membership subscriptions and continuous professional development (CPD) requirements. We compare it with the supplies management and procurement as well as the legal profession to establish the similarities, differences and best practices that CS can borrow.

[23] Company Secretary n(20).

[24] Companies Commission of Malaysia, 'Corporate Compliance Division' (*Corporate Portal*, 2018) https://www.ssm.com.my/Pages/About_SSM/Organisation/Regulatory-and-Enforcement/Corporate-Compliance-Division.aspx.

[25] United Nations Office on Drugs and Crime (UNDOC), 'Country Review Report of Malaysia' (2017) Timor-Leste and Swaziland of the implementation by Malaysia of articles 5-14 and 51-59 of the United Nations Convention against Corruption for the review cycle 2016-2021 <https://www.unodc.org/documents/treaties/UNCAC/CountryVisitFinalReports/2018_11_16_Malaysia_Final_Country_Report.pdf>.

5.2.1. The Supplies Management and Procurement Profession

Despite procurement and supplies management profession being one of the most regulated professions, it has glaring issues with compliance, especially among users. Instances of non-compliance stem from ignorance of the law or wilful non-compliance facilitated by unenforced sanctions coupled with enforcement gaps.[26]

However, there have been efforts to promote compliance, including: the establishment of a new award scheme to recognize and reward high performance standards in supply chain practice,[27] devolving services to all 47 counties through the creation of regional chapters of the Kenya Institute of Supplies Management (KISM),[28] and integrating supplies management and procurement into the university curriculum.[29]

5.2.2. The Legal Profession

The legal profession is well known particularly as a result of the influence of the Law Society of Kenya (LSK). Stakeholders in the legal profession are also constantly putting in place mechanisms to create awareness and promote the profession through a variety of mechanisms, including: legal awareness seminars, legal aid clinics,[30] seminars and conferences.[31]

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[26] Kenya Institute of Supplies Management (KISM), 'STRATEGIC PLAN 2020 – 2024: Transforming Supply Chain Management for Prosperity and Posterity' https://kism.or.ke/wp-content/uploads/2021/10/KISM-Strategic-Plan-2020-%E2%80%93-2024.pdf.

[27] Ibid.

[28] Ibid.

[29] For instance, it is a course offered at the University of Nairobi's Faculty of Law as a final year elective course.

[30] Kituo cha Sheria, 'Report on the Annual LSK Legl Awareness Week Held on 12th October 2020-16th October 2020 At the Milimani Law Courts and Supreme Court – Kituo Cha Sheria' (2020) <http://kituochasheria.or.ke/report-on-the-annual-lsk-leagl-awareness-week-held-on-12th-october-2020-16th-october-2020-at-the-milimani-law-courts-and-supreme-court/> accessed 12 January 2023.

[31] The Law Society of Kenya, 'Legal Awareness Week' (2018) <https://lsk.or.ke/public/legal-awareness-week/> accessed 12 January 2023.

As a result, advocates are generally appreciated and accepted in society and business circles. Illustrative of this is the fact that the LSK is given powers to nominate persons to public entities. In terms of integration of the legal profession in the university curriculum, law is a subject that is taught in various universities. Also, there is a basic introduction of law to young learners in primary schools.

6. Recommendations and the Way Forward

As discussed above, lack of awareness amongst the public and prospective practitioners presents a major obstacle to the advancement of the CS profession in Kenya. Furthermore, it is inaccurate to say that nothing has been done to remedy the situation. Stakeholders in the field have made several interventions aimed at improving the situation. We will consider these first before getting recommending further action.

6.1. Current Efforts

Currently, the ICS has spearheaded the initiative to have the CPS Act amended in order to: rebrand the name of the ICS to capture its core mandate i.e., governance; address ambiguities and redundancies in the prescribed qualifications of membership; introduce an accelerated route through affiliated membership to increase the number of institute members; introduce annual renewal of practising certificates etc.[32]

While the Kenya Accountants and Secretaries National Examinations Board (KASNEB) has attempted to market the CS courses at tertiary level, those tasked with this function have relatively inadequate understanding of the profession and, therefore, lack the necessary passion to inspire recruitment. In this regard, there have been efforts by ICS, RCPSB and KASNEB to enter into MoUs with CS institutions, such as the Traction School of Governance and Business and Star College, to jointly market the profession, enhance student career development in the area, and conduct joint awareness forums.

[32] Institute of Certified Secretaries (ICS), 'A Report on Review of CPSK Act CAP 534 of the Laws of Kenya' (2021).

General Solution

A number of initiatives that could be undertaken to raise awareness on the CS profession, include: monitoring compliance with statutory provisions requiring entities to engage the services of CSs; mainstreaming the CS profession in the public service and creating awareness amongst students; mainstreaming the ICS Governance Standards and Guidelines in the public service; enhancing advocacy initiatives; strengthening the role of the CS Student's Association as a seedbed for the profession. To achieve these broad goals, the following targeted actions are recommended:

6.2. Recommended Targeted Interventions

6.2.1. Effecting Changes to the Name of the Profession and Affiliated Institutions.

This will be useful in shifting the mindset of stakeholders. Precisely, the name of the profession needs be amended by substituting the word "company" with "certified" and introducing the term "governance". CS practitioners would be referred to as "certified secretaries" and "governance professionals". The Institute's name should would also be amended to read the "Institute of Certified Secretaries and Governance Professionals" and RCPSB to be "Certified Secretaries and Governance Professional Board". This will go a long way towards incorporating the governance aspect and facilitate recognition of CS professionals in all sectors.

6.2.2. Partnerships

Additional strategic partnerships are needed for the purpose of enhancing the marketing of the profession.

6.2.3. Use of Legislative Processes to Enforce Compliance with Good Governance Requirements.

The ICS needs to use its position to lobby for the implementation of relevant legislation and policies[33] that are geared towards ensuring that governance practice becomes an obligatory requirement in both

[33] Public Service Commission (PSC) & State Corporations Advisory Committee (SCAC), (n 13).

public and private institutions. For instance, the CS qualification can be made a requirement for at least one board member within an institution. Entities that are not yet bound by the requirements to hire company secretaries across the private and public sector ought to be.

6.2.4. Leveraging on Technology.

Technology offers a cheap way of advertising which is also likely to reach a wider target population. ICS can leverage on technology to offer affordable programmes for its members as well as to market the profession to users and prospective members.

6.2.5. Enhanced Affordability and Timeliness of CS Training.

Affordability and timeliness of CS training will increase the number of learners.

6.2.6. Bridging Awareness Gaps among Prospective Practitioners.

ICS should hold frequent career workshops with students at various academic levels. Local partnerships with the institutions of learning would also come in handy.

6.2.7. Building Stronger Relationships with other Professional Associations.

ICS ought to forge stronger relationships with other professional associations, such as LSK, CIArb (K), and AAK etc., in order to provide governance training for professionals in other sectors.

6.2.8. Building Regional Partnerships with CS Professional Associations in other Countries.

Creating strong partnerships at the regional and global level is a viable way of ensuring wider acceptance and awareness of the CS profession and governance practice. The ICS can take advantage of its pivotal position, locally and regionally, to support the development of the CS profession across the borders. The starting point could, for instance, be the formation of a regional umbrella body for the CS profession.

6.2.9. Addressing Non-compliance

There is a need for a multipronged approach involving legislative reform, advocacy and lobbying. The ICS should take an active role in advocating for legislative reforms as well as lobbying sector regulators around the role that the CS can play to entrench good governance.

7. Conclusion

As discussed, those concerned about the welfare of the profession cannot afford to overlook the low levels of awareness and acceptance of the ICS profession. We must take note that due to the speed at which the profession is evolving, Kenya risks lagging behind in integrating and implementing good governance.

This paper has shown that the role of ICS profession is still hugely misconceived in Kenya. It has also demonstrated that there are low levels of awareness among potential users and prospective practitioners, and the effort that has been exerted by some stakeholders, though commendable, is still distant in as far as achieving the desired levels of awareness and acceptance is concerned. Additionally, it has illustrated why moderate extent of integration is partly attributable to statutory gaps and partly to non-compliance, caused by ignorance or willful neglect to engage a CS.

In view of the above, it is not only prudent but also critical that concerted effort is employed to save the situation. Luckily, Kenya has a few leaves to borrow from India, Malaysia and the UK, which are comparable jurisdictions that have adopted best practices. In the same vein, the profession can borrow from supplies management and procurement as well as legal profession, which are steps ahead in terms of awareness and acceptance.

Other interventions that could help in this regard include: effecting changes to the name of the profession and affiliated institutions; formation of partnerships to market the profession; use of legislative processes to enforce compliance with good governance requirements; leveraging on technology; enhancing affordability and timeliness of CS training; building

stronger relationships with other professional associations; building regional partnerships with CS professional associations in other countries; employing a multipronged approach for legislative reform, advocacy and lobbying to address non-compliance.

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