

MAKERERE UNIVERSITY
DEPARTMENT OF ADULT AND CONTINUING EDUCATION
BUSINESS LAW II

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Question:

- a) Distinguish btw ltd co. and other business Organizations
- b) Mr. Opio has learnt that you are studying B. law II at MUK. He desires to operate a business. Advice him on the most appropriate business organization, which he can operate and explain why.

Submitted on the 2nd May 2005.

A. Distinction between limited liability companies and other business organization

A group of people may come together in order to pursue or promote a common purpose or activity but without going through the various legal procedures that ultimately result in the creation of a registered company. In such cases the association will not be a body corporate. The legal consequences of what those people do will depend on the provisions of the Act of Parliament and the general law governing the activities in question. If the provisions of the Act are violated the law will disregard the apparent association and, if necessary, make the individuals personally responsible for the things that they have done while using the name of the association.

The common examples of unincorporated associations are trade unions, clubs and Societies, Unit Trusts, co-operative societies and partnerships Public corporations, To start with let first go through the limited liability company.

1. Limited Liability Company

The primary advantage of these entities is that they are all based on the simple principle that the liability of the shareholders/subscribers and officers is strictly limited to their direct investment in the company. Generally, the only exceptions are when some kind of fraudulent or grossly reckless act or omission has occurred involving the aforementioned.

It is important to note that the 'innocent' shareholder without any involvement in the malfeasance will not lose the benefit of limited liability.

Basic Types Of Limited Liability Company

1. A Private Company Limited By Shares

This is the most common type of company in Uganda. The principal purpose is to earn profits for the shareholders who may or may not be the same as the Director(s) or Secretary. These companies can be formed and registered with as little as One hundred

thousand (US\$ 100,000). In most cases, they adhere to a standardized format and are remarkably inexpensive.

2. A Public Company Limited By Shares

Theoretically this is a company, which has the same profit motive as a private undertaking save that its shares can be offered for sale to the general public. In reality, the vast majority of public limited companies simply operate as "private" companies employing the public limited companies name simply as a prestige marketing "tool". Nevertheless, even a public limited company, which has not sought a public stock exchange listing, must adhere to the requirements of companies Act.

The most important differences are that there must be a minimum paid up. Penalties for non-adherence to the provisions of the Companies Act are also higher. The cost of a non-listed and standard format public limited companies will. However, the cost of forming a publicly listed public limited company can run into millions since the legal documentation (the Memorandum & Articles of Association) will always need to be specially drafted and the admission rules set out

The latter requiring the services of underwriters, accountants and lawyers

3. A Company Limited By Guarantee

This is a company, which has not been established to earn profits for its members but rather to carry out a particular purpose. Charitable, housing and organizational associations most commonly use this type of vehicle. The price of such a company will vary greatly depending on its intended use.

2. Trade Unions

Trade Unions are registered under s.11 of the Trade Unions Act 1952 with the primary object of regulating the relations between employees and employers. Section 27(1) of the Act provides that a registered trade union may sue or be sued under its registered name. However, s.23 provides that no suit or other legal proceedings shall be maintainable in any

civil court against any registered trade union or an officer or member thereof in respect of any act done in contemplation or furtherance of a trade dispute. S.24 bars any such suits in respect of any tortious act alleged to have been committed by or on behalf of the trade union. Under section 25, a trade union is liable on any contract entered into by it or by an agent acting on its behalf. Under s.24 all property of a registered trade union is vested in its trustees for the use and benefit of the union and its members, and is under the control of the trustees.

3. Clubs and societies

These are unincorporated associations, which are not subject to statutory regulation. Their constitution rests upon the ordinary law of contract between the members by which they agree either expressly or impliedly to be bound by the rules in force from time to time of the association.

In law a club has no legal existence separate from its members. However, there is a distinction between club property and property of the members. Club property is vested in trustees who are usually the club's governing committee. The committee in accordance with club rules holds the property.

With respect to exercise of power, members normally delegate executive powers to certain officers and a committee. Consequently, the liability of the members for the acts of officers or committee depends on normal agency principles. These will determine: -

- (i) Whether members are fully liable or only to the extent of club funds,
- (ii) Whether the officers and members of the committee are liable as such,
- (iii) If they are, whether they are entitled to be indemnified either by the members personally or out of club funds.

Nevertheless, in normal circumstances, contracts made by officers in carrying on the club in the usual way will bind the committee personally, but not the members. However, the committee will be entitled to be indemnified out of the club funds so far as they will go. In other instances a third party may be taken to have agreed that the committee shall not be liable beyond the extent of club funds.

Concerning the position of a club servant, he is not normally liable on club contracts but if he acts within the scope of his employment, he will bind his employers. Under normal

contractual rules a club servant is treated as the servant of the club's committee, while in tort he is treated as a servant of the members as a whole and not of the committee.

A member who is wrongfully expelled from the club can obtain redress by means of injunction or declaration and also recover damages from the committee and out of club funds. The action is usually framed in the form of representative action.

The principles enumerated above in relation to clubs similarly apply to learned and similar societies. Most of such societies are normally recognized as charitable and therefore entitled to concessions of taxation and local rates. However, in many other respects their constitution is similar to that of clubs in the sense that they may be unincorporated or incorporated under the

Companies Act and consequently legally indistinguishable from clubs. Finally, it may be noted that the legality of unincorporated clubs and societies may depend on their not carrying on, business for their own gain or for that of their members. If this condition is unfulfilled they will be illegal if their membership exceeds 20 under section 392 of the Companies Act.

4. The unit trusts

A unit trust is defined as any arrangement made for the purpose of having the effect of providing for persons having funds available for investment, facilities for the participation by them as beneficiaries under a trust in profits and income arising from the acquisition, holding, management or disposal of any property whatsoever.

Essentially then, the unit trust is an investment scheme by which persons pool their subscriptions under a trust deed. The scheme involves a managing company and a trustee or trustees, which is usually another company or bank. The practice is normally for the managing company to acquire securities such as shares or debentures, which have been quoted on the stock exchange, and to transfer them to trustees who become the sole custodians thereof. The securities are in turn divided into units and offered to the public for investment after quotation on the stock exchange. The investors then become beneficiaries under the trust deed and are entitled to the securities in proportion to their holdings. In addition, they are also entitled to dividends in proportion to their holdings. The unit trust may be fixed i.e. with the securities to be held strictly defined or it may be flexible or

managed. In the latter case the managing company has wide powers and discretion to invest, subject to the provisions of the trust deed. The unit trust has the advantage of enabling people with small investments to spread the risk over a wide area. Sections 8 and 9 of the Exchange Control Act, 1964 impose restrictions on the creation or transfer of securities in favour of a or to a person resident outside Uganda. "Securities" are defined to include units under a unit trust scheme.

Co-operative societies

There exists legislation regulating the formation and operation of co-operative societies. The criteria for registration of a co-operative society by the relevant Registrar is that the society must have as its object the promotion of the economic interests of its members in accordance with the object of facilitating the operations of such a society. Such a society may then be registered with or without limited liability. Upon registration, the co-operative society then becomes a corporate body with perpetual succession and a common seal and power to hold property and enter into contracts. Co-operatives have been described as a bulwark against the capitalism, which dominates the incorporated limited liability company in the sense that priority is placed on service to members rather than maximization of profits. Furthermore, a cooperative is essentially a union of capital. The main purpose of an ordinary company is to realize a profit on investment, while that of a co-operative society is to provide a service to members on sound economic lines, avoiding loss. While the ownership of the number of

A shareholder is limited in a company that is not generally the case with co-operatives whose membership is open. Again, while the control of a company is based on the number of shares held, with a co-operative, control is democratic, depending on the principle of one member, one vote. With respect to the interest or dividends on shares in a company, this is limited only by the company's profit earning. In contrast, in a co-operative, share capital is paid at a fixed and modest rate of dividend. With regard to surplus earnings, in the case of a company these belong to the corporation. In the case of a co-operative these belong to the members or patron. Although in a company, profits are divided in proportion to the shares held, surplus in respect of a co-operative is divided according to the number of its patrons. Lastly, while shares in a company may be freely traded and fluctuate in value according to

the profits made, shares in a cooperative are not traded for speculation and held in the name of members only.

3. Partnership

A partnership is defined by s.3 of the Partnership Act as "the relation, which subsists between persons carrying on a business in common with a view of profit". This is a definition of the relation that exists between the individual persons who are trading as partners, rather than a definition of the apparent entity called a partnership. A partnership is not a body corporate and, being legally non-existent, cannot carry on a business. Section 6 of the Act states that persons who have entered into partnership with one another, are called collectively a firm, and the name under which their business is carried on is called the firm-name.

The basic differences between registered companies and partnerships are as follows:

a) Formation

Registration is the legal pre-requisite for the formation of a registered company: *Fort Hall Bakery Supply Co V Wangoe*.

The Partnership Act does not prescribe registration as a condition precedent to partnership formation. A partnership may therefore be formed informally or, if the partners deem it prudent, in writing under a Partnership Deed or Articles.

b) Legal status

A registered company enjoys the legal status of a body corporate, which is conferred on it by the Companies Act.

A partnership is not a body corporate and is non-existent in the contemplation of the law. Such business as appears to be carried on by it is in fact carried on by the individual partners.

c) Number of members

A registered private company must have at least two members under s 4 of the Companies Act and a maximum of fifty members (excluding current and former employees of the

company who are also its members), under s.30 of the Act. A public registered company must have at least seven members under s 4 of the Companies Act but without a prescribed upper limit. A partnership cannot consist of more than 20 partners.

(d) Transfer of shares

Shares in a registered company are freely transferable unless the company's articles incorporate restrictive provisions.

A partnership has no shares as such but a partner cannot transfer his interest in the firm to a third party unless all the partners have agreed to the proposed transfer.

e) Management

A company's members have no right to participate in the company's day-to-day management. Such management is vested in the board of directors.

Partners have the right to participate in the firm's day-to-day management since s.3 of the Partnership Act requires the business to be carried on 'in common'. The right of participation in the firm's management is however not given to a partner who has limited his liability for the firm's debts.

f) Agency

A member is not, per se, an agent of the company: **Salomon v Salomon & Co Ltd**. A partner is an agent of the firm because the partners themselves carry the business on 'in common'. The Partnership Act, s.7 also expressly provides that every partner is an agent of the firm and his other partners for the purpose of the business of the partnership.

g) Liability of members

Because a company is at law a different person altogether from its members, it follows that a wrong to, or by, the company is not a wrong to, or by, the company's members. Consequently:

- i) A member cannot institute legal proceedings in order to redress a wrong done to the company: *Foss v Harbottle*.
- ii) A member cannot be sued in order to redress a wrong done by the company, such

as failure to repay a loan in accordance with the loan agreement between it and a creditor: *Solomon v Solomon & Co. Ltd.*

A company's members will not therefore be subjected to the trauma and expense that are associated with litigation.

A partner is personally liable for the firm's debts in accordance with Section 11 of the Partnership Act, which provides that "every partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while he is a partner". He is therefore not only subjected to the trauma and expense associated with litigation but is also exposed to the harsh provisions of the bankruptcy law that would be invoked against him if his personal assets cannot pay the firm's debts in full.

h) Powers

The ultra vires doctrine limits a company's powers to the attainment of the company's objects under its memorandum of association. Partnerships are not affected by the ultra vires doctrine and partners enjoy relative freedom to diversify the firm's operations.

i) Termination

A member's death, bankruptcy or insanity does not terminate the. Company's legal existence whereas a partner's death, bankruptcy or insanity terminates the partnership, unless the partnership agreement provides otherwise.

j) Borrowing money

A company can borrow on the security of a 'floating charge'. A partnership cannot borrow on a 'floating charge'.

k) Ownership of property

A company's property does not belong to the shareholders, either individually or collectively. Consequently, a member cannot insure the property since he has no insurable interest therein: *Macaura v Northern Assurance Co (4)*. A firm's property is the property of

the partners who can therefore insure it and, in the case of cash, make drawings from it.

4. Public Corporation

A public corporation has been defined to mean a body setup to operate nationalized industries or for the organization of other public enterprises and services. Corporations are classified into commercial corporations i.e. those which are intended to operate an industry or public utility according to commercial principles, though subject to ministerial control. An example is the Uganda Electricity Board. Secondly are social service corporations i.e. those intended to carry out a particular social service on behalf of the government. An example is the Uganda Revenue Authority, a revenue collection agency.

Public corporations have emerged as a chosen legal instrument for the public control of basic industries in the economy. In effect, though, public corporations are statutory companies created by individual statutes. They differ from the companies because the Companies Act does not apply to them. It is suggested, however, that the ordinary common law of corporations applies to them except where expressly or by implication modified by the statute creating them. For instance, the *ultra vires* doctrine which restricts an incorporated company to the pursuit only of its stated objects applies to public corporations and they are required to keep trading accounts which should conform with the best commercial standards.

The main difference between a public corporation and an ordinary registered company is that the former has neither shareholders nor share capital. In the words of Denning L J. (as he then was) in *Tamlin v. Hannaford*, thus: III

The significant difference is that there are no shareholders to subscribe the capital or to have any voice in its affairs. The money which the corporation needs is not raised by the issue of shares but by borrowing; and its borrowing is not secured by debentures but is guaranteed by the Treasury. If it cannot repay, the loss falls on the consolidated fund... i.e. on the taxpayer. There are no shareholders to elect the directors or to fix their remuneration. If it should make losses and be unable to pay its debts its property is liable to execution. But is not liable to be wound up at the suit of any creditors. The taxpayer would. No doubt be expected to come to its rescue before the creditors stepped in.

CONSIDERATIONS FOR DECIDING THE MOST SUITABLE BUSINESS ENTITY TO MR. OPIO

1. Sole Proprietorship:

In this situation, one owns the business oneself and can reap whatever financial benefits come from it. One can make decisions on one's own and guide the growth of the business without having to consult with any other entity. This also means that no other employee will ever have the chance to have own stocks.

This may sound pretty good. But be aware that with a sole proprietorship, there is no distinction between one's business life and one's personal life as far as taxes and other financial obligations are concerned. As far as the government is concerned, proprietor and the firm are one and the same. This could have negative repercussions on the proprietor. Moreover, as a sole proprietor, one's business will exist only as long as one continues to own it.

2. Partnership:

In the same way as a sole proprietorship, a partnership draws no financial distinction between a partners's personal and business finances. There are also inherent risks in partnerships. It is important to draft a "partnership agreement" to outline what happens if there is a disagreement among partners, if one wants to end the partnership, if one of the partners dies, etc.

3. Limited Liability Company

Limited liability companies are extremely flexible, and can be used for a very wide range of businesses. The members (equivalent to shareholders or partners) can, but need not, have limited liability; can, but need not have, managers (equivalent to directors and officers) and can elect to be taxed either as corporations, or as partners (if they have two or more members) or be disregarded for tax purposes like a sole proprietorship.

RECOMENDATION

Therefore, some issues to consider when deciding include personal protection from liability, tax liabilities, and business continuity. In such a situation then, I would advice Mr. Opio to form a limited liability company for reasons that it is a legal entity established by individual(s) under the laws of a country to conduct businesses as allowed by its articles of association. The limited liability company exists separately from its shareholders, directors and employees. A company is a 'person' in the eyes of the law. It functions in the same manner as a person and has the same rights and responsibilities as a person. The corporation may make contracts, assume liabilities, sue and be sued. The corporation and its shareholders and directors have specific duties and obligations to each other.

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