Assessment of the Capital Maintenance Doctrine under Uganda Company Law: Challenges and Prospects

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ABSTRACT

This study assesses the capital maintenance doctrine within the context of company law in Uganda. Riding on the policy rationale that 'capital should not be dissipated unlawfully' and that 'the members must not have the capital returned to them surreptitiously' the capital maintenance rules were designed with the aim of ensuring that a company does not engage in transactions relating to its share capital in a manner that is tantamount to returning capital to members. The rules were however crafted in a lopsided manner which tends to lock the prospects of fair dealings in share capital as may be justified by the actual financial position of a company. Using a doctrinal approach, this paper interrogates the relevant provisions of the Companies Act 2012 as well as existing scholarly literature espoused in books, journal articles and online sources. The study adopts the resource dependency theory which centers on the role that company managers play in providing the necessary resources for the organisation vis-à-vis the external environment. Findings reveal that the provisions of the Act still remain inclined to the rules-based approach of asserting the capital maintenance doctrine. As such, the so called reforms introduced by law in 2012 have failed to produce the desired innovations in the core areas of company law relating to the maintenance of company capital. For a more balanced approach of capital maintenance regulation, the paper advocates for the adoption of a practical approach using the solvency test which gives consideration to the financial position of the company.

Key Terms: Corporate Personality, Regulations, Share Capital, Solvency Test

INTRODUCTION

One of the greatest motivations behind incorporation of companies is the desire for limited liability. By this, members are only liable for the company's debt up to the amount if any, unpaid on the shares they hold in the company. This means that the obligation to repay company's debts is squarely on the company itself rather than its shareholders or directors.[1] A key corporate law concern therefore is how to maintain business solvency bearing in mind that creditors may only go after the assets of the company to enforce its loan obligations. Capital maintenance doctrine is a term ascribed to a set of company law principles relating to the protection of company capital.[2] The underlying basis of the doctrine is to ensure that a company that sets out to raise capital receives proper consideration for shares that it issues and that having received such capital it must not repay it to members except in certain circumstances.[3] Capital maintenance doctrine is not a straight forward concept, rather it refers to a collection of rules containing general prohibitions and in some cases, providing circumstances or better still types of action that can be taken by a company in relation to its share capital. The legal rules cover six critical areas of capital maintenance: undercapitalization and minimum capital requirements, obtaining proper consideration for company shares, restriction of share capital reduction, payment of dividends or other distributions to shareholders, prohibition of financial assistance by company for purchase of own shares and buying back of own shares by the company.[4] In this treatise, we will examine the capital maintenance rules in the context of company law in Uganda. This will include a discussion on the history and rationale for the capital maintenance doctrine.

THEORETICAL FRAMEWORK

The concept of corporate personality is a hallmark of modern company. This is founded on the conception that an incorporated company acquires a personality distinct from its members. As stated by the English House of Lords in the landmark case of Salomon v Salomon & Co. Ltd[5];'The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them'. One of the notable implications is that members cannot be held liable for the debts of the company with limited liability. With this far reaching effect, the capital maintenance doctrine was developed as a mechanism to guarantee business solvency and for the protection of rights of creditors. This stems from the resource dependency theory of corporate governance according to which 'firms are dependent on resources provided by others in order to sustain growth, as well as other organizations that may be dependent on them.'[6] As recounted: 'the capital maintenance doctrine first developed around the19th century… premised on the rule that creditors provide a credit based on an express or implied representation that consideration received for shares (the share capital) shall be applied only for the business and that it shall not be returned to the shareholders except in a winding up after all creditors have been paid.[7] This point was also emphasized in Flitcrofts Case[8], where Jessel M R observed that; 'the creditors have a right to see that the capital is not dissipated unlawfully' and that 'the members must not have the capital returned to them surreptitiously'.[9]

Trevor v Whitworth[10] is generally believed to be the founding case for the capital maintenance doctrine. This was a case concerning share by back. A company bought back almost a quarter of its own shares. During liquidation of the company, one shareholder applied to court for the balance of amounts owed to him after the buyback. The Court of Appeal held that he should be paid. The House of Lords held the buyback was ultra vires. According to the House of Lords;

If the claim under consideration can be supported, the result would seem to be this, that the whole of the shareholders, with the exception of those holding seven individual shares, might now be claiming payment of the sums paid upon their shares as against the creditors, who had a right to look to the moneys subscribed as the source out of which the company's liabilities to them were to be met. And the stringent precautions to prevent the reduction of the capital of a limited company, without due notice and judicial sanction, would be idle if the company might purchase its own shares wholesale, and so effect the desired result... I cannot think that the employment of the company's money in the purchase of shares for any such purpose was legitimate.[11]

From the nascent conceptualization in Trevor v Whitworth which was decided in the light of share by back, the capital maintenance doctrine has undergone significant reform under a more formal statutory regime. In contemporary company law, the capital maintenance doctrine is an embodiment of rules procedures, and standards for raising and preserving a company's capital.

LITERATURE REVIEW

The question of how to raise and maintain capital for a company has garnered significant scholarly attention. Precursor to this has been the issue of undercapitalization, where inadequate capital is provided by shareholders. Harvey describes undercapitalization in terms of its consequences in that it 'reflects a perspective in corporate law, favorable to piercing the corporate veil when shareholders provide inadequate capitalization for the company.[12] The significance of the undercapitalization factor in the capital maintenance doctrine is based on the principle that 'the equity owners of a corporation are personally liable when they provide inadequate capitalization and actively participate in the conduct of corporate affairs.'[13] In Minton v Cavaney,[14] the California Court of Appeal held that the evidence supported findings of inadequacy of capitalization and participation and therefore upheld the decision to pierce the corporate veil and attribute personal liability to the shareholders. There is no specific measure of inadequacy of capitalization that may prompt the court to pierce the corporate veil. However, "[a]n obvious inadequacy of capital, measured by the nature and magnitude of the corporate undertaking, has frequently been an important factor in cases denying stockholders their defense of limited liability."[15] A common rationalization of the share capital provisions is that they help protect company

creditors from the abuse of limited liability by shareholders.[16] Therefore as argued by Mulbert: 'The judge-made doctrine of piercing the corporate veil because of undercapitalization, from a functional perspective, aims at establishing a particular structure, namely a corporation having "sufficient" working capital in relation to its business activities to lessen the probability of a company becoming insolvent because of exogenous shocks'.[17] It has been seen that the practice of piercing the corporate veil because of undercapitalization is a judge-made rule.[18] But this is not entirely so as a company law system may impose a minimum capital requirement with the effect that shareholders may be held personally liable when the share capital falls below a certain minimum. The threshold is different for private and public companies with that of public companies obviously assuming a higher requirement. It is worth noting that Uganda company law does not impose minimum capital requirements. The question is, does this 'omission' mean that shareholders may decide to fund the company the way they want or may decide not to fund it at all? A major gap in the scholarly exertion by Harvey is the failure to resolve this puzzle. Even though not too obvious, the answer is No. The reason is that shareholders may be held personally liable where the company is undercapitalized. The effect is that whereas there may be no minimum capital requirement, the freedom to capitalize the company in the manner shareholders like is greatly limited[19]considering the possibility of shareholders' personal liability as a result of undercapitalization. In view of this, the undercapitalization factor forms part of regulation aimed at ensuring business solvency, and therefore, courts are expected to pay sufficient attention to it whilst implementing rules of capital maintenance.

The capital maintenance rules are designed first and foremost to ensure that a company receives proper consideration for the shares it issues[20] and then to preserve the share capital thereafter. As argued by Farrar, 'taking up shares in a company imports the duty of actual payment or undertaking to pay the nominal value in full at some point in time'.[21] When the shares are issued at premium that is at more than their nominal value then the extra premium must also be paid.[22] The price paid on company shares is what is in contractual parlance referred to as 'consideration'. This may be furnished in cash or in non-cash contribution including goodwill.

At common law, whilst the presence of consideration is a major requirement for the enforcement of contracts, the law is also that consideration need not be adequate.[23] This means that courts will not be inclined to assessing the value of what is offered and accepted as consideration as it is assumed to be the price at which a willing seller agrees to sell what he things is worthwhile to sell.[24] This stems from the general rule of contract which holds that consideration need not be adequate. In Re Wagg Ltd,[25] the court held that the value paid to the company (in non-cash consideration) in exchange for shares is measured by the price at which the company agrees to buy what it thinks it to be worth its while to acquire.[26] This proposition nonetheless appears contradictory with other settled principles of common law relating to company shares. For instance, that shares should not be issued at discount, or below their nominal value except under specific stipulation of the law.[27] The issue here is how to ensure compliance without attempting to measure the value of property representing consideration especially when shares are issued for non-cash consideration. The danger that lurks behind this conundrum is that shares may be issued at disguised discount in contravention of the capital maintenance rules.

Generally the value of non-cash consideration for the issue of shares has traditionally been regarded as a question for the directors' judgment.[28] In UK, the Companies and Securities Law Review Committee recommended however that for a greater degree of certainty, it is desirable to lay down legislative standards prescribing rules by which the directors' actions in forming the requisite judgment are governed.[29] This approach suggested among others, an independent expert valuation of non-cash consideration. As submitted by the Committee, 'Such a regime, if adopted, would facilitate identification of circumstances in which shares are issued at a discount or at a premium and would make more certain quantification of the discount or premium.'[30] This approach reflects the company law position in several jurisdictions in Africa. In Ghana, shares issued for non-cash consideration attracts a duty to "deliver to the Registrar for registration a contract in writing duly stamped evidencing the terms of the agreement and the true value of the consideration."[31] The statement in the contract of the value of the non-cash consideration is sufficient evidence of the true value of the consideration, but in winding up, upon finding that the true value of the consideration was less than the shares issued, court may direct that the shares shall be treated as unpaid to the amount of money that it shall direct.[32] The Nigerian position is that where a public companies agrees to accept payment for its shares in form of non-cash consideration, the company shall appoint an independent valuer being either an auditor, surveyor, engineer, or accountant to determine the value of the non-cash consideration prior to allotment of the shares.[33]

METHODOLOGY

The study employs a doctrinal research methodology embodying primary and secondary sources. The primary sources include statutes, mainly the Companies Act of Uganda. References are also made to the company legislations of some other countries including Ghana, Nigeria and the United Kingdom. Case law espousing various principles of law are equally examined and synthesized in the study to reveal the approach of courts in implementing the capital maintenance doctrines. This was supplemented by secondary materials drawn from textbooks, journal articles and internet sources among others. These materials were meticulously read and analyzed to formulate conclusions about the challenges and prospects attending to the capital maintenance doctrine and its implementation within the rubric of company law in Uganda This approach enables the researcher to take legal propositions as a starting point and structure the research methodology and organization around them.

LEGAL FRAMEWORK

The capital maintenance doctrine is enshrined in a myriad of company law rules relating to how capital is raised and maintained by companies. The rules covers aspects such as independent valuation of non-cash consideration, restriction on share capital reduction, prohibition of payment of dividend out of capital and offering of financial assistance for the purchase of own shares by a company, and restrictions on share- buy- back. These rules are examined in details in the succeeding paragraphs.

Independent Valuation of Non-cash Consideration

The Companies Act, 2012 section 25 (2) (a) makes it a requirement for company shares issued for non-cash consideration to be valued in cases where a private company is sought to be re-registered as a public company. As stipulated in section 27 (3) of the Act, an application for re-registration may be rejected by the Registrar, where it appears to him or her that a reduction of the company's capital which has the effect of bringing the nominal value of the company's allotted share capital below the authorised minimum has occurred.

The assumption that flows from the above exposition is that directors retain powers, under the "business judgment rule" to determine the value of non-cash consideration for company shares, except that court may invalidate any allotment evinced by fraud or any other process calculated to shortchange the company. The implication is that whilst the Companies Act of Uganda purports to guard against company shares being issued at discount, as part of the capital maintenance rules, there is no corresponding mechanism for determining when shares are issued at discount. This is a fundamental weakness in the capital maintenance rules that needs to be addressed. The idea that a company must obtain proper consideration for its shares demands an independent valuation of non-cash consideration for proper ascertainment of circumstances in which shares are issued at a discount or at a premium.

Restriction on Share Capital Reduction

A company may, if allowed by its articles, reduce its share capital in a number of ways including; diminution or extinction of liability in respect of unpaid share capital, and cancellation of any paid up share capital which is lost or un-represented by available assets. It may also pay off any paid up share capital which is in excess of the requirement of the company.[34] The question is how does the legal approval of reduction of share capital align with the capital maintenance doctrine? On its façade this seems contradictory, but the law provides safeguards for the protection of creditors in the procedure for reduction of capital. Under the procedure, reduction of capital requires a special resolution, publication of the resolution in the Gazette and a newspaper with nation-wide circulation and most importantly, confirmation by the court.[35] The procedure ends with registration of the order of court sanctioning the reduction of capital by the Registrar of Companies. It is at that point that the resolution for reducing the share capital of the company takes effect. The approach of the law as highlighted above, lies between the substantive and the procedural. This leaves a company with the freedom to take substantive decision in respect of its share capital but subject to control of those elements of the decision that may be prejudicial to creditors. It is this procedure/control rather than the power of the company to reduce its share capital that qualifies the law in this perspective as part of the capital maintenance doctrine.

Unlike Uganda where the same procedure for reduction of share capital applies to both private and public Companies alike, in UK an alternative and simplified procedure was introduced by the Companies Act, 2006 for private companies. The new procedure which took effect on 1 October 2008, makes it possible for a private company to be able to reduce its share capital by a special resolution supported by a solvency statement given by all the directors.[36]

One of the greatest concerns of company law reformers has always been on reducing the cost of administering private companies and accelerating their decision making processes. The procedure for reduction of share capital in private companies without court confirmation was therefore introduced to mitigate the delay and cost involved in court confirmation.[37] However, this procedure provides an alternative (preferably) rather that the lone standard for the reduction of share capital. In practical terms, "the procedure may not always be the appropriate method for carrying out a reduction of capital in private companies, particularly when all of the directors are not willing to sign the solvency statement or where the directors would prefer the comfort of obtaining court approval if there is the possibility of an objection to the reduction from creditors."[38] Under such circumstances, the concerned company may still be able to go through a court process to effect the reduction.

In Uganda, the company law reform project that gave birth to the Companies Act 2012 failed to address this important issues. The consequence is that under Ugandan law, both private and public companies remain subject to the same legal regime with regards to the provisions on reduction of share capital. It is hoped that a future amendment of the Companies Act will address this issue by introducing a provision that allows for solvency statement procedure for reducing share capital in private companies. This will make it simpler and less costly for private companies seeking to reduce share capital than the current procedure that requires the confirmation of court. This is the position under Section 641 (1) (a) of the UK Companies Act 2006 which provides for a reduction of share capital by private companies on the basis of a special resolution supported by a solvency statement.

Prohibition of Payment of Dividend out of Capital

It should be said at the outset of the section that a commercial companies are set up mainly to earn profits for the shareholders out of which dividends can be paid.[39] It must be noted also that dividend represents a return on investment and not a return of investment. It is from this sense that the capital maintenance rule which prohibits the payment of dividend out of capital was crafted. This rule finds expression in the Model Articles dubbed the Regulations for the management of companies by shares, not being a private company which enacts that; "A dividend shall not be paid otherwise than out of profits."[40] The only exception to this rule is as provided for under section 75 of the Act. The current provision allows a company to pay dividend on any shares of a company issued for the purpose of raising money to defray the expenses of the construction of any works or buildings or the provision of any plant which cannot be made profitable for a lengthened period.[41] Such payment must however be authorized by the company's articles of association and with approval of the Registrar of Companies.[42]

The possible explanation that can be put forward in relation to this "compromise" is that it helps to strike a balance between the capital needs of the company and at the same time, it offers protection to creditors. This hinges on the understanding that a capital project is by nature, a long-term yielding investment with the potential and prospects of meeting its on cost.

In this section we are mainly concerned with the rule prohibiting payment of dividend except out of profits. This probably raises the question as to what exactly are profits for purposes of dividends. The term "profit" is generally employed in business to demonstrate the difference between income and expenditure. Where the difference is positive, then the company is said to have made profits and where the number is negative, then it translates to losses. As explained in In Re Spanish Prospecting Co.[43]: "Profit" implies a comparison between the state of a business at two specific dates usually separated by the interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be done by a comparison of the assets of the business at the two dates.[44]

It should be noted that not all profits realised by a company are automatically distributable to shareholders in

form of dividend. The law gives directors certain powers on matters of dividend. First dividend can only be recommended by directors, and the dividend so recommended can only be decreased but cannot be increased by the shareholders.[45] Second, directors may set aside from profits, such sums of money as reserves as they deem fit.[46] They (the directors) may also carry forward any profits which they may think prudent not to divide.[47] Finally, a company may also resolve on the recommendation of directors to capitalize its profits.[48] In the final analysis what may be called profit for purposes of dividend is not necessarily the colossal sum of money declared by directors but that which the directors have in fact set aside for distribution. This brings us to the conclusion that dividend can only be paid out of the distributable profits of the company. These are: the accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less the accumulated, realized losses, so far as not previously written off in a reduction or reorganisation of capital duly made.[49]

Paying dividend otherwise than out of profits is unlawful. The position at common law is that "where dividend is paid and it is unlawful in whole or in part, and the recipient knew or had reasonable grounds to believe that it was unlawful then that shareholder holds the dividend (or part) as a constructive trustee."[50] Strangely, the common position targets the recipient of unlawfully paid dividend rather than the directors who effected the payment. Fortunately certain statutory reforms have been implemented to correct this anomaly. The position under the Act makes directors liable to the company and its creditors within six years after paying an unlawful dividend or other distribution to its members.[51] The extent of liability is to the full amount of the dividend or other distribution unlawfully paid.[52]

Whilst this is commendable in terms of ability to hold directors accountable for breach of capital maintenance rules, it is not sufficient especially compared to jurisdictions where criminal sanctions have been introduced. In Romania for instance, paying an unlawful dividend is an offence punishable with between 1 to 3 year imprisonment.[53] This approach is very strategic to the capital maintenance doctrine based on its deterrent value and the potential of making the directors more circumspect in exercising the statutory powers. This is not only justified in terms of creditor protection but also the broader ends of public policy demanding the punishment of the officers of the company who are behind the unlawful payment.

Financial Assistance for Acquisition of Shares

An important trajectory of the capital maintenance doctrine focuses on regulating corporate dealing in own shares. However, the scope and complexity of this rule differs depending on whether the company is a private company or a public company. A point to note first of all is that the rules are not as stringent for private companies as they are for public companies. Section 65 of the Act makes provision for the relaxation thus: "A private company is not prohibited from giving financial assistance—

1. for the acquisition of its shares; or
2. for the acquisition of shares in another company where the acquisition of shares is in its holding company and—
3. the holding company is a private company;
4. giving the assistance complies with the requirements of sections 70 and 72.

The key requirements under sections 70 and 72 are; passing a special resolution and giving notice to the Registrar respectively. Some restrictions however exists. First, financial assistance is permissible if the company has net assets which will not be reduced by the financial assistance or, to the extent that they are reduced, if the assistance is provided out of distributable profits. Secondly, financial assistance is not allowed in the case of a private company which is a subsidiary company, for acquisition of shares in its holding company unless the company proposing to give the financial assistance is a wholly-owned subsidiary.[54]

For public companies, the position appears to be more stringent. Section 63 of the Act prohibits a public company or its subsidiary from giving financing assistance for the acquisition of the company's shares. The rule applies whether the assistance is given directly or indirectly. Financial assistance may be in form of a loan, guarantee,

security or otherwise.[55] Prohibition of financial assistance for the acquisition of own shares by a public company or its subsidiary is perhaps the most contentious of all the capital maintenance rules. Tracing its history, Davies and Worthington comment: "…this rule does not constitute one of the glorious episodes in British Company law. The rationale for its introduction was under-articulated; it has proved capable of rending unlawful what seem from any perspective to be perfectly innocuous transaction."[56] As further re-counted by "…in 1980, two reported cases[57] caused considerable alarm in commercial and legal circles, suggesting as they did, that the scope of the section was even wider, and the risk of wholly unobjectionable transactions being shut down even greater, than had been formally thought".[58]

In Belmont Finance Corp v Williams Furniture Ltd,[59] Belmont Finance Corp was wholly owned by City Industrial Finance, Mr. James the chairman of both. Belmont's directors paid £500,000 under a scheme to help Maximum Co, owned and controlled by Mr Grosscurth, to buy shares in Belmont from City. City received £489,000 ultimately. Belmont later claimed City was liable to account as a constructive trustee. The Court of Appeal held that City Industrial Finance was liable to account. In Armour Hick Northern Ltd v Whitehouse,[60] B (Parent Company) consisted of three shareholders, who were directors of B & A (Whitehouse & Hick= 3000 shares and C= 7000 shares). B was in debt with C[sic][61] (Vendor Company), amounting to £93000. For the full repayment of debt in B, C agreed to transfer its shares to directors of B & A at par value, provided if indebtedness to them is fully discharged. So, directors of B & A arranged A (Subsidiary) to pay for the debt. Consequently, this share transfer made directors of B & A as the sole shareholders of B. Subsequently, B & A went into liquidation. The liquidators took action against C and directors of B & A, on behalf of A for the return of the £93000. It was held to be sufficient that assistance was given in connection with an acquisition.

The criticisms that trailed these decisions prompted reforms in the UK which have also found way into the Company law in Uganda. This accounts for the relaxation now available to private companies as discussed above. For public companies, certain exceptions have also been introduced where financial assistance may be permissible. First, where lending of money is part of the ordinary business of the company.[62] Secondly, in case of provision of money by a company for the purchase of its shares or shares of its holding company for the benefit of the company's employees.[63] Furthermore, the prohibition does not apply to making of loans to persons in the employment of the company other than directors in good faith with a view to enabling those persons to purchase or subscribe for fully paid shares in the company or its holding company.[64]

Nonetheless, one may express a serious concern at this point that present rules have completely lost touch with founding consideration namely; to guard against unlawful dissipation of capital for the protection of creditors. It thus appears that an entirely harmless transaction can be stroke down regardless of whether it actually amounted to dissipation of capital or not. It may be for this sort of concern that the Companies Act of New Zealand, adopts the solvency test as a primary basis for regulating financial assistance rather than merely codifying rules that constrict a company's ability to enter into genuine transactions on the false pretext of capital maintenance rules. The solvency test was first set out in s 4 of the 1993 Act with two important requirements that is to say; the company has the ability to pay its debts as they become due in the normal course of business, and that the company's assets be of greater value than its liabilities, including contingent liabilities.[65] Therefore, a company must comply with the solvency test for it to be able to validly offer financial assistance for the acquisition of its own shares.

The Australian Corporations Act 2001 adopts a similar but more pragmatic approach of regulating financial assistance. S 260A broadly provides that a company may give financial assistance to any person to acquire shares in the company or a holding company of the company if among other things; the financial assistance does not prejudice the interest of its shareholders or the company's ability to pay its creditors, and provided the assistance is approved by a special resolution of shareholders and notice is given to the Australian Securities and Investment Commission.

The above exposition clearly indicates that the search for a more pragmatic and realistic legal regulation of financial assistance for purchase of own shares by companies in Uganda is far from over. Looking at the wave of reforms in other jurisdictions like Australia and New Zealand, it is hoped that this will someday trigger changes in Uganda Company law. In that way, foremost consideration will be given to the ability of a company to meet the solvency test rather than focusing on prohibition of financial assistance for the purchase of the

company's own shares.

Prohibition of Share Buy-back

Trevor v Whitworth,[66] a UK Company law case is the locus classicus on share buyback or repurchase of own shares by a company. In that case, it was held to be unlawful for a company to repurchase its own shares. The House of Lords reasoned that: "…the stringent precautions to prevent the reduction of the capital of a limited company, without due notice and judicial sanction, would be idle if the company might purchase its own shares wholesale…"[67] However, certain reforms have been introduced under which a company may be allowed to repurchase its own shares. Under the Companies Act, shares may be issued as redeemable preference shares if authorized by the company's articles of association.[68] By redeemable preference shares, it means the company retains the option of redeeming the shares. Redemption is therefore a process by which a company repurchases its own preferred stock from shareholders.[69] This offers the first and perhaps most significant exception to the rule laid down in Trevor v Whitworth.

Another exception to the rule above finds expression in S 247 of the Companies Act 2012. This section was introduced as an alternative to the equitable relief of winding up of company on the ground of unfairly prejudicial and oppressive conduct of directors. The provision gives powers to the Registrar of Companies to make certain orders as he/she may deem fit without winding up the company. Notable among the reliefs is an order for the purchase of the shares of a member by the company. This serves mainly to preserve the company and to protect the interests of the vast stakeholders who stand to be adversely affected in the event of the company being wound up.

Forfeiture of shares constitutes another exception to the rule that prohibits the repurchase of shares by a company. This is a non-judicial remedy available to a company in respect of shares not paid for by its holder. Forfeiture must however be in accordance with the law which demands among other things the giving of notice of intention to forfeit to the concerned shareholder.[70] Forfeiture has implications for both the shareholder and the company. For the shareholder, all rights and entitlements are extinguished, and for the company, the shareholder does not owe any remaining balance. This may affect the share capital the company. The law however allows the company to sell or dispose of forfeited shares in a manner that the directors may deem fit.[71] This is to avoid the company losing part of its share capital as a result of the forfeiture.

SUMMARY OF FINDINGS

This paper examined the capital maintenance rules within the context of company law in Uganda. The rules were designed with the aim of ensuring that a company does not engage in transactions involving its share capital in a manner that will be tantamount to return of capital to members. The paper analyzed the reforms that have been introduced by statute to whittle down the harsh effects of these rules. The key findings of this study indicate different policy considerations for the capital maintenance doctrine. For example, the powers to make substantive decision on reduction of capital is a reflection of the freedom of a company over its share capital but also the control of elements of decisions that may be prejudicial to creditors. On the other hand, paying dividend out of capital in respect of shares of a company issued for the purposes of raising money to finance projects with long-term yielding ability reflects the long-term goals and aspirations of the company. In another sphere, relaxation of the rule prohibiting financial assistance for the purchase of own shares by a company takes into consideration the interest of employees. Accordingly, money may be provided for the purchase of shares for the benefit of company employees. Finally, the power of the company to buy-back its own shares reflects the flexibility a company has in issuing different classes of shares and in dealing with dissenting shareholders. This allows for the redemption of redeemable preference shares, as well as provide as an exit option for minority shareholders who complain of unfairly prejudicial and oppressive conduct of directors in the sense that the shares of such a shareholder can be purchased by the company.

CONCLUSION

This study assessed the capital maintenance doctrine within the context of company law in Uganda. The study observes that the rules-based approach remains the dominant view in construing the capital maintenance

doctrine. The capital maintenance rules are essentially designed with the aim of ensuring that a company does not engage in transactions relating to its share capital in a manner that is tantamount to returning capital to members. The rules under the Companies Act are, however, crafted in a lopsided manner which tends to hinder the prospects of fair dealings in share capital as may be justified by the actual financial position of a company. This calls for a more balanced approach of capital maintenance regulations in Uganda.

RECOMMENDATIONS

As noted above, the rules-based approach is the dominant method by which the capital maintenance doctrine is crafted under Ugandan law. Successive reforms in Uganda have failed to produce the desired innovations in the core areas of company law relating to the capital maintenance doctrine. This approach is contra-distinguishable from the position in other jurisdictions where in giving effect to the capital maintenance doctrine, primary consideration is given to the actual financial position of the company. In Australia and New Zealand for instance, the solvency test has been made the major yardstick for operationalization of the capital maintenance doctrine. This approach is more practical and realistic in offering protection to the creditors. As defined under the South African Companies Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonable foreseeable financial circumstances of the company at that time, the assets of the company when fairly valued, equal or exceed its liabilities.[72] This approach is strongly recommended in order to maintain a sound and stable business environment in Uganda.

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6. Mayar Lash 'When Are Shareholders Responsible for Company Debt?' at https://legalvision.com.au/shareholders-responsible-company-debt/ visited on 29/10/21.
7. Mbeli T. Valentine 'Legal and Economic Technicalities Attending to Issuing Company Shares for Non-Cash Consideration' https://www.academia.edu/ accessed on 07/02/25
8. Pieter Holthuis 'Corporate finance, undercapitalization and shareholders' liability' available at https://www.cleber.nl/en/corporate-finance-undercapitalization-shareholders-liability/ accessed on 07-02-25.
9. ScienceDirect 'Resource Dependence Theory' https://www.sciencedirect.com/topics/economics-econometrics-and-finance/resource-dependence-theory#:~:text=3.6%20Resource%20dependence%20theory&text=According%20to%20the%20RDT%2C%20firms,Pfeffer%20and%20Salancik%2C%201978) accessed on 03-02-25
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FOOTNOTES

[1] Mayar Lash 'When Are Shareholders Responsible for Company Debt?' at https://legalvision.com.au/shareholders-responsible-company-debt/ visited on 29/10/21.

[2] The hallmark of the capital maintenance doctrine is that a company must obtain proper consideration for shares that it issues and that having received such capital it must not repay it to members except in certain circumstances. See Md. Saidul Islam 'The Doctrine of Capital Maintenance and its Statutory Developments: An Analysis' *The Northern University Journal of Law* IV (2013) 47

[3] *Ibid.*

[4] These rules are contained in various aspects of the Companies Act, for example, Article 116 of the Regulations for

the Management of Companies by Shares, not being a Private Company. See also Article 69 (1) which states: "A

company shall not pay a dividend or make any other distribution to its members except out of profits available for

that purpose."

[5] UKHL 1, AC 22.

[6]Jeffrey Pfeffer 'The External Control of Organizations: A Resource Dependence Perspective' quoted in ScienceDirect 'Resource Dependence Theory' https://www.sciencedirect.com/topics/economics-econometrics-and-finance/resource-dependence-theory#:~:text=3.6%20Resource%20dependence%20theory&text=According%20to%20the%20RDT%2C%20firms,Pfeffer%20and%20Salancik%2C%201978) accessed on 03-02-25.

[7] Emem Udo 'The Doctrine of Capital Maintenance Under The UK Company Law: Issues and Perspectives' https://www.linkedin.com/pulse/doctrine-capital-maintenance-under-uk-company-law-issues-emem-udoh visited on 30-10-21

[8] (1882) 21 Ch. D. 519.

[9] *Ibid.*

[10] 12 App Cas 409

[11] *Ibid* Per Lord Herschell.

[12] Harvey Gelb 'Piercing the Corporate Veil—The Undercapitalization Factor' *Chicago-Kent Law Review* 59 (1) (1982) 6.

[13] *Ibid.*

[14] *Minton v Cavaney* 56 Cal. 2d 576, 364 P.2d 473, 15 Cal. Rptr. 641 (1961).

[15] *Anderson v Abbott*, 321 U.S. 349, 362 (1944).

[16] John Armour "Share Capital and Creditor Protection: Efficient Rules for Modern Company Law" *The Modern Company Review* 63 (3) (2000) 355.

[17] Peter O Mulbert 'A Synthetic View of Different Concepts of Creditor Protection - A High-Level Framework for Corporate Creditor Protection' Center for German and International Law of Financial Services and Faculty of Law, University of Mainz and ECGI Law Working Paper N°.60/2006 36.

[18] *Ibid*.

[19] Pieter Holthuis 'Corporate finance, undercapitalization and shareholders' liability' available at https://www.cleber.nl/en/corporate-finance-undercapitalization-shareholders-liability/ accessed on 07-02-25.

[20] LexisNexis 'Share Capital and its Maintenance' available at https://www.lexisnexis.co.uk/legal/guidance/share-Accessed on 07-12-21

[21] Farrar, JH. *et al*. *Farrar's Company Law* 4th edn (London: Butterworth's, 1998)146.

[22] *Ibid.*

[23] *Chappell &Co. Ltd. v Nestle Co. Ltd* (1960) Ac. 87.

[24] Mbeli T. Valentine 'Legal and Economic Technicalities Attending to Issuing Company Shares for Non-Cash Consideration' https://www.academia.edu/ accessed on 07/02/25.

[25] (1897) 1 Ch 796.

[26] *Ibid.*

[27] *Ooregun v Gold Mining Co. of India v Roper* (1892) AC 125.

[28] See *The Crown v The Bullfinch Proprietary* (W.A.) Ltd. (1912) 15 C.L.R. 443; Commissioner for Stamp Duties v Broken Hill South Extended Ltd. [1911] A.C. 439; J.C. *Williamson's Tivoli Vaudeville Pry. Ltd. v F.C.T.* (1929) 42 C.L.R. 452.

[29] See the companies and securities law review committee report to the ministerial council on the issue of shares for non-cash consideration and treatment of share premiums September, 1986 report of the companies and securities law review committee on the issue of shares for non-cash consideration and treatment of share premiums

[30] *Ibid*.

[31] Ghana Companies Act, 2019, Act 992 Section 45 (2).

[32] I*bid* section 45(4).

[33] See generally section 162 (1)-(6) Companies and Allied Matters Act, 2020.

[34] Section 76 (1) (a)-(c) Companies Act.

[35] See generally, Section 77 of the Companies Act.

[36] Md. Saidul Islam "The Doctrine of Capital Maintenance and its Statutory Developments: An Analysis" *The Northern University Journal of Law* IV (2013) 2218-2578, 52.

[37] Paul L. Davies & Sarah Worthington *Gower and Davies Principles of Modern Company Law* 9th edn. (London, Sweet and Maxwell, 2012) 355.

[38] Catherine Hendy "The solvency statement: reducing share capital" available at https://www.weightmans.com/insights/the-solvency-statement/ accessed 07-02-25.

[39] Yagba, TAT. *et al. Elements of Commercial Law* (Zaria: Tamaza Publishing Co. Ltd, 1994) 283.

[40] Article 116 Regulations for the management of companies by shares, not being a private company. See also Regulation 69 (1) which states: "A company shall not pay a dividend or make any other distribution to its members except out of profits available for that purpose."

[41] Companies Act, 2012, Section 75 (1).

[42] *Ibid* Section 75(2).

[43] (1911) 1 CH. 92 at 98

[44] *Ibid.*

[45] See Article 114 Table A Companies Act

[46] Article 117 (1) Table A Companies Act.

[47] Article 117 (2) Table A Companies Act.

[48] Regulation 128 (1) Companies Act.

[49] Regulation 69 (3) Companies Act.

[50] *Precision Dippings Ltd v Precision Dippings Marketing Ltd (1986) 1 Ch 457.*

[51] See Regulation 69 (5) Companies Act.

[52] *Ibid.*

[53] See Article 272 of the Romanian Law No. 31/1990 Regarding Commercial Companies.

[54] See section 65 (2)-(4) Companies Act.

[55] Section 63 (1) Companies Act.

[56] Paul L. Davies & Sarah Worthington *Gower and Davies Principles of Modern Company Law* 9th edn. (London, Sweet and Maxwell, 2012) Davies p. 359.

[57] *Belmont Finance Corp v Williams Furniture Ltd* No.2 (1980) 1 All England Reports 393, CA*; Armour Hick Northern Ltd v Whitehouse* [1980] 1 W. L. R 1520.

[58] Paul L. Davies & Sarah Worthington n. 56, 361.

[59] [1980] 1 All E.R. 393, CA.

[60] [1980] 1 W. L. R 1520.

[61] The logical position is that C was in debt with B.

[62] Companies Act Section 63 (2) (a).

[63] *Ibid* Section 63 (2) (b).

[64] *Ibid* Section 63 (2) (c).

[65] Haynes Christopher "The Solvency Test: A New Era in Directorial Responsibility" *Auckland University Law Review* 26 available at https://www.nzlii.org/nz/journals/AukULRev/1996/7.pdf accessed on 07-02-25.

[66] *Trevor v Whitworth* (1887) 12 App Cas 409.

[67] Per Lord Herschell.

[68] Companies Act 2012 Section 68 (1).

[69] Tamplin True "Redemption of Preference Shares: Practical Problems and Solutions" https://learn.financestrategists.com/explanation/shares-and-debentures/redemption-of-preference-shares-practical-problem-and-solutions/ accessed on 19/07/2022.

[70] In the case of *[Public Passenger Services Ltd. v M.A. Khader* [1996] it was held that: "A proper notice is a condition precedent to the forfeiture of shares and even the slightest defect in the notice will invalidate the forfeiture".

[71] See Regulation 36 Companies Act.

[72] South African Companies Act 2008, section 4 (1) (a).