



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA
AT NAIROBI (MILIMANI COMMERCIAL COURTS)
Bankruptcy Cause 58 of 2004
IN THE MATTER OF MRS AMINA HAJI
AND
IN THE MATTER OF THE BANKRUPTCY ACT CAP 53 LAWS OF KENYA
RULING

On 19th April 2004, the Applicant Mrs. Amina Haji presented a Bankruptcy petition under the provisions of Section 5 of the Bankruptcy Act, Chapter 53, Laws of Kenya the (Act) for a receiving order for the protection of her estate.

When the application was placed before my sister, Lady Justice Kasango on 26th April 2004, she declined to issue a receiving order "because the debts alleged to be due and the debtor is unable to pay are debts payable by Target carriers Limited."

In the application dated 30th April 2004 and filed on the same date under a Certificate of Urgency of the same date and drawn by her Advocates, Alex Karanja Ndungu & Co. the Petitioner seeks a variation of the court's order made on 26th April 2004 declining to make a receiving order against the Petitioner. The Petitioner swears in her Supporting Affidavit, para. 6:-

"6. That almost all the debts listed as being payable by Target Carriers Ltd are actually personally guaranteed by the Directors including myself making me liable to court action, and paragraphs 9 and 10.

"9. that the list of creditors above was not meant to be filed together with the statement of affairs but was meant to assist my Advocate prepare all documents for presentation to court.

10. That I verily believe from the information from the said Advocates that the inclusion of the list was inadvertent and was not meant to mislead the court at all."

The application is expressed to be brought under the provisions of Sections 3(1) (f), 11, 97, 100 & 133 of the Act, and Rules 1, 15, 16 & 144 of the Bankruptcy Rules and all enabling provisions of the law. The application prays for orders that:-

- (a) the Court do vary the order it made on 26.04.2004
- (b) a Receiving Order be issued in respect of the estate of the Petitioner,

(c) the Court do order for a stay of any intended legal action against the Petitioner, The application is based on the grounds:-

(a) That the Petitioner has consciously and after careful consideration of the consequences voluntarily presented this petition,

(b) That the Petitioner has as an individual fallen into bad times and has completely been overwhelmed by her commercial obligations hence the decision to adopt this painful course of action,

(c) That the Company Target Carriers Limited whose list of creditors was inadvertently filed together with the statement of affairs was not meant to be filed and almost all the debts included therein were incurred by the Petitioner and are due from her,

(d) That it is meet and just that the orders sought by the Petitioner be granted to enable the Official Receiver to take delivery of the Petitioner's estate;

For completeness of the record and the eventual conclusion and decision in this Ruling, I set out below the various provisions of the Act, and the Rules upon which this application is brought.

Section 3 of the Act lists the various acts of Bankruptcy, Section 3 (1)(f) states that a person commits an act of bankruptcy if he files in the Court a declaration of his inability to pay his debts or presents a bankruptcy petition. Section 11 of the Act grants the Court jurisdiction to stay any action, execution or other legal process against the property or the person of the debtor, and on proof of presentation of a petition, the Court may either stay the proceedings or allow them to continue on such terms as it may think just. Section 97 of the Act invests jurisdiction in Bankruptcy in the High Court unless specifically or generally delegated by the Chief Justice to any subordinate court. Section 100 of the Act grants the bankruptcy court "full power to decide all questions of priorities, and all questions whatsoever, whether of law or fact which may arise in any case of bankruptcy coming within its cognizance, or which the court may deem it expedient or necessary to decide for the purposes of doing complete justice or making a complete distribution of property in any such case."

It is important to pose here for a moment. The Bankruptcy Act and the Bankruptcy Rules comprise a complete code on the subject of Bankruptcy, and Rule 317(2) provides that the rules of procedure of the High Court shall not apply to any proceedings in Bankruptcy. Unlike the Civil Procedure Act, (Cap. 21 Laws of Kenya), and the Civil Procedure Rules which by Section 80 of the Act and Order XLIV of the Rules specifically provide for, and the manner, and by whom, and on what grounds, an order of the court may be reviewed, varied or set aside, there is no similar provision under the Bankruptcy Act or the Rules for review, varying or setting aside an order made under the Bankruptcy Act. It is Section 100 of the Bankruptcy Act which gives the Bankruptcy Court "full power to decide all questions of priorities and all other questions whatsoever, whether of law or fact which may arise in any case of bankruptcy coming within its cognizance or which the Court may deem it expedient or necessary to decide for purposes of doing complete justice

The Petitioner has applied and prays that the court do vary the order of court made on 26th April 2004 by Lady Justice Kasango. Before deciding upon this prayer, it is again necessary to look at the other relevant provisions of the Bankruptcy Act. Section 8 of the Act provides that a debtor's petition shall allege that the debtor is unable to pay his debts, and that the presentation of the petition is deemed to be an act of Bankruptcy even without the previous filing by the debtor of any declaration of inability to pay his debts. Where such a petition is presented, the Court is bound to make a receiving order, and the only reason for refusing to do so is that the debtor has not previously filed with the official receiver his statement of affairs in terms of Section 16 of the Act. A receiving order once made may only be withdrawn with the leave of the court.

Under Section 9 of the Act, on the making of a receiving order the official receiver is constituted the receiver of the property of the debtor, and after the making of the receiving order except with the leave of, and on terms the court may impose under circumstances provided for under the Act, no creditor to whom

the debtor is indebted in respect of any debt provable in Bankruptcy shall have any action or other legal proceedings against the debtor. The only specific exception to this unfettered bar to realize any remedy against the debtor, subject of a receiving order, is that of a secured creditor whomay still move against the debtor under the security granted by the debtor to that creditor.

Further, a person who is subject to a receiving order enjoys the immunities set out in Section 11 of the Bankruptcy Act. The Section provides that the Court may at any time after presentation of a bankruptcy petition:-

(a) Stay any action, execution or other legal process against the Property or person of the debtor, and (b) on proof of "mere" presentation of the petition for

Bankruptcy, any court in which the proceedings are pending by or against the debtor may either stay the proceedings or allow them to continue on terms. I have used the phrase "mere presentation" quite advisedly for although the grant of these immunities is subject to the discretion of the court, a receiving order will routinely be made on reliance upon the certificate of the official receiver that the debtor has satisfied the conditions for the grant and issue of a receiving order. A receiving order if made, has the effect of making the debtor a ward of Court and any proceedings pending are stopped by operation of the receiving order. A debtor who therefore applies to become a ward of court pursuant to a petition for a receiving order under the Bankruptcy Act will do so only in respect of debts for which he is personally liable. Where the court of Bankruptcy has any doubt about the alleged acts of Bankruptcy, the petition for a receiving order may be declined.

In the instant case, the Petitioner attached a list of debts which the petitioner swears were incurred by her personally. The list however schedules the debts under the name of Target Carriers Limited, a limited liability company. The Companies Act has a whole body of provisions for dealing with insolvent companies, and the liability of its shareholders to contribute in the event of dissolution of the company. Unless therefore there is direct proof of the director's personal liability there will be little cause for the individual director to seek and be granted a receiving order for under section 118 of the Bankruptcy Act no receiving order may be made against any corporation or against any company registered under Companies Act.

When this cause first came before my sister, Lady Justice Kasango, she declined to issue a receiving order. To again use her very words "I decline to issue a receiving order because the debts which the debtor alleged that she is unable to pay are debts payable by "TARGET CARRIERS LIMITED".

The application in issue seeks orders "to vary the order made on 26th February 2004". The grounds in support of the prayers include paragraph 6 of the Supporting Affidavit of Mrs. Amina Haji and paragraph 3 of the grounds, and are in these terms,

"6. That almost all the debts listed as being payable by Target Carriers Ltd are actually personally guaranteed by the directors including myself making me liable to court-action"

and ground No. 3 of the grounds of the application-

"that the company Target Carriers Limited whose list of directors was inadvertently filed together with the statement of affairs was not meant to be so filed and almost all the debts included therein were incurred by the Petitioner personally and are due from me."

I want to believe that when my sister, Lady Justice Kasango, declined to make the receiving order in this matter she must have had at the back of her clear mind, the principles which underly the corporate status of a limited liability company. Upon the issue of a certificate of incorporation, the company becomes a body corporate or, in other words a corporation (S.16(1)). Prior to the date of the certificate the company had no legal existence.

A corporation is not, like a partnership or a family, a mere collection or aggregation of individuals. In the

eyes of the law it is a person distinct from its members or shareholders, a metaphysical entity or a fiction of law, with legal but not physical existence. It is as Lord Selborne said "a mere abstraction of law," and Lord Macnaghten observed "at law a different person altogether from the subscribers to the memorandum of association". The principle of the independent existence of a company was explained and emphasized by the House of Lords in the case of *Salmon vs Salmon & Co. Ltd* [1897] A.C. 22, 51.

In that case, Salmon a leather merchant and wholesale boot manufacturer was the owner of a profitable business, and in order to obtain the advantage of limited liability, he, being, perfectly solvent at the time, converted his business into a company. He took 20,000 shares in the company, and his wife and five children took one share each. No other share was issued. Salmon received also mortgaged debentures to the amount of £ stg. 10,000.00 in part payment by the Company to the business. Later, the company went into financial difficulties, the then holder of the debentures appointed a receiver and the company went into liquidation.

The Courts were asked to decide whether the debentures originally issued to Salmon, were valid and entitled in priority over the unsecured creditors who denied them priority on the ground that the company was a "one-man company" and a sham, and so Vaughan Williams J. held, that being of the opinion that *A. Salmon & Co. Ltd* was a mere alias or agent for Salmon, and, therefore, that Salmon was bound to pay the unsecured creditors of the company out of his own pocket notwithstanding that his shares had all been fully paid up. The Court of Appeal affirmed the decision of the learned Judge but on the ground that the whole scheme was a fraud on the policy of the Companies Act, and that it was never intended by the legislature that a company should consist of one substantial person and six mere dummies devoid of any real interest. This decision was unanimously reversed by the House of Lords on the ground that the only mode of ascertaining the intent and meaning of the Act was to examine its provisions and find what regulations it had imposed as a condition of trading with limited liability.

Lord Halsbury L.C. said:

"..... the statutes enact nothing as to the extent or

degree of interest which may be held by each of these seven, or as to the proportion of interest or influence possessed by one of the majority of the shareholders over the others."

Lord Macnaghten said:-

There is nothing in the Act requiring that subscribers to the Memorandum should be independent, unconnected, or that they or any of them should take a substantial interest in the undertaking. Or that they should have a mind and will of their own, as one of the learned Lords Justices seems to think or that there should be anything like a balance of power in the constitution of the company."

Already before Salmon's case in *Farrar Vs. Farrar Limited*, (1888) 40 Ch. D. 395, Lindley L. J. said:-

"A sale by a person to a corporation of which he is a member is not, either in form or in substance, a sale by a person to himself. To hold that it is, would be to ignore the principle which lies at the root of the legal idea of a corporate body, and that idea is that the corporate body is distinct from the persons composing it. A sale by a member of a corporation to the corporation itself is in every sense a sale valid in equity as well as at law."

There are many modern cases to this effect. This concept is embodied in Section 16 of the Companies Act, (Cap. 486 Laws of Kenya) that upon the issue of the Certificate of Incorporation the subscribers to the memorandum of association and other persons who may later become members of the company become a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company with power to hold land and having perpetual succession and a common seal but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up.

For the Petitioner to assume the liabilities of the company Target Carriers Limited, merely by a declaration to do so, is a matter which is not only contrary to the principle of separation as distinct legal entity of the shareholder to the company, but does also call for a caution in the Court of Bankruptcy, and a little more proof of the extent if any of such personal liability. Reference has been made to personal guarantees. How were these made and between which parties? We observe that the creditors list of Target Carriers Ltd as at 30th November 2003 contained some well known petroleum products suppliers and other well-known names in the motor vehicle industry.

In as much as the petitioner seeks the protection of the Court of Bankruptcy cognizance must also be taken of the position of the creditors whose legitimate claims may well be paid put by issue of a receiving order. The Court of Bankruptcy will therefore not hesitate to decline to issue a receiving order in bankruptcy where there is even a whiff of suspicion that the Petition is brought largely to defeat the likely legitimate claims of a large number of creditors like in this present case. This would really be an abuse of the process of the court (Re Bound (1888) 21 Q.B.D. 17). The clear philosophy behind the issue of a receiving order is that the debtor is enabled to put his affairs together again during the currency of the receiving order, and be protected from the pressure of a committal order by obtaining an adjudication in Bankruptcy against herself, she must therefore come to court with clean hands. She must show how the debts of Target Carriers Ltd suddenly became hers for there is a method, a way of dealing with delinquent or insolvent companies like Target Carriers Ltd, if, it is indeed insolvent. That way is not by its directors seeking and hiding behind receiving orders.

To avoid therefore an abuse of the process of the court of bankruptcy, and as the Petitioner Mrs. Amina Haji has stated on oath in her Supporting Affidavit that the debts of Target Carriers Ltd were personally guaranteed by her, let the petitioner make full disclosure before the receiving order may be granted, how she guaranteed the debts before she can be afforded the protection of the court of bankruptcy. The disclosures will enable the court to decide on the matters of the receiving order and consequences thereof and be able to do complete justice as envisaged under Section 100 of the Bankruptcy Act.

For these reasons, I decline to vary the order made on 26th April 2004 by Lady Justice Kasango, and I also decline to grant the consequential orders sought in the application herein. The application filed by Mrs. Amina Haji on 30th April 2004 in Bankruptcy Cause No. 58 of 2004 is dismissed with costs.

Delivered and dated at Nairobi this 31st day of May 2004.

M. J. ANYARA EMUKULE

JUDGE