BUSINESS LAW

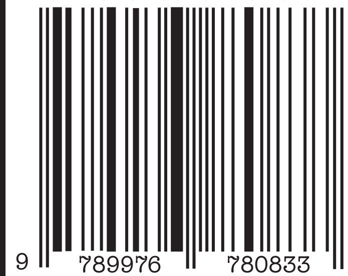
STUDY TEXT

A5

Foundation level

THE NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS TANZANIA (NBAA)

A5 COST ACCOUNTING



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FOREWORD.

The National Board of Accountants and Auditors is a professional body in Tanzania, established under the Auditors and Accountancy Registration Act No 33 of 1972 (CAP 286 R.E.2002). The Board has been charged with among other things, the responsibility to promote, develop and regulate the accountancy profession in the country.

In fulfilling its statutory obligations, NBAA prepares National Accountancy Examination Scheme for students aspiring to sit for Accounting Technician and Professional Examinations. Further, for effective implementation of the examination scheme and improve examination results, the Board provides Study Guides for all subjects to assist both examination candidates and trainers in the course of learning and teaching.

The Study Guides have been prepared in the form of text books with examples and questions to enable the user to have comprehensive understanding of the topics. The Study Guides cover a wide range of topics in the NBAA syllabi and adequately cover the most comprehensive and complete knowledge base that is required by a leaner to pass the respective examination levels.

Furthermore, the Study Guides have been prepared to match with the Competency Based Syllabi to enable the learners to be exposed to practical understanding of issues rather than memorisation of concepts. In this case, the Study Guides are characterized by the following features:-

1. Focus on outcomes – The outcomes shown in every topic provides clear understanding on what to be learnt.

2. Greater workplace relevance – the guides emphasize on the importance of applying knowledge and skills necessary for effectively performance in a work place. This is different from the traditional training where much concern has been expressed in theoretical perspectives.

3. Assessments as judgments of competence – The assessment questions embedded in the Study Guides are adequate measures of understanding of the subject matter.

Study Guides are also useful to trainers specifically those who are teaching in the review classes preparing learners to sit for the professional examinations. They will make use of these Study Guides together with their additional learning materials from other sources in ensuring that the learners are getting sufficient knowledge and skills not only to enable them pass examinations but also make them competent enough to perform effectively in their respectively workplace.

NBAA believes that these standard Study Guides are about assisting candidates to acquire necessary skills and knowledge that will enable them to perform as professionals. The outcomes to be achieved are clearly stated so that learners may know exactly the skills and knowledge they are supposed to acquire in a particular topic.

NBAA wishes all the best to NBAA Examination candidates, trainers in their review classes, lecturers in the higher learning institutions and all other beneficiaries of these learning materials in making good use of the Study Guides towards promoting the accountancy profession in Tanzania.

CPA. Pius A. Maneno
EXECUTIVE DIRECTOR

JUNE, 2019

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Features of the book

The book covers the entire syllabus split into various chapters (referred to as Study Guides in the book). Each chapter discusses the various Learning Outcomes as mentioned in the syllabus.

Contents of each Study Guide

'Get Through Intro': explains why the particular Study Guide is important through real life examples.

'Learning Outcomes': describes the competences to be demonstrated by a learner on completion of a particular Study Guide.

The Learning Outcomes include:

'Definition': explains the meaning of important terminologies discussed in the learning Outcome.

'Example': makes complex concepts easy.

'Tip': helps to understand how to deal with complicated portions.

'Important': highlights important concepts, formats, Acts, sections, standards, etc.

'Summary': highlights the key points of the Learning Outcomes.

'Diagram': facilitates memory retention.

'Test Yourself': contains questions on the Learning Outcome. It enables students to check whether they have assimilated a particular Learning Outcome.

EXAMINATION STRUCTURE

The syllabus is assessed by a three-hour paper-based examination. There are five conventional questions of 20 marks each that need to be solved.

The examination will consist of two sections.

Section A One conventional question of 20 marks
Section B Forty multiple choice questions of 2 marks each

SECTION A

INTRODUCTION TO THE TANZANIAN LEGAL SYSTEM

A1

STUDY GUIDE A1: THE LEGAL SYSTEM OF TANZANIA

Get Through Intro

The legal system of a country is very important. This is because the legal system defines the culture, history and future of the country. There are basically three major known legal systems known as common law, civil law and religious law. The legal systems define the legal tradition such as how laws are made and applied. Tanzania follows a common law legal system.

In this Study Guide, students will be able to know the structure of the legal system in Tanzania, particularly Tanzania Mainland and the way it operates. Moreover, students will be able to understand the sources of law and differentiate legal obligations from moral obligations.

Through this Study Guide learners will be able to know where and how to find the law as well as how a person can get remedy when his rights are infringed. Further, this Study Guide lays a foundation for learners to understand concepts and principles covered in the next Study Guides.

Learning Outcomes

a) Identify and explain the Tanzanian legal system.
b) Identify, state and explain the sources of business law in Tanzania.
c) Classify the laws applicable in Tanzania.
d) Compare the operation of courts and tribunals in Tanzania

The Tanzanian legal system

[Learning Outcome a]

The Tanzanian legal system can be better understood in the context of the meaning of law generally, and the institutions through which the law operates. This should also define the subjects and objects of law. This is because for there to be a legal system there must be those expected to be regulated by the law, institutions to enforce the law and officials to administer the law. Thus, **the phrase legal system includes rules, institutions and officials responsible for the administration and enforcement of the law.** The description of the legal system offered above (which is described in the context of law) refers mostly to what is known as positive law or the law that can be enforced through a court of law and similar institutions.

Generally speaking, in our daily lives, we use the word 'law' to refer to different phenomena. For instance some people talk of the law of nature, laws of science, rules of social and moral behaviour etc. However, in this study guide, we are concerned with the set of rules which carry in them an element of 'obligation' and 'force'. They are the rules that every person to whom they apply must obey, and, if one does not obey them, he can be taken to court or similar institution and get punished for disobeying or breaking the law.

The Osborne's Concise Law Dictionary defines the term 'law' with reference to various definitions which have been expounded by different philosophers as follows:

1. **Meaning of Law**

Definition

A law is an obligatory rule of conduct. It is defined as the commands of him or them that have coercive power (Hobes).

A law is a rule of conduct imposed and enforced by the Sovereign (Austin).

Also the term ‘law’ is the body of principles recognised and applied by the State in the administration of justice (Salmond).

Blackstone, however, maintained that a rule of law made on a pre-existing custom exists as positive law apart from the legislator or judge.

From the above definitions, it can be noted that there are three elements of law as discussed earlier. These are:

i. An obligation to obey the law.

ii. Institutions (of the state) responsible for enforcement of the law such as the police force.

iii. Officials presiding in respective institutions for the administration of justice such as judges and magistrates.

Another important aspect of law is the element of punishment. Law is a rule of action to which people’s conducts must conform. The violation of such rule attracts sanctions or punishment.

From the above discussion, we can now turn to our learning outcome (a)which requires us to identify and explain the Tanzanian legal system. A starting point to achieving this outcome was to understand the meaning of law and its characteristics. The next step is to understand the court hierarchy or system. According to Article 107A (1) of the Constitution of the United Republic of Tanzania, 1977, Courts are the institutions entrusted with the role of interpreting the law and administration of justice in the country. Therefore it is important to understand the courts system of this country and the jurisdiction of the respective courts. The specific laws applicable on each aspect (area of law) and type of court covered in this study guide will be dealt with under each respective Study Guide where necessary.

2. Court System of Tanzania

The court system of Tanzania is two-fold: one applicable in Tanzania Mainland and another applicable in Zanzibar. The court system of Tanzania Mainland is formed of the various courts of judicature which are organised hierarchically. It is made up of the Court of Appeal at the apex, followed by the High Court of Tanzania, the Resident Magistrate Court and the District Court (the two being at the same judicial hierarchy) and finally the Primary Court.

There are also other institutions which are not part of a judiciary per se but do perform some adjudicatory functions. These are: the Special Constitutional Court of Tanzania and tribunals established for specific purposes as described later.

Diagram 1: Structure of Tanzania Court System

The Court system in Tanzania can be described as follows:

2.1. Special Constitutional Court of Tanzania

The Special Constitutional Court is established under Article 125 of the Constitution of the United Republic of Tanzania of 1977. This court is of an ephemeral status and sits only when there is a dispute to resolve. According to Article 126(1), the major function of this court is to hear and give a conciliatory decision in case there is a dispute between the Government of the United Republic of Tanzania and the Revolutionary Government of Zanzibar concerning the interpretation of the Constitution of the United Republic of Tanzania. As per Article 126(3) the conciliatory decision of this court is final and is not appealable to any other forum.

2.2. Court of Appeal

The Court of Appeal of Tanzania is established under Article 117(1) of the Constitution of the United Republic of Tanzania. It is the highest Court in the hierarchy of the Judiciary of Tanzania. It consists of the Chief Justice and other Justices of Appeal who are all appointed by the President. The Court of Appeal of Tanzania is the court of final appeal at the apex of the Judiciary in Tanzania. According to Article 117(3) of the Constitution, the Court of Appeal has jurisdiction to hear and determine cases arising from decisions of the High Court or of a Magistrate with extended jurisdiction. The Court of Appeal has no powers to hear cases in the first instance. It only hears cases referred to it on appeal.

2.3. High Court

The High Court of Tanzania is established under Article 108(1) of the Constitution of the United Republic of Tanzania and it has unlimited original jurisdiction to entertain all types of cases. Article 108(2) of the Constitution provides that the High Court has unlimited jurisdiction (powers) to hear and determine any matter which the Constitution or any other law does not expressly preclude it from being heard by the High Court. Similarly, the High Court has powers under the same Article 108(2) to deal with any matter which according to legal traditions obtaining in Tanzania is ordinarily dealt with by a High Court.

Moreover, Section 2(1) of the Judicature and Application of Laws Act Cap. 543 provides that the High Court has unlimited civil and criminal jurisdiction. Such jurisdiction is however subject to the jurisdiction of the Court of Appeal of Tanzania as provided for by the Constitution or any other written laws.

In the case of **Northern Tanzania Farmers' Cooperative Society Ltd v W.H Shelukindo** (1978) 2 LRT 36, the High Court held on its jurisdiction stating that:

"The High Court is a creature of the Constitution and exercises unlimited pecuniary and exercises unlimited pecuniary and territorial civil and criminal jurisdiction unless expressly restricted by the legislature".

The High Court also exercises original jurisdiction on matters of a constitutional nature including cases under the Bill of Rights section of the Constitution of URT and have powers to entertain election petitions.

The structure of the High Court is as follows. There is the High Court Main Registry (including the sub-Registries available in different parts of the country) which administers justice in all matters of civil and criminal nature. There are also four specialised divisions of the High Court which administers justice in specific types of cases. These are the Commercial Division which deal with cases of a commercial nature; the Labour Division which deal with labour and employment disputes; the Land Division which deal with all land disputes; and the Corruption and Economic Crimes Division which is mandated to hear and determine cases of corruption and economic crimes.

All appeals from subordinate courts may be referred to the High Court of Tanzania and finally to the Court of Appeal.

2.4. Resident Magistrates (RM's) Courts and District Courts

The Resident Magistrate Courts and the District Courts, both enjoy concurrent jurisdiction. These courts are established under the Magistrates' Courts Act (MCA) of 1984 [Cap. 11 R.E. 2002]. According to section 5(1) of the MCA, Resident Magistrate's Courts are established by order of Chief Justices published in the Government Gazette. The same Order of the Chief Justice designates the territorial jurisdiction of that court (section 5(2) of MCA).

The District Courts, unlike the Resident Magistrates Courts, are established in all districts in Tanzania in accordance with section 4(1) of the MCA. The District Court have jurisdiction to entertain cases arising from the territorial boundaries of the district in which it is established. District Courts receive appeals from the Primary Courts. They can also exercise original jurisdiction in criminal and civil matters in accordance with powers conferred by any written law (section 40 of the MCA).

2.5. Primary Courts

The primary courts are the lowest courts in the hierarchy and are established under section 3(1) of the MCA. Primary courts are established in every district. They deal with criminal cases and civil cases as provided under section 18(1) of the MCA. Noteworthy, primary courts have jurisdiction over all civil matters where the law applicable is customary law or Islamic law.

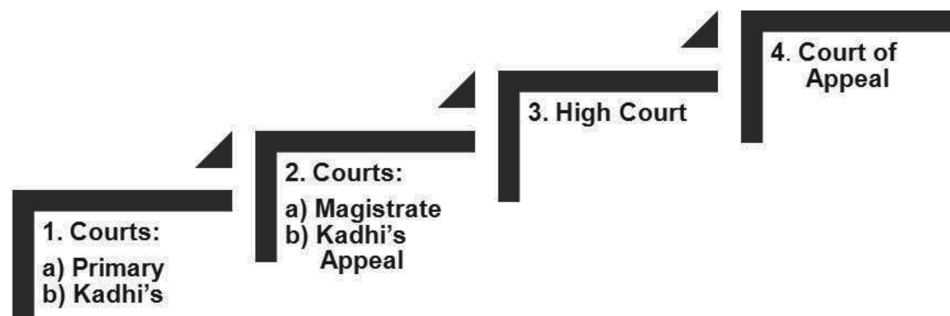
2.6. Tribunals

Tribunals are quasi-judicial bodies which have been mandate to adjudicate particular types of cases. They are established under specific Acts of Parliament. Examples of these tribunals include the District Land and Housing Tribunals, Ward Tribunals, Village Land Councils, the Fair Competition Tribunal etc. There are also other administrative bodies which perform specific adjudicatory functions such as the Tax Tribunals which deals with settlement of tax disputes and the Commission for Mediation and Arbitration which adjudicates on labour and employment disputes.

3. Court System of the Revolutionary Government of Zanzibar

The Zanzibar court system is quite similar to that of Tanzania mainland, except that Zanzibar retains Kadhi's courts. Kadhi's courts adjudicate cases of family law such as divorces, child custody and inheritance where both parties profess Islamic religion. The structure of the Zanzibar court system is as demonstrated in Diagram 2 below.

Diagram 2: Structure of the Zanzibar legal system



The structure of the Zanzibar legal system is as follows:

3.1. Court of Appeal of Tanzania

In this structure, the Court of Appeal of Tanzania handles matters on appeal from the decisions of the High Court of Zanzibar, except those involving Islamic law. The composition of the Court of Appeal is that which is stated in the Constitution of the United Republic of Tanzania and operates in the same way as it does for cases referred to it from the High Court of Tanzania.

3.2. High Court of Zanzibar

The High Court of Zanzibar is structured with the same structure as the High Court of Tanzania.

3.3. Magistrate's Court

These Courts have jurisdiction to entertain cases of which do not involve Islamic law. Cases involving Islamic law are entertained by the Kadhi's courts.

3.4. Kadhi's Appeal Court

The main role of the Kadhi's Appeal Court is to hear all appeals from the Kadhi's court, which adjudicates on Islamic law.

3.5. Kadhi's Courts

These are the lowest courts in the court hierarchy in Zanzibar. They have powers to adjudicate on all Islamic family matters such as divorce, distribution of matrimonial assets, custody of children and inheritance when both parties profess Islam.

3.6. Primary Courts

These have the same rank as the Kadhi's Courts. They deal with criminal and civil cases of customary nature but which do not involve Islamic law.

Test Yourself 1

i) Why do you think it was necessary to have a dual legal system in Tanzania?
ii) What is the significance of the Commercial Division of the High Court to businesses?

Identify, state and explain the sources of business law in Tanzania **[Learning Outcome b]**

4. Historical Background of Sources of Law in Tanzania

The current Tanzanian legal system is a result of colonialism, particularly the British. Before the colonialism, African societies had not developed into centralised organs like states. In such societies 'social behaviours was regulated by custom and traditions, or customary law'. In the late 19th and early 20th centuries, African states were colonised. In order to govern these African societies, the colonialists brought in their own governance structures including laws that were applicable in the colonising countries. These laws were modified where necessary in order to accommodate local circumstances. In Tanganyika (later Tanzania after union with Zanzibar), most of the laws applicable during colonialism were adopted after independence and modified to suit to circumstances of an independent country.

5. Sources of Business Law in Tanzania

The question on the sources of law is a pertinent one. As we have seen above the term 'law' connotes many things but not all notions of law can be enforced by a court of law. As a practising accountant you will need to know how to successfully confine your dealings within the confines of law so as to avoid unnecessary litigations and possible losses. You will need to know the law so as to be able to comply with it. In law, there is a maxim that ignorance of the law is not a defence. Therefore, it is very important for any professional to be acquired with knowledge of the basic laws relevant to his/her profession.

5.1. Constitution of the United Republic of Tanzania

The Constitution is a basic law of the land. It does not necessarily have directly to relate to business law but it lays down the general and basic legal framework and standards within which other arms or organs of the state must operate. It establishes the Legislature that is responsible for making laws, the Executive which is responsible for enforcing the law and the Judiciary which interpret the law. The Constitution defines powers of each organ of the government and sets limits in which those powers may be exercised.

Similarly, the Constitution defines rights and duties of citizens. The rights include right to life (Art 14), right to privacy and personal security (Art 16), right to work (Art 22) and right to own property (Art 24). The duties include duty to participate in work (Art 25), duty to abide by the laws of the land (Art 26) and duty to safeguard public property (Art 27). The Constitution is the supreme law of the country from which other laws whether written or unwritten derive their validity. This means that, no law is valid if it contravenes the provisions of the constitution.

5.2. Statutes

Statutes are those pieces of legislation which are enacted or made by the Parliament. Each law that is made by the Parliament is codified into a single document know as a statute or an Act of Parliament. Statutes contain the substantive or procedural provisions which have to be observed by the subjects and actors under that law. Some of the statutes relevant to business professionals include:

i. The Law of Contract Act [Cap. 345 R.E. 2002],
ii. The Companies Act [Cap 212 R.E. 2002],
iii. The Sales of Goods Act [Cap. 214 R.E. 2002],
iv. The Electronic Transactions Act, No. 13 of 2015

5.3. Delegated Legislation

Under Article 97(5) of the Constitution the Parliament is given powers of enacting laws that make provisions for conferring on any person or department of Government the power to make regulations having the force of law or conferring the force of law on any regulations made by any person, or any department of Government.

Laws made under that procedure are known as delegated legislation or subsidiary legislation. For subsidiary legislation to be legally acceptable it must cover only a part or apply to a specific area mentioned in the Principal legislation to be regulated by the relevant subsidiary legislation. The regulation must also be made by the authority specifically mentioned in the Parent Act and nothing else. Failure to comply with this principle the other authority purporting to make such a subsidiary legislation will be said to be acting ultra vires (that is outside or beyond its powers). The subsidiary legislation purportedly made by the authority acting ultra vires is null and void and therefore has no any legal force.

In most cases, powers to make subsidiary legislation are delegated to Ministers, Local Government Authorities such as town and municipal Councils, Heads of Departments and other public bodies such as the President or the Chief Jus

5.4. Customary Law

As pointed out earlier, the British introduced their law into Tanganyika as its colony. This was done through the Tanganyika Order in Council, 1920. This piece of legislation 'required the Governor, when making Acts, to respect existing native laws and customs provided they were not inconsistent to justice or morality'. Similarly local courts were required to apply relevant native laws in all cases involving natives subject to a condition that such native law was not repugnant to justice or morality, not inconsistent with the Order- in- Council, Act or any Regulation or Rule made under any Order-in-Council or Courts. It appears the rationale for applying native laws in cases involving natives was also to avoid technicalities of procedure obtaining under the English common law system but rather to base on substantial justice.

Customary laws were retained as a source of law even after independence. According to the case of **Maagwi Kimito v Gibeno Werema** [1985] TLR 132, customary laws have the same status as other law of this land provided they are not inconsistent to the Constitution and principles of natural justice.

Case Study

In the case of **Mtatiro Mwita v Mwita Marianya** Georges, C.J (as he then was) observed as follows:

If persons of the same tribe enter into an agreement well known to tribal custom under which terms are prescribed, these persons must in the absence of evidence to the contrary, be understood to be contracting in accordance with these terms. In such case relevant customary law must be applied if it is...applicable and is not repugnant to justice or morality or inconsistent with any written law.

Both parties to this case belonged to a Kuria tribe. The plaintiff had received a bullock from the defendant in exchange for some finger millet. The bullock later died within a short period of two months of an unknown cause. It was an established custom of a Kuria tribe that if an animal so exchanged died within a one year period the party in possession of the dead animal was supposed to return skin and meat to the other party whereas the other party would be obliged to replace the animal. On appeal, overruling the decisions of the lower courts and allowing the appeal, the Chief Justice found no reason as to why primary courts should not be able to hear cases involving agreements well known to tribal customs.

5.5. Received laws

During British colonialism, Tanganyika received and applied some laws from England. These received laws are applicable in Tanzania by virtue of section 2(3) of the Judicature and Application of Laws Act (JALA) [Cap. 358 R.E. 2002]. Received laws include common law, doctrines of equity and the statutes of general application in force in England by 22nd July 1920. Some of the statutes that have been declared as statutes of general application include: The Fire Prevention (Metropolis) Act 1774, the Life Assurance Act 1774 and the Marine Insurance Act 1906. All of these are applicable to insurance industry.

5.6. Case Law

Case law refers to judicial decisions that have a binding force to future cases. This is law laid down in course of deciding cases at the level of High Court or Court of Appeal. As it was observed earlier, the function of the judiciary is to interpret the law. In the course of interpreting laws and by applying different methods of statutory interpretation, judges give meaning to statutory provisions and that meaning has legal force like any other law. When a statutory provision is construed in a certain way in particular facts that construction has to be followed in subsequent cases of similar facts. This is the basis of the doctrine of precedent.

Under the doctrine of precedent (also known as *Stare Decisis*) lower (subordinate) courts are obliged to follow principles established in decisions of judgements made by higher courts (courts of record) when deciding cases of a similar nature to that decided by the higher court. In Tanzania, courts of record are the High Court and the Court of Appeal. Therefore, other lower courts are bound to follow the principles laid down in the decision of those two courts. Case law can be found in different case reports such as the High Court Digest (HCD), the Law Reports of Tanzania (LRT), the Tanzania Law Reports (TLR) and in other unreported cases.

5.7. Writings of eminent legal scholars

These are authoritative works written by legal experts in this field of law. They interpret the law putting it in the correct perspective. Because of this function, courts refer to them when seeking an interpretation on certain areas of law. However, it should be noted that these writing do not constitute binding sources of law but rather they save a persuasive role to help courts in interpreting the law.

Test Yourself 2

How does the knowledge of the sources of law help the work of a business professional?

Classification of the laws of Tanzania

6. Classification of laws of Tanzania

Laws may be classified as follows:

6.1. Public law and Private law

(a) Public Law

Public law concerns matters relating to society as a whole, particularly the activities of state bodies such as the legislature, the departments of central government and the very large number of bodies and agencies stemming from these departments, court and tribunals, local government and the police. It is therefore concerned with the state in its political or sovereign nature and regulates relations between the state or governmental agencies, and the citizen or between different governmental agencies. The main branches of public law are Constitutional law, Administrative Law and Criminal Law.

(b) Private law

Private law deals with the rights and duties existing between one individual and another in their private capacities. We may therefore define private law as the law regulating the relation between private persons, organizations or associations. Examples of private law include the law of contract, which regulates agreements between individuals or between organizations, law of agency where one person acts on behalf of another person, property law and land law. Also the law of torts, which determines when compensation is to be paid to another person whose legal rights, have been infringed by another. Under private law the state is neither the subject nor the object of duty. However, the machinery of the state is involved in settling disputes between individuals.

6.2. Civil Law and Criminal law

(a) Civil Law

The term 'civil law' is used to connote different meanings. Mainly it means the law that is used to regulate different civil wrongs or actions, as opposed to criminal law which deals with crimes. Civil wrong is a breach of private duty, which may arise from an agreement between individuals or which is imposed by a rule of law as in the law of torts.

(b) Criminal law

Criminal law is a branch of public law that deals with crimes or offences. The parties in a criminal case which is governed by criminal law are the state and the individuals. Crimes are generally wrongs which the state has interest to prohibit. Therefore, although crimes are often committed by individuals against other individuals, they are rather prosecuted by the State and the victim becomes a witness for the state.

6.3. Substantive Law and procedural law

(a) Substantive Law

This is a class of laws that provide rights and duties. Substantive law is the substance for which the statute is enacted to cover. Substantive law may be found in statutes, cases law and other sources of law as described earlier. The violation of such rights or breach of such duties may lead to litigation of either criminal or civil nature. It is the basis upon which a cause of action (legal claim) may be based. For example, contractual terms have to be honoured by all parties to a contract. Dishonouring contractual terms amounts to breach of contract and may result into litigation.

(b) Procedural Law

It is a class of laws which provides the procedures for obtaining the rights or enforcing the duties established in substantive legal framework. For example while the Penal Code provides that any person who commits murder is guilty of an offence and shall upon conviction be sentenced to death (section 196 of the Penal Code), the Criminal Procedure Act provide for the procedure on how to establish the said offences, how to reach to a conviction, judgement and sentence. The same applies in civil law, where for example the Law of Contract Act provides the remedies for breach of contract, the Civil Procedure Code provides for the procedure from instituting a civil case to enforcement of the remedy.

6.4. International law and domestic law

(a) International Law

International law is the operating among or between nations. It is divided into public international law and private international law. Public international law regulates affairs and relations of states. Sources of public international law include Treaties, Conventions, Bilateral and Multilateral Agreements and Protocols. Private international law regulates affairs between individual persons in matters involving more than one state.

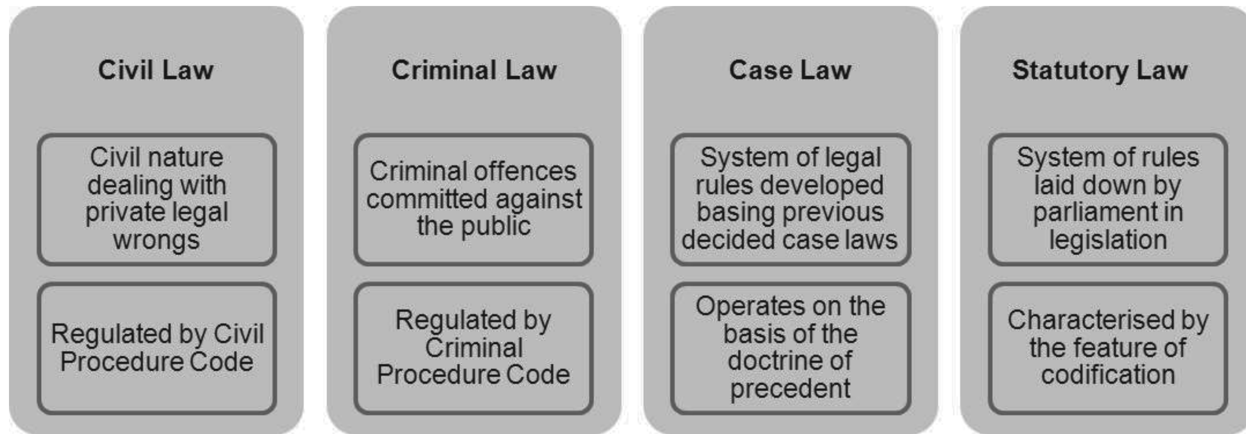
(b) Domestic law

Domestic law is the law obtaining and applicable in the individual sovereign state as per the sources of law recognised and applicable in that individual state. It is sometimes referred to as Municipal Law.

Test Yourself 3

Identify and explain the similarities and differences between crimes and civil wrongs.

Diagram 3: Branches of Law



Answers to Test Yourself

Answer to TY 1

i) Tanzania follows a common law legal system inherited from Britain, however due to autonomy of Zanzibar as one part of the union, the system of laws between Tanzania mainland and Zanzibar are different. In this regard, the High Court of Zanzibar has exclusive original jurisdiction for all matters in Zanzibar, as is the case for the High Court on mainland Tanzania. It was necessary to retain the dual legal system in order for each part of the union to be able to administer its own affairs which are non-union matters.

ii) The commercial division of the High Court is significant to business because it enables quick dispensation of cases of a commercial nature. If commercial cases take long time to be decided in courts business may suffer loss of profit or loss of business.

Answer to TY 2

Knowledge of the sources of law assists a business professional to make decisions which are informed by the law. It also helps in conducting business without violating the law.

Answer to TY 3

- Crimes are wrong which the state intends to prohibit while civil wrongs are violations against individual persons' rights.
- Crimes are prescribed in the Penal Code and other statues while civil wrongs arise out of relationships between persons.

SECTION B

LAW OF BUSINESS ORGANISATIONS

B1

STUDY GUIDE B1: FORMS OF BUSINESS ORGANISATIONS

Get Through Intro

An accountant's main function has always been to provide owners / managers of an organisation with accurate and timely financial information. This information serves as the foundation from which tactical and strategic decisions are made. However, much more is expected of accountants today. The view of accountants being pure "number crunchers" or gatherers of information is fading.

Today accountants are becoming more involved in the operational and strategy formulation side of business. They now advise and consult with owners and managers on productivity, profitability and other business issues. In short, an accountant is now expected to become an integral part of the organisation. To do this, he will need to understand the nature of organisations, their structure and their operations. The contents of this Study Guide will provide you with an appreciation of the rationale behind organisations, how business organisations may differ and the different types of business organisations.

Learning Outcomes

a) Identify and explain the forms of business organisations recognised by law in Tanzania.
b) Identify, state and explain the nature of and differences between a legal partnership and a company.

Identify and explain the forms of business organisations recognised by law in Tanzania.
[Learning Outcomes a and b]

1. **Meaning of an organisation**

Definition

An organisation is an arrangement where a collection of people with a set of shared objectives create a formalised group.

A business organisation refers to a commercial or industrial enterprise and the members who are a part of it. Such organisations are formed to provide goods or services (or both) to consumers.

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2. **Forms of Business Organisations in Tanzania**

There are generally two forms of business organisations, namely:

(a) Non-corporate business organisations such as partnership and sole trader (sole proprietor).
(b) Corporate business organisations, for example private limited companies and public limited companies.

The next Learning Outcome explains a detailed description of the above mentioned business forms.

Identify, state and explain the nature of and differences between a legal partnership, sole proprietorship and a company.
[Learning Outcome b]

2.1. Non-corporate Business Organisations

Non-corporate business associations are businesses which have no separate legal personalities from that of their owners. They are of two types, namely sole proprietorship (also known as sole trader) and partnership.

2.1.1. The Sole Proprietorship

Meaning of a sole proprietor

A sole proprietor can be described as a person who carries on a business on his own account. Even though sole proprietorship is usually a small business, this is not always or necessarily the case. A sole trader could employ any number of employees.

Sole proprietorship business is characterised by the following features:

(a) A sole proprietor may operate by his or her own name. If a sole proprietor chooses not to trade under his/her own name, he/she must register under the Business Names (Registration) Act [Cap 213 R.E. 2002].

(b) A sole proprietor has the sole responsibility for the debts of the business and is liable personally to the full extent of all he possesses in both business and private assets. That is, he or she has unlimited liability. Where a sole proprietor business becomes insolvent; that is, the situation in which the assets are no longer matching the liabilities he or she is said to be bankrupt, brought about by the procedure known as bankruptcy laid down in the Bankruptcy Act [Cap 25 R.E. 2002].

Example

A typical example of a sole trader is the small neighbourhood grocery store run by its owner. Although other persons are employed, all major decisions regarding the store are made by the owner.

When setting up a sole proprietorship, the individual is required to follow the following steps:

i. Visit TRA regional or district office and fill TIN application form to apply for Taxpayer Identification Number. The process for TIN application involves taking of biometric information such as photograph, finger prints and signature. There is no fee for obtaining a TIN.
ii. After obtaining TIN certificate, the applicant will be required to apply for business license from the Trade office in District, Municipal, City Council or the Ministry of Trade and Industry depending on the type of business one wants to establish. There are certain amounts of fees to be paid for one to obtain a business licence. The fee depends on the type of business.

2.1.2. The Partnership

2.1.2.1. Meaning of Partnership

A partnership is an association consisting of a number of persons who have come together for a matter of common interest. The partnership does not have a separate legal existence from their members, except for limited liability partnership which have similar features like companies. Thus the property of the partnership is regarded as belonging to the members jointly. Likewise, liability of a partnership is shared by all the partners. In Tanzania, partnerships are governed by the Law of Contract Act [Cap. 345 R.E. 2002].

Section 190(1) of the Law of Contract Act defines partnership as the relationship which subsists between persons carrying on a business in common with a view of profit. The relationship in a partnership arises from contract and not from status. Persons who enter into partnership with one another are collectively referred to as a 'firm' and the name by which the partnership operates is known as the 'firm name'.

In the case of auditors and accountants, the term partnerships is defines and section 2 of the NBAA (Practising) By-Laws, 2017 to mean a form of business organization in which two or more persons go into business as co-owners to share profits and losses in accordance with the partnership agreement.

Thus, when two or more individuals pool their resources and join forces in furtherance of a common goal, a partnership is formed. A partnership is a mutual agreement between two or more individuals involving division of authority and profits among partners.

Example

Common examples of partnerships are law firms, auditing firms and accountancy firms.

2.1.2.2. Nature of a Partnership

The law of partnership is based on agency where each partner becomes an agent of the others. Thus, a partnership is only appropriate for a relatively small number of persons who have trust in each other and who are therefore able to provide the funds for the business from their own resources.

2.1.2.3. Essential features of a definition of a partnership

A partnership has the following features:

i. It is an association of two or more persons. A partnership cannot be carried out by a single person.
ii. It does not have separate legal existence from its members, except for limited liability partnership.
iii. It is a result of agreement between parties and is therefore operated according to that agreement which is known as the partnership deed.
iv. The agreement must be to carry on some 'businesses', i.e. a trade, profession or occupation over a period of time. For example, we have lawyers who are the private advocates doing business together as partners; accountants trading together and so on. However, if people come together for a different purpose other than doing business, such an arrangement will not constitute a partnership.
v. The business must be carried in common with a view to profit. Essentially, partners must intend to make and share profit. However, the law to render void all partnerships which end up making losses.

Tip

See also **Roland Rugalabamu v. Hassan Mahige** (1988) TLR 243 on the nature of partnership.

2.1.2.4. Types of partnerships

In a partnership, each person contributes something to the business, such as ideas, money, property, or some combination of these. Management rights, profit share, and personal liability will vary depending on the type of partnership the business takes. There are three modern forms of partnership: general partnership, limited partnership, and limited liability partnership. Below is a brief description of these main types of business partnerships.

a) **General Partnerships**

A general partnership involves two or more owners carrying out a business purpose. General partners share equal rights and responsibilities in connection with management of the business (section 194 (a) of LCA), and any individual partner can bind the entire group to a legal obligation. Each individual partner assumes full responsibility for all of the business's debts and obligations (section 194 (e) of LCA). The Law of Contract Act mostly recognizes this form of partnership.

b) **Limited Partnerships**

A limited partnership allows each partner to restrict his or her personal liability to the amount of his or her business investment. Not every partner can benefit from this limitation. For a limited partnership to exist, at least one participant must accept general partnership status, exposing him or herself to full personal liability for the business's debts and obligations. The general partner retains the right to control the business, while the limited partner(s) do not participate in management decisions. Nevertheless, both general and limited partners benefit from business profits.

c) **Limited Liability Partnerships (LLP)**

Limited liability partnerships (LLP) have the features of a limited liability company and offer some personal liability protection to the participants. Individual partners in a limited liability partnership are not personally responsible for the wrongful acts of other partners, or for the debts or obligations of the business.

2.1.2.5. Types of Partners

Partners in a firm may be carrying out different roles and status. The types of partners are as follows:

a) **General partner**

This is a standard type of partner who has a right to participate in the management of the partnership and right to share in the profit as well. He is also liable to the liabilities of partnership to the full extent unless otherwise stated.

b) Sleeping/dormant partner

This is a partner who puts money to the firm but wishes not to have active role in the management of the firm. However, he retains the right to shall in the profits and liabilities of the firm.

c) Limited partner

This is a kind of partner who restricts his or her personal liability to the amount of his or her business investment. This partner has a right to share the profits of the partnership, but has no right to participate in the management of the firm. His liability to contribute is limited to the amount of capital originally he agreed to contribute.

d) Salaried partner

According to section 2 of the NBAA (Practising) By-Laws, 2017, a salaried partner means a partner who has neither contributed capital to the firm nor has any voting rights in the firm nor participate in the share of profits or losses but receives compensation in the form of salary or allowances. According to the NBAA By-laws salary partners do not constitute a partnership.

2.1.2.6. Rules to determine the existence of partnerships

Section 191(2) of the Law of Contract Act provides for the rules for determining the existence of partnership. In fact, when determining existence of partnership, regard has to be had on all relevant facts pointing to the relationship between the parties. Specifically, the section provides that in determining whether a group of persons is or is not a partnership regard shall be had to the following rules:

(i) Joint tenancy, tenancy in common, joint property, common property or part ownership does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof;

(ii) The sharing of gross returns does not by itself create a partnership, whether the persons sharing such returns have or have not a joint common right or interest in any property from which or from the use of which the returns are derived;

(iii) The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business but receipt of such a share, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business, and in particular the receipt of such share or payment:
   a) By a lender of money to persons engaged or about to engage in business;
   b) By a servant or agent as remuneration;
   c) By the widow or child of a deceased partner, as annuity; or
   d) By a previous owner or part owner of the business, as consideration for the sale of the goodwill or share thereof does not of itself make the receiver a partner with the persons carrying on the

business.

2.1.2.7. Formation of a Partnership

Forming a partnership does not necessarily require any legal formalities. Partnerships are set up and regulated either by an agreement between the partners or in the absence of such agreement, by the rules set out in the Law of Contract Act [Cap 345 R.E. 2002]. A partnership may be created orally or in writing. The advantage of putting the partnership agreement in writing is that it provides room for documenting specific and important terms to govern the partnership which may be difficult to achieve if a partnership agreement was oral. An oral partnership agreement relies on the provisions of the law of Contract Act (LCA) for governance of the partnership.

For instance, section 213 of the LCA provides that death or bankruptcy of any partner automatically dissolves the partnership except where there is an agreement to the contrary among partners. Therefore, to avoid partnership ventures from collapsing on such ground, it is paramount for partners to enter agreement by writing.

According to section 4(a) of the Business Names (Registration) Act [Cap. 213 R.E. 2002], 'every firm having a place of business in Tanzania and carrying on business under a business name which does not consist of the true surnames of all partners who are individuals and the corporate names of all partners who are corporations without any addition other than the true names of individual partners or initials of such names' is required to be registered by the BRELA and obtain a certificate of registration.

For Certified Public Accountants in Public Practice, registration of partnership firms is important because section 5(c) of the NBAA (Practicing) By-laws provides that firm applying for registration as Certified Public Accountants in Public Practice must among other things submit a proof of formation of partnership. A sample of the partnership deed is shown below

DEED OF PARTNERSHIP

This deed is made this ………day of……….2019

BETWEEN

XXXXXXXXXXXXXXXX of P.O. Box ……Dar es Salaam (hereinafter referred to as the Partner) on the one part

AND

YYYYYYYYYYYYYY of P.O. Box ….. Dar es Salaam (hereinafter referred to as the Partner) of the other part

WHEREAS the partners have entered into partnership upon the terms hereinafter appearing:

1.0 PARTIES

The partners will become and remain partners in the business for the term of two years from the date of execution of this deed and after the expiration of the said term of two years and subject to the provisions of determination hereinafter contained in this deed, may be extended for a further term to be agreed by the partners.

1.1 The name of the business and for which the partnership will be carried is **ZZZZZ INVESTMENT AND GENERAL SUPPLY**.

2.0 OBJECTS OF PARTNERSHIP

The object for which the partnership is established is to carry on the business of stationaries and general supply.

3.0 **TERM OF THE JOINT VENTURE**

3.1 Either partner shall be at liberty to determine the partnership at the end of two years from the date of these presents by giving not less than 3(three) calendar months previous in writing of his or her intention to do so and on the expiration of such notice the partnership shall be determined accordingly.

3.2 Upon the final determination of the partnership by lapse of time or otherwise than by death or retirement, the amount to be paid to the outgoing partner or his trustee or the representative of the deceased partner , shall be ascertained by taking a general account and making a statement in writing of the share of such partner of the capital and effects of the partnership and all unpaid profits and interests on capital belonging to her or him at the date of death , bankruptcy or retirement as the case may be.

4.0 BUSINES PLACE

The business of the partnership shall be carried at **UPUNGO PLAZA, MOROGORGO ROAD, UBUNGO, DAR ES SALAAM.**

5.0 PARTIES RESPONSIBILITIES

5.1 Both partners will at all times diligently employ themselves in the business of the partnership and carry of the same for the great advantage of the partnership.

5.2 Either partner shall be faithful to the other partner in all matters relating to the business of the partnership and shall give a true account of and full information relating to the same as often as he/she shall reasonably be required to do.

5.3 Neither partner shall without the consent in writing of the other partner do any of the following:

5.3.1 Be either directly or indirectly engaged or interested in any business or occupation, which is likely to divert his/her intention from the partnership business.

5.3.2 Engage , make any contract or dismiss any employee of the partnership

6.0 CHEQUES

At least two partners shall have power to draw cheques in the name of the partnership.

7.0 CAPITAL

The capital of the partnership consists of the office furniture, shelves, computers, safe and other fittings brought in by each partner individually but which will be credited to the respective partner in the books of account of the partnership.

8.0 EXPENSES

All outgoing expenses of the partnership and all loses shall be paid out of the capital and profits of the partnership and if the same shall be deficient then by the partners in equal shares.

9.0 PROFIT

The partners shall be entitled to the net profit of the business in equal shares and the same shall be divided between the partners immediately after the settlement in the manner hereinafter provided by the general annual account in each year.

10.0ACCOUNTS

Proper books of account shall be kept by the partners and all such entries made therein as are normally entered in books of accounts are kept by persons engaged in business of a similar nature to the business of the partnership.

11.0BANKERS

The banker of the partnership shall be CRDB Bank PLC, Azikiwe Branch at Dar es Salaam or such other bankers and /or branches as shall from time to be agreed upon by the partners. All cheques shall be signed by both partners or as agreed upon.

12.0**DETERMINETION OF PARTNERSHIP**

Upon the determination of the partnership otherwise than by liquidation of either partner or by notice to determine as herein before provided a general account shall be taken of the assets and liabilities and transactions of the partnership, and the assets shall as soon be realized and the liabilities discharged and the net surplus after the payment of the expenses of realization and discharge of liabilities and any unpaid profits due to either partner, shall be divide between the partners in equal shares , and each partner shall execute and do such deeds , documents and things.

13.0ARBITRATION

Any dispute which may arise between the partners or their representatives with regard to the interpretation of these presents, any part thereof, or as to the rights or liabilities of either partner under these presents or with regard to the winding up of or any other manner or things relating to the partnership of affairs thereof, shall be referred to a single arbitrator in conformity with the provisions of the Arbitration Ordinance of Tanzania, chapter 15 of the Laws.

14. **APPLICABLE LAW**

This deed shall be governed by the laws of the united republic of Tanzania.

IN WITNESS WHEREOF, the partners have put their hands on these presents on the day and in the year and in the manner hereinafter appearing:

SIGNED AND DELIVERED by the said
XXXXXXXXXXXXXXXXXXX } …………………..
This……….day of …………2019

BEFORE

……………………..

SIGNED AND DELIVERED by the said
YYYYYYYYYYYYY } …………………..
This……….day of …………2019

BEFORE

……………………..

2.1.2.8. Authority of Partners

In partnership, every partner is an agent of the firm and therefore has an implied authority to bind the firm by transactions entered into in the ordinary course of business (section 201(1) of LCA). This character of partnership, as will be seen later, is one of the distinguishing features of a partnership from a company as the latter requires a resolution authorizing the CEO for entering into any binding contracts

Also, according to section 202 of the LCA an act or instrument relating to the business of the firm done or executed in the firm name, or in any other manner showing an intention to bind the firm by any person thereto authorized, whether a partner or not, is binding on the firm and all the partners. Also in accordance with section 204 of the LCA every partner is liable to make compensation to third persons in respect of loss or damage arising out of or any penalty by wrongful act or omission of any partner acting in the ordinary course of business of the firm, or with the authority of the other partners. Thus, an outsider who contracts with a partner within the scope of that implied authority may treat the firm as bound, despite any restriction on the authority of that partner to which the partners have agreed, unless the outsider knew of the restriction.

Example

Merchantile Credit v Garrod (1962) 3 All ER 1103

X and Y were partners in a firm. The firm was carrying on a business of letting garages and repairing cars. The partnership agreement included an express term to the effect that it excluded buying and selling cars. Without Y's knowledge, X, acting without the owners' consent, sold a car to a finance company and paid the proceeds of sale into the partnership account. It was held that Y was liable to repay the amount to the finance company. The prohibition on selling and buying in the partnership agreement did not entitle Y (or the firm) to avoid liability since X's conduct was of a kind normally undertaken by persons trading as a garage, that is X apparently had authority to sell cars.

Tip

See also **Melita Meyasi v. The National Bank of Commerce** [1977] LRT No. 42

In a trading partnership, the following acts are within the implied authority of partners:

- Borrowing money in the name of the firm and giving security by pledging its goods or by depositing title deeds to create an equitable mortgage
- Signing cheques, and drawing, accepting or indorsing bills of exchange
- Employing a lawyer (legal counsel) to defend an action against the firm
- Receiving payment of debts and giving valid receipts
- Buying and selling goods on account of the firm
- Engaging employees to work for the firm

2.1.2.9. Liability of Partners

a) **Liability for torts**

This is based on the usual common law principle of vicarious liability (taking into account the fact that each partner is an agent of the others) all the partners are liable for a tort committed by a partner in the ordinary course of the firm's business, or with the authority of his co-partners.

Example

Hamlyn v. Houston (1903) 1 KB 81

A partner bribed a competitor's clerk to disclose confidential information relating to it. The partner used the information and the rival firm consequently suffered loss. It was held that the partner's firm was liable for his wrongful acts since he was acting in the ordinary course of business when he obtained information about the rival.

Partner's liability in tort is both joint and several. This means that a partner is liable jointly with the other partners and individually liable. Thus, a plaintiff may issue separate writs against each partner either at the same time or successively and judgment against one partner does not prevent an action being brought against others.

b) **Liability for misapplication of money or property**

This may occur in any one of the following scenarios:

i. Where one partner acting within the scope of his apparent authority, receives money or property of a third person and misapplies it; or
ii. Where a firm, in the course of its business, receives money or property of a third person and the money or property is misapplied by one or more of the partners while in the custody of the firm, then the firm is liable for the loss.

c) **Liability in contract**

Every partner is liable jointly with his or her co-partners for all debts and obligations of the firm incurred whilst he was a partner.

d) **Liability of a retired partner**

A partner who retires does not cease to be liable for partnership debts incurred before his retirement. These may include debts arising after his retirement from transactions during the period when he was a partner. A retired partner may be discharged from liability for debts incurred while he was a partner if the debts are later discharged by the new firm, or if the creditors agree to release him by novation. A retired partner may be liable on contracts made after his retirement if he continues to be an 'apparent partner', by, for example, allowing his name to remain on the firm's notepaper.

e) **Liability of a new partner**

A person admitted as a partner does not thereby incur liability for debts incurred before he became a partner. There may be a contract of novation between a retired partner, the firm as reconstituted by the entry of a new partner, and the creditors. Under such a three-party agreement, the creditors and the firm agree that the reconstituted firm will be liable for unpaid debts of the old firm and that the retired partner be discharged from liability.

2.1.2.10. Duties of Partners

Partners have duties at common law and under statute as follows:

a) **Duty to act in good faith**

Partners have duty to act with utmost good faith in all undertaking of the partnership. This is contained in the principle of *uberrimae fidei*. Thus:

a) Partners are bound to render true accounts and full information on all matters affecting the partnership. This is important especially when dealing with third parties because all partners will be held liable for the consequences of each partner's actions and omissions.
b) A partner must account for any profit made by him without the consent of the others by using the firm's property, name, or trade connections.
c) A partner may have a separate account unless he had agreed to the contrary, but a partner must account for any profit made in a business of the same kind as, and competing with, the firm.

b) To carry on the business of partnership for the greatest common advantage

Partners have duty to ensure that they conduct themselves in ways that are disadvantageous to the interests of the partnership (section 192 of LCA).

2.1.2.11. Dissolution of a partnership

The term 'dissolution' means bringing to an end or winding up. Thus dissolution of a partnership refers to the process of bringing to an end an existing partnership, thereby discharging the partners from obligations earlier agreed to. According to section 212 of the LCA, a partnership may dissolve by operation of law, i.e. is statutory dissolution or by agreement of the parties. Statutory dissolution includes dissolution by expiration of time of operation of partnership, by death or bankruptcy of a partner, by notice of a partner to others of his intention to dissolve the partnership, dissolution by illegality of partnership, and dissolution by order of court or arbitrator.

2.1.2.12. Effect of dissolution of partnership

After dissolution, the authority of the partners continues so far as is necessary to wind up the partnership affairs and complete transactions already commenced and which are unfinished. On dissolution, any partner can insist on realization of the firm's assets, (including goodwill), payment of the firm's debts, and distribution of the surplus, subject to any contrary agreement. Upon dissolution, assets of the firm are to be applied in the following order:

a) Paying debts and liabilities of the firm to third parties.
b) Paying partner rateably what is due to him from the firm; for example what was paid as advances distinct from capital. Paying to each partner rateably from the firm what is due to him in respect of capital. Where assets are insufficient to pay each partner his or her capital in full, any deficiency must be borne by the partners in the same proportion, as the profits would have been divided.
c) If something still remains, it is to be divided among partners proportionately according to how they will deem it fit.

2.1.3. The Company
2.1.3.1. Meaning of a company

Definitions

The Companies Act of 2002 does not contain an express definition of the term company (see section 2). Section 27 on the one hand provides a description of what a private company is. It states that a private company means a company which by its articles:

a) Restricts the right to transfer its shares; and
b) Limits the number of its members to fifty, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in the employment, and have continued after the determination of that employment to be, members of the company; and
c) Prohibits any invitation to the public to subscribe for any shares or debentures of the company.

On the other hand, section 3(3) of the Companies Act, defines a public company as a company limited by shares or limited by guarantee and having a share capital, being a company the memorandum of which states that it is to be a public company. Therefore, the Companies Act does provide direct definition of a company but provides the features of two different forms of companies, i.e. private and public companies. However, various authors have expounded the meaning of a company.

Saleem et al defines a company as 'a group of persons associated together for the purpose of attaining a common objective, social or economic'. The authors argue that even though primarily and traditionally companies are formed to carry on a business with a view of earning profit, they may also be formed to promote commerce, art, science, religion or charity of any other useful objective. The authors cite definitions of a company by Lord Justice Lindley and Justice Marshall. Lord Justice Lindley defines a company as follows:

'An association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is always more or less restricted.'

The above definitions imply that the objective of forming a company must be to carry on some trade or business. Even though it may not have been the intention of the author of this definition, business should be understood in a broad sense, not necessarily referring to profit-making type of businesses. This is more evident under the Companies Act of 2002 which creates room for non-profit making companies to be formed.

For example, section 3(1) of the Companies Act, 2002 when describing the mode of forming incorporated companied provides as follows: 'Any two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability'. Thus section 3(1) of the Companies Act, 2002 makes it clear that a company can be formed for any lawful purpose and not necessarily for purposes of carrying out business as understood in the strict sense of the word.

To crown it all, section 32(1) of the Companies Act, 2002 foresees a possibility of formation of a private company for promotion of commerce, art, science, education, religion, charity or any other useful or social objective. If such a company so formed under section 32(1) intends to apply its profits, if any, or other income, in promoting its objectives, and to prohibit the payment of any dividend to its members, it may be exempted from using the word 'limited' as an addition to its name.

Also, the definition indicates that the capital of the company which arises from members' contributions or shares must have some money value. On the other hand, nothing arises from vacuum. Every shareholder must have either contributed directly or apportioned a share from what someone else has contributed. For example, parents may buy shares in companies and allocate those shares for their children. Moreover, somebody's share in the capital of the company is proportionate to his or her contribution or dues/entitlement to that capital where the capital of the company is its backbone.

Justice Marshall on the other hand defines a company/corporation as 'an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of the law, it possesses only the properties which the character of its creation confers upon it, either expressly or as incidental to its very existence'.

Thus from the foregoing we can say a company is an artificial person created by the law with separate legal personality distinct from the personalities of those who formed it. It has the capacity to sue and be sued, power to own property and to enter into legal agreements.

A landmark case of **Salomon v Salmon [1897] AC 22** laid down the foundation for the principle that a corporate body (company) has its distinct legal personality from its shareholders. This is true regardless of how insignificant or significant shares the shareholders hold in a particular company. This legal principle was cemented further in subsequent cases including **Maccaura v. Northern Assurance Co Ltd [1925] AC 619** where it was held that shareholders do not have even insurable interests in a particular asset which the company holds, since the company is a separate legal entity.

Case Study

Salomon v Salmon [1897] AC 22

Salomon was a merchant of leather and manufacturer of boots. In 1892 he formed a company to take over the business that he had solely owned for sometimes. He and six other members of his family subscribed its memorandum for one share each. Salmon and his two sons became the directors of this company. The company paid some 39,000 Sterling pounds to Salomon for the business previously owned, the mode of payment being to give Salomon 10,000 pounds in debentures, secured by a floating charge on the company's assets and 20,000 pounds shares of 1 each. The balance of some 9,000 pounds was to be paid to Salomon in cash.

It turned out that the business did not prosper and when it was wound up a year later its liabilities (including the debenture debt) exceeded its assets by some pound 8,000. The liquidator representing the unsecured creditors advanced an argument to the effect that the company's business was in reality still Salmon's, the company being merely a sham designed to limit Salmon's liability for debts incurred in carrying it on. It was argued therefore, that Salmon should be ordered to indemnify the company against the debts. It was argued further that, payment of the debenture debt to Salmon should be postponed until the company's other creditors were satisfied.

The trial judge, Vaughan Williams J, agreed with the liquidator. He held that the subscribers of the memorandum, other than Salmon, held their shares as mere nominees for him, and Salomon's sole purpose in forming the company was to use as an agent to run his business for him. On appeal, the Court of Appeal reached the same conclusion but for different reasons. It held that the Companies Act were intended to give the privilege of limited liability only to genuine independent stakeholders (independent of or separate from the company) and not to a man who was really the sole owner of the business and who merely found six nominees to join with him in going through the formalities of incorporation (as is presumably the case with Salmon).

Dissatisfied, Salmon appealed to the House of Lords which reversed the decisions of the two courts below it by stating that the company was a separate and distinct person from its members. Accordingly, the debentures were perfectly valid, and Salomon was entitled to the remaining assets in part payment of the secured debentured held by him. Lord Halsbury remarked: 'either the company was a legal entity or it was not. If it was, the business belonged to it and not to Mr. Salomon. If it was not, there was no person and nothing to be an agent of at all'

Test Yourself 1

Identify the legal principles that were established, elaborated and/or implied by the judgement of the House of Lords in the case of **Salmon v Salmon**?

2.1.3.2. Types of Companies

There are two main types of companies: private and public companies. However, section 23 of the Business Laws (Miscellaneous Amendments) Act, No. 3 of 2012 introduced a new section 26A to the Companies Act, 2002 which established a new form of company known as limited liability single shareholder company. This form of a company allows a single person to form and own a company as a single shareholder. However, this form of company has not yet become operational in Tanzania. Therefore, our discussion shall cover only the two forms of company currently operational.

a) **Private limited companies**

Most organisations exist or are formed as limited companies. The word limited is used here because the liability of the owners of the organisation is limited to the shares that they acquire in the company. Ownership of a private limited company is usually restricted to a limited number of persons, mostly from the friends and relatives of the owners. As explained earlier, the features of a private limited company are described under section 27 of the Companies Act, 2002.

Example

Jay and Tony are engineers who want to go into the business of manufacturing toothpicks. However, they do not have sufficient capital. They decide to form a private limited company, J&T Limited and sell a percentage of the business to an investor. The combined funding of the three people allows J&T Limited to buy all the necessary equipment and start production.

According to section 27(1) of the Companies Act, number of members in a private company should range between two and fifty. Private companies are not allowed to issue shares or debentures to the public. As such, private companies cannot raise capital from the public but rather from private sources such as borrowing and share subscriptions by its members.

b) **Public limited companies**

Public limited companies also have the protection of limited liability. However, unlike private limited companies, ownership of public companies is open to the public. They are usually listed on a country's stock exchange or on some unlisted securities market.

Example

Examples of public companies include CRDB Bank PLC, Tanzania Cigarette Company and Tanzania Breweries Limited.

Differences between a legal partnership and a company

	Company	Partnership
(a)	**Creation by registration** Mode of creation is through registration under the Companies Act 2002. Registration is compulsory under Companies Act, section14.	**Creation by agreement** A partnership is created by express or implied agreement of the partners (i.e. contractual agreement) according to Sections 190 and 191(1) of Law of Contract Act Cap 345 2002 R.E. Agreement may be oral or in writing
(b)	**Legal personality** Company is an artificial legal person and has legal personality distinct from its members **Salmon v salmon Co Ltd (1897)**	**No separate legal personality** Partnership has no separate legal personality. It may however sue and be sued in the firm's name. **Dulichand v. Commissioner of income tax Nagpur** A.I.R (1956) S.C 354
(c)	**Transferability of shares** Shares in public companies are freely transferable but restricted in private companies	**Transferability of interest** A partner cannot transfer his or her share without the consent of all of his partners. He or she may assign the rights to his share of the profits, but the assignee does not become a partner.
(d)	**Has perpetual succession** Company has perpetual succession	**No perpetual succession** A partnership is affected by death, insanity or retirement of a partner, except where an agreement to the contrary exists
(e)	**Whether shareholder binds the company** Shareholder (member) of a company is not an agent of the company, and can therefore not bind the company by his or her acts	**Whether a partner binds the firm** A partner is an agent of the firm and other partners and the firm shall therefore be bound by his or her acts. Section 201, 202 and 194(a) of the LCA.
(f)	**Management is by directors** Members of a company may not take part in its management unless they become directors. Section 181 of the Companies Act	**Management is by partners** All partners are entitled to share in the management unless the partnership agreement provides otherwise.

(g)	**Nature of liability in a company** In a company, liability is limited by shares or guarantee.	**Nature of liability in a partnership** In a partnership, liability is unlimited except for limited liability partnerships. Section 203 and 204 cap 345.
(h)	**Applicable law is the Companies Act** Affairs of the company are controlled by the Companies Act, 2002.	**The main law applicable is the Law of Contract Act** Affairs of a partnership are governed by the Law of Contract Act, Cap. 345 and respective professional bodies such as the Accountants and Auditors (Registration) Act, [Cap 286 R.E 2002].
(i)	**Strictly regulated** The powers and duties of a company are closely regulated by the Companies Act; its constitution is specified in the Memorandum of Association (although they can be freely altered by special resolution).	**No strict regulation** Partners have more freedom to carry on any business they wish and to make their own arrangements with regard to the running of the firm.
(j)	**Number of shareholders** For a private company, membership must be between two and fifty members. For public company, number of members is unlimited.	**Number of partners** A partnership cannot have more than 20 partners as a general rule (sections s.332 and s.333) with exception of some professional partnerships such as accountants and lawyers.
(k)	**Complicated procedures and cost** Formation and running of a company must comply with the requirements of the Companies Act. The documents required for its formation e.g. the Memorandum and Articles of Association or the prospectus is costly. Also records must be maintained and the accounts audited annually and filed with the Registrar of Companies.	**Easy procedure and lower cost** Relatively easy to establish, run and incurs low cost. Does not involve many documents even when it is formed in writing.

Answers to Test Yourself

Answer to TY 1

The case of **Salmon v salmon** laid down the principle that a Company is an artificial legal person and has legal personality distinct from its members. This case was the basis of the concept of corporate personality and limited liability of companies.

SECTION B

LAW OF BUSINESS ORGANISATIONS

B2

STUDY GUIDE B2: FORMATION OF COMPANIES IN TANZANIA

Get Through Intro

This Study Guide takes students through the basic procedures and formalities regarding formation of companies in Tanzania. Understanding of these procedures is very important to a business professional since at some point one may wish to incorporate a company. That exercise would be much simpler for a person with knowledge on the requirements provided by the law.

Learning Outcomes

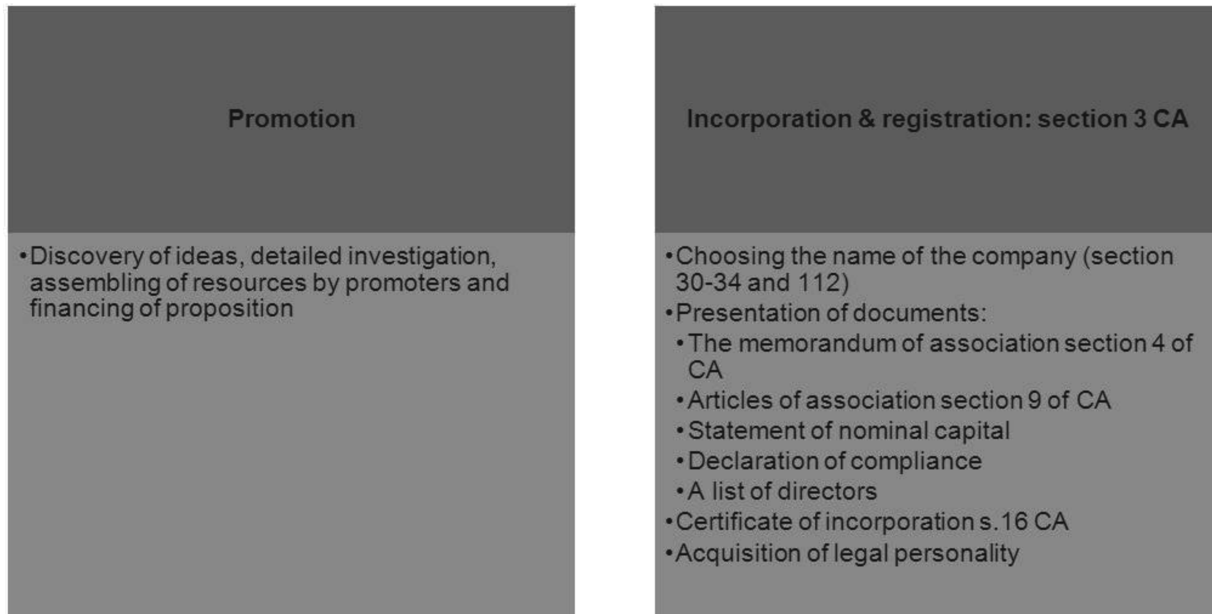
a) Explain the process of incorporating companies and consequences of incorporation of the companies

Explain the process of incorporating companies and consequences of incorporation of the companies

[Learning Outcome a]

In Study Guide B1, we have explained the meaning of a company. This Study Guide discusses the process of forming of a company and legal consequences arising for such formation.

Diagram 1: Formation of the company



1. Formation of the company

Formation of a company takes a number of processes. These are grouped as **promotion, incorporation, subscription of capital and commencement of business**. Each of these processes is explained below.

Subscription of capital is discussed in Study Guide B4

1.1. Promotion

This involves discovery of ideas, doing detailed investigation, assembling of resources by promoters and financing the formation of company. The person who performs the initial tasks of incorporating the company is known as a promoter. A promoter is any person involved in the planning, incorporation, or initial running of a company.

The formation of a company is tedious task. It involves thinking, planning and evaluating the costs of bringing an idea to work. Thus, it requires some sort of pioneering work by a person or group of persons who are technically referred to as promoters. So typically, a promoter is a person expected to have conceived the idea of the business enterprise and makes reasonable analysis of the business's prospects. He or she should also work out tentative scheme of organisation and possibly bring together the requisite resources to start the business.

Thus, promotion is defined as 'the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom'. The case of **Whaley Bridge Calico Printing Calico v Green & Smith** Bowen L. J stated that the term 'promoter' is a term not of law, but of business, usually summing up in a single word a number of business operations familiar to commercial world by which a company is generally brought in existence.

1.2. Functions of promoters

The promoters of a company take every effort to bring a company into existence and they are undertaking almost all the functions necessary to form a company.

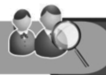
Some of these functions are outlined below:

(a) Generating the idea of starting a business and forming a company.
(b) Conducting a feasibility study to determine whether the proposed business is profitable.
(c) Deciding the name of company, and place of registered office.
(d) Settling the details of the Memorandum and Articles of Association.
(e) The nomination of first directors, bankers, solicitors, secretary and other key officials of company.
(f) Filing the required documents with the registrar of companies.
(g) Arranging for issue of a prospectus, in case of a public company.
(h) Safe custody of important documents such as certificate of incorporation and certificate of commencement of business.

1.3. Fiduciary duties of a Promoter

The fiduciary duty is a legal relationship between two or more parties. A fiduciary is expected to be extremely loyal to the person to whom he/she owes the duty (the "principal"). They must not put their personal interests before the duty, and must not profit from their position as a fiduciary, unless the principal consents.

A promoter stands in a fiduciary position with the company formed by him or her. This position requires upholding confidence or trust with regard to the company that he promotes.



Example

A company promoter may receive £10,000 from an investor in a company and instead of banking the money into the company bank account and using it for company purposes; he uses it for his own purposes. Here, he is not acting in the interest of the company. He is breaching his fiduciary duties towards the company.

In the case of **Erlanger v Sombrero Phosphate Co** (1878) 3 A.C 1218, it was observed thus:

'In equity the promoters of a company stands in a fiduciary relation to it and those persons whom they induce to become shareholders in it, and cannot in equity bind the company by any contract with themselves as promoters without fully disclosing to the company all material facts which the company ought to know'.

a) **Duty to fully disclose material information in respect of interest or profit**

Considering the role that a promoter plays in forming a company, there is information and other benefits that he or she may possess or have access to, to the detriment of the public and members of the company when it is formed. Thus, the law provides for some safeguards to protect the public in situations where for instance a promoter forms a company, sells shares in the company for cash, and then sells his own property to the company in return for that cash, thus making personal profit. In order to deal with such cases, the law imposes a duty to the promoter to disclose to the company any profit made by him or her in the course of forming the company. A promoter is not barred from making profit out of promotion.

The principle requires that if there is an intention by the promoter to sell the company to the public, the promoter's profit must be disclosed to potential members in the prospectus. The potential members, knowing what proportions of the price of their shares will go to the promoters, the public are adequately informed at the time of making decisions of whether or not to purchase the shares.

b) **Duty not to make profit to the detriment of the company**

It is not prohibited for a promoter to make profit out of promotion but rather, he or she is barred from making secret deals with the company which allow him to obtain vast profit at the expense of the company. In other words, any profit made by a promoter resulting from his position as a promoter must be fully disclosed to the company. Should a promoter violate a rule to disclose information which consequently gives him a benefit of making unjust profit, the company is entitled, upon discovering it, to compel him to account for and surrender such profit.

c) **Duty to give benefit of negotiation to the company**

As noted earlier, a promoter does a lot of preliminary work in relation to the formation of a company. These may include acquisition of materials and even property such as land. Since at the time of formation the company has not come into existence and cannot therefore own land, the promoter may stand in the position of buying some property in his own name, to be transferred later to the company.

Thus where he purchases some properties for the company, he cannot later on sell that property to the company at a higher price than that which he or she paid for the said property. When the promoter violates this rule the company may, upon discovering that violation, rescind the contract and recover the purchase price already paid to the promoter.

d) **Duty not to make unfair use of the position of promoting**

The promoter is not supposed to make an unfair or unreasonable use of his position. He or she must also take care to avoid anything which appears to be of undue influence in nature or fraudulent.

1.4. Incorporation & registration

Section 3 of the Companies Act explains the conditions for formation of an incorporated company with or without limited liability. These conditions are as follows:

a) The number of persons intending to form a company must be two or more;
b) The persons must be associated for a lawful purpose;
c) Subscription of the associates' names to the memorandum of association must be done; and
d) Registration of the intended company in accordance with the requirements of the Companies Act (and any other relevant law) must be carried out.

2. Steps for registration of companies

One of the essential stages in formation of companies is registration (also known as incorporation) of a company. This stage involves choosing the name of a company and presentation of documents such as the Memorandum of Association, Articles of Association, statement of nominal capital, declaration of compliance and a list of directors.

2.1. Choosing the name of the company

A company, like any other legal entity, must have a name by which it can be identified. Thus the promoters are free to choose a name which if accepted by the Registrar of companies will be used for their company once registered. The law imposes some restrictions on the possible name that can be used for registering a new company. The most important one relates to the uniqueness of the name in relation to names of other existing companies. Section 30(2) of the Companies Act, 2002 provides that no company shall be registered by a name which, in the opinion of the Registrar, is the same as or too similar to a name appearing in the index of company names or is otherwise undesirable.

However, section 9(1) of the Business Names (Registration) Act Cap 213 R.E 2002 sheds some light on what the Registrar is likely to consider as a desirable name. It provides that: 'the Registrar shall refuse to register any firm, individual or corporation carrying on business under a business name:

a) which contains any word, which in the opinion of the Registrar, is likely to mislead the public as to nationality, race or religion of the persons by whom the business is wholly or mainly owned or controlled;
b) which includes any of the words 'Imperial', 'Royal', 'Empire', 'Common wealth', 'Government', 'Municipal', or any other word, in such a context as, in the opinion of the Registrar, imports or suggests that the business enjoys the patronage of Her Majesty or of any member of the Royal Family, or as to import any connection with or recognition by the Government of any part of Her Majesty's dominions or a local authority;
c) which includes the words 'building society' or 'cooperative' or their equivalent in any other language or any abbreviation thereof?
d) Which is identical with or is similar to that under which any firm, individual or corporation is registered

> under this Act, or under the Companies Act, or under the Co-Operative Societies Act, if in the opinion of the Registrar would be likely to mislead the public.

What appears to be of paramount consideration from the provision quoted above is restriction of names likely to mislead the public that may come in contact with the business enterprise. Avoiding deception to the public is not the only reason for restrictions on business names. Saleem et al argue that a business name may also be considered undesirable if it suggest a criminal or immoral intent on the part of the company. For instance;

> 'Magaidi Co Ltd' will be undesirable since in Kiswahili the word 'Magaidi' mean terrorists. The Company by virtue of such name shows that it has criminal intent.
>
> 'Malaya Distributors Ltd' shall also be undesirable since it has immoral connotations. 'Malaya' in Kiswahili mean 'prostitute'.

Once the promoter has identified the proposed name of the company, it is supposed to conduct a name search in the register of names. Currently, name search may be done online through the BRELA website. After obtaining clearance, the promoter may decide to reserve the name. According to section 30(1) of the Companies Act, a reservation of name may last for a period of 30-60 days.

i. Changing company name

Section 31(2) of the Companies Act, 2002 provides room for companies to change of names where upon its first registration is registered in a name which in the opinion of the Register is too similar to the name of a company already in existence. Also, a company may change its name by special resolution and upon approval by the Registrar. Similarly, section 33(1) empowers the Minister responsible for trade to direct a company to change its name if that name is misleading on the nature of the companies activities as to be likely to cause harm to the public.

Where a company changes its name either under section 31(1) (that is by the company's special resolution) or under section 31(2) following a direction by the Registrar of companies it is supposed to notify the Registrar of Companies about such change of name within fourteen days. Upon receipt of such a notice, and subject to the provisions of section 30(2) the Registrar shall enter the new name on the register in the place of the former name. After entry of the new name in the register, the Registrar is supposed to issue to the company a certificate of change of name, and shall notify such change of name in the government Gazette.

ii. Power to dispense with the word 'limited' in a company's name

As we saw at the beginning of this part discussing corporate entities, usually the term 'limited' is reserved for companies as opposed to firms and other business identities. These other business associations may use the term 'co' which is for example law business names and firms, but not 'limited'.

It was observed earlier, the Companies Act allows the formation of private companies for non-profit making business. Such a company when proposed to be registered may dispense with the use of the term 'limited'. Thus section 32(1) provides as follows:

> Where it is proved to the satisfaction of the Registrar that an association about to be formed as a private company is to be formed for promoting commerce, art, science, education, religion, charity or any other useful, or social objective and intends, to apply its profits, if any or, other income in promoting its objectives, and to prohibit the payment of any dividend to its members, the Registrar may by licence direct that the association may be registered as a private company with limited liability, without the addition of the word "limited" to its name and the association may be registered accordingly and shall on registration, enjoy all the privileges and (subject to the provisions of this section) be subject to all the obligations of limited companies.

iii. Prohibition of wrongful use of the word 'limited' at the end of a company's name

Section 34 of the Companies Act provides that it is an offence for any person trading or carrying on any business or profession that is not incorporated with limited liability to trade under a name or title with "limited" or any contractions or imitations of that word as the last word. Similarly, a person who is not trading as a public company commits an offence if he carries out any trade, profession, or business under a name, which includes as its last part, the words "public limited company", or any contractions thereof.

In a similar vein, a public limited company is prohibited from using a name which in certain material circumstances may give an impression that it is a private company. If such a company uses a name which may reasonably be expected to give the impression that it is a private company, thereby contravening section 34(2) and (3) (on wrongful use of words "limited" or "public limited company), it attracts penalties in the form of a fine and default fine in case of continued contravention.

iv. **Publication of name by company and form of seal**

Section 112 of the Companies Act provides for the requirement and the way in which the company may publish its name. The company is required to paint or affix and keep affixed or painted its name on the outside of every office or place in which its business is carried on, in a conspicuous position, in easily legible letters.

The company is also required, where it has a common seal, to have its name engraved in legible letters on its seal. Moreover, the company is required to have its name and its registered office mentioned in legible letters in all business letters of the company and in all notices and other official publications of the company, in all bills of exchange, promissory notes, endorsements, cheques and orders for money or goods purporting to be signed by or on behalf of the company. The name and registered offices of the company are also required to be mentioned in all company's invoices, receipts and letters of credit of the company.

However section 32(4) of the Companies Act exempts a company which is exempted from the requirements relating to the use of the word "limited" and which does not include that word as part of its name, from the requirements of section 112(1) relating to the publication of its name and the sending of lists of members to the Registrar of companies.

Contravention of section 112(1) save as permitted by section 32(4) is an offence and the company and every officer in default shall be liable to a fine. A In the same way by virtue of section 112(3) if a company fails to have its name engraved in legible letters on its seal where a company has a common seal, such a company shall be liable to a fine. The company failing to have its name and its registered office mentioned in legible letters in all business letters and other documents as required by section 112(1) (c) shall also be liable to a fine.

Test Yourself 1

Amina Kifundo formed a business entity and named it GKK & Co Advocates for carrying out professional legal consultancy and litigation services. In all official correspondences and headed papers of the established business, the official title of the authorized signatory reads "GKK, a Managing Partner".

Required:

Assuming you have been asked to comment on the accounting procedures required to be complied with by this business entity, what would be your approach?

2.2. Presentation of documents

The documents required for the registration of a company are the Memorandum of association, Articles of Association, statement of nominal capital, declaration of compliance and a list of directors. Each of the above-mentioned documents is elaborated below

2.2.1. The Memorandum of Association

This is a basic and crucial document for the incorporation of a company which sets out the basic constitution of the company and presents the company to the outside world. Any person interested in dealing with a particular company will first and foremost look at the company's memorandum of association in order to find out its objectives, for instance. Section 2 of the Companies Act defines the term "memorandum" as the memorandum of association of a company as originally framed or as altered from time to time.

Section 3 of the Companies Act clearly provides that two or more persons associated for any lawful purpose may, by subscribing their names to a Memorandum of Association, for an incorporated company, with or without limited liability form a company. Section 4 of the Companies Act provides for how a Memorandum of Association should be in terms of form and substance. The form aspect includes the language that should be used in a memorandum of association. According to section 4 of the Companies Act a memorandum of association must be printed in the English language. However, section 19 of the Business Laws (Miscellaneous Amendments) Act, 2012 amended section 4 of the Companies Act by providing that the memorandum of association may be written in English or Kiswahili. The contents of the memorandum of association include the name clause, the registered office clause, the objects clause, the liability clause, the capital clause, and the association clause.

i. **The name clause**

Section 4(a) of the Companies Act provides for how the name of the company should appear**.** The section states that the name must have the words "public limited company" as the last words of the name of the company in case of a public company. This can also be abbreviated as 'PLC'. For a company limited by shares or by guarantee (not being a public company) the section requires that the name of the company in the memorandum of association must end with word "limited". The essence of this is to warn outsiders likely to

interact with the company as to the nature of the liability of the company. It tells the potential creditors of the company that the liabilities of the company are only limited to the assets of the company and not to the assets of the members of the company. The creditors cannot access individual funds of the members to satisfy their debts. However, as mentioned earlier, Memorandum of Association prohibits companies from paying dividend to its members.

ii. The registered office clause

According to section 110(1) of the Companies Act, a company has to have a registered office to which all communications and notices may be addressed. This clause operates to show the territory by which a company has its place of business. This also helps to determine the domicile of a company in litigation.

iii. The objects clause

This is a clause indicating the purpose for which the company is formed. It stated the activities that the company will carry out after incorporation. Section 4(b) of the Companies Act provides that the memorandum of association must state the objects of the company. The objects clause defines the range of activities which the company may legally undertake. If the company acts beyond its objects clause it is said to act *ultra vires.* Initially, in order to avoid the effects of acting ultra vires companies used to draft very long objects clauses covering so many activities that the company was likely to undertake. Later, the law was amended to allow companies to state their objects clauses by indicating that it would carry on business as a general commercial company. According to section 7 of the Companies Act, 'where the company's memorandum states that the object of the company is to carry on business as a general commercial company (it means): (a) the object of the company is to carry on any trade or business whatsoever, and (b) the company has power to do all such things as are incidental or conducive to the carrying on of any trade or business by it. So instead of specifying each object which the company may undertake, it may be safer for the objects to clause to state that the company would carry on business as a general commercial company.

iv. The liability clause

The memorandum of the company must state the nature of liability of its members. The liability may be limited or unlimited. In respect of a limited liability company, either by shares or by guarantee, the Memorandum of Association must state that the liability of its members is limited (section 4(2) of the Companies Act). For a company limited by guarantee in particular, its Memorandum of Association must state that each of its member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year after he ceases to be a member, for purposes of payment of debts and liabilities of a company contracted before he ceased to be a member (section 4(3) of the Companies Act).

v. The capital clause

Section 4(4) provides for the content of a memorandum of association in respect of a company having a share capital. It states that the memorandum of association of such a company must also state, unless the company is an unlimited company, the amount of share capital with which the company proposes to be registered and the division thereof into shares of a fixed amount. By virtue of section 4(4)(b) no subscriber to the memorandum of association may take less than one share. Finally, there must be shown in the memorandum of association against the name of each subscriber the number of shares each subscriber takes.

vi. The association clause

This clause shows the intention of the members to be formed into a body corporate. It is a clause which merges the members' natural personalities into a single legal personality called a company. Section 5 of the Companies Act provides that the memorandum of association must be dated and signed by each subscriber in the presence of at least one attesting witness. The particulars of each subscriber shall be written opposite the signature of every subscriber and attesting witness in legible characters; names should be written in full, along with the subscriber's occupation and postal address.

vii. Alteration of the memorandum of association

The memorandum of association, also known as a constitution of the company, being a very crucial document, is highly regulated by law including the Companies Act and case law. Thus members of any company do not enjoy the freedom to alter the conditions contained in the company's memorandum of association, except as permitted by law (section 6 of the Companies Act). Section 8 of the Companies Act provides that a company may alter the provisions of its memorandum of association by a special resolution. Such provisions may include the objectives of the company and change to the effect that a public company becomes a private company and vice versa. In case there is an application to the court opposing the proposed alteration, the decision of the court shall be binding on the company. In case an application for opposition is preferred, it must be made within thirty (30) days after the date on which the resolution altering the company's memorandum was passed. Such an application may be made on behalf of persons entitled to make the application by such one or more of their number as they may appoint in writing for the purpose. Procedure for application for alteration of company memorandum is stated in section 8(2-5) of the Companies Act.

2.2.2. Articles of Association

Articles of Association are another crucial document required for registration of a company. This document contains the main regulatory framework of the company from within the company itself. Thus, the Articles deal with matters of administration of the company such as the issue and transfer of shares, powers of directors, payment of dividend if any, procedures of meeting and the Secretary of the company.

Section 2 of the Companies Act defines the term "articles" as articles of association of a company, as originally framed or as altered by special resolution, including so far as they apply to the company, the regulations contained in Table A in the first schedule to the Companies Act.

Section 9(1) of the Companies Act clearly states that registration of a company limited by shares, company limited by guarantee or unlimited company shall require the presentation of a memorandum of association and articles of association. Section 9(1) states further that such documents shall be signed by the subscribers to the memorandum and that they (in particular the articles) shall contain the regulations for the company. The articles of association must be written in English or Kiswahili, contents divided into paragraphs and numbered consecutively, signed by each subscriber to the memorandum of association, and printed.

Contents of the articles of association include provisions on share capital; rights of shareholders; variation of those rights; payment of commissions; share certificates; call on shares; transfer and transmissions of shares; forfeiture of shares; alteration of capital; directors and their powers; meetings and their procedures; voting in meetings; borrowing powers of the company; and procedures for winding up. A company may draft its own articles of association or may adopt all or part of the regulations contained in Table A of the Companies Act (section 11).

2.3. Registration of memorandum and articles of association (MEMARTS)

Section 14 of the Companies Act provides as stated above that the memorandum and articles of association (collectively abbreviated as MEMARTS) shall be delivered to the Registrar of companies for registration. Section 14(2 & 3) provides that together with the MEMARTS, there be delivered a statement in a prescribed form containing the following:

a) Name and address or registered office;
b) The person or persons being the first director or directors of the company;
c) The person or persons being the first secretary or joint secretaries of the company and in the case of a first director or directors, particulars of any other directorships held during the five years preceding the date on which the statement is delivered to the Registrar.
d) The intended address of the company's registered office on incorporation

These particulars have to be filled in the prescribed forms 14a and 14b which can be obtained from BRELA offices or from its website. Section 14(4) specifically provides that the Registrar shall not register a company's memorandum delivered under section 14(1) unless he is satisfied that all the requirements of the Companies Act have been complied with. There is therefore a need for a declaration of compliance. In addition, the promoter must submit to the Registrar an ethics and integrity form signed by one of the Directors of the Company.

On registration of the memorandum of a company, the Registrar shall certify under his hand that the company is incorporated and, in the case of a limited company, that the company is limited, and, in the case of a public company, that the company is a public company (section 15(1) of the Companies Act).

2.4. Certificate of incorporation

Upon registration of the memorandum of association of a company, the Company will be given a certificate of incorporation. As per section 15(2) of the Companies Act, 'from the date of incorporation mentioned in the certificate of incorporation, the subscribers to the memorandum, together with such other persons as may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company, 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'.

3. Legal effects of Memorandum and Articles

Section 18 of the Companies Act provides that the memorandum and articles of association (MEMARTS) once registered becomes binding on the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the Memorandum and of the Articles. In essence, the effects of registration of the MEMARTS are as follows:

3.1. The company binds each member

Where the articles contain a clause which dictates how certain matters should be dealt with or settled such a clause binds the members provides it concerns membership rights. By becoming a member of such a company with such a clause, a member forfeits his other rights to that extent in issues concerning membership rights.

This can be illustrated by the case of **Hickman v. Kent [1915] 1 Ch 881.** In this case the articles provided in effect that in case of a dispute between a member and the company, such a dispute shall first be referred to arbitration for settlement. The Association wished to expel the plaintiff from membership of the association. The plaintiff in turn applied to the court for an order of injunction to prevent the Association from expelling him from membership. The Court held that the Association was entitled to have the action stayed since the dispute concerned membership rights whereas the articles provided for such disputes to be first referred to arbitration for settlement rather than preferring a court action.

3.2. Members enjoy contractual relationship amongst themselves

Another legal effect of registration of memorandum and articles of association is that members of the company become contractually bound to each other. In the day to day workings of a company, some complex situations may arise. For instance, the articles may contain a clause giving members pre-emption rights when another member wishes to sell shares. The articles may also, in rare cases, place a duty on members to purchase the shares of a retiring member.

Because of the aforementioned examples and other complicated cases, the trend has been for the articles to allow a two stage process in respect of transfer of shares in the context discussed. The first stage is usually for the articles to contain a clause requiring any member intending to transfer his shares to inform the company. Subsequently, another clause will require the company to inform other members of the possibility to purchase the shares, the transfer of which is so notified to the company. Should a member intending to transfer shares default by not notifying the company, the company has a right of action against the transferor. Similarly, if the second stage is not complied with, the right of action will be available to the shareholders against the company.

ANSWERS TO TEST YOURSELF

Answer to TY 1

In its nature this appears to be a partnership, though in practice Amina seems to be trading as sole trader. In this case undertaking business in the nature of partnership while it is not, is misleading to third parties, thus Amina may be liable to third parties who suffer damages as a result. See section 204 of the LCA in which every partner is liable to make compensation to third persons in respect of loss or damage arising out of or any penalty by wrongful act or omission of any partner acting in the ordinary course of business of the firm, or with the authority of the other partners.

However, for purposes of accounting procedures, Amina’s business should be considered and treated as sole proprietorship type of business. This is irrespective of the use of the phrases such as “Managing Partner” or “Co”. This is because; there can be no partnership involving only one individual. It should also be noted that the symbol for indicating a company as a business entity is the word “Limited” or its abbreviation “Ltd” and not “Co”.

STUDY GUIDE B3: THE CONCEPT OF CORPORATE LEGAL PERSONALITY AND ITS CONSEQUENCES

Get Through Intro

The earlier Study Guides have discussed the features of various business forms like sole trader, partnerships and companies. Once a company is formed it enjoys a separate legal status independent of its members. This in turn provides the company and its shareholders with some unique advantages like limited liability to its members, perpetual succession, etc. This study guide will enable a learner to understand the nature of corporate personality and its legal effect.

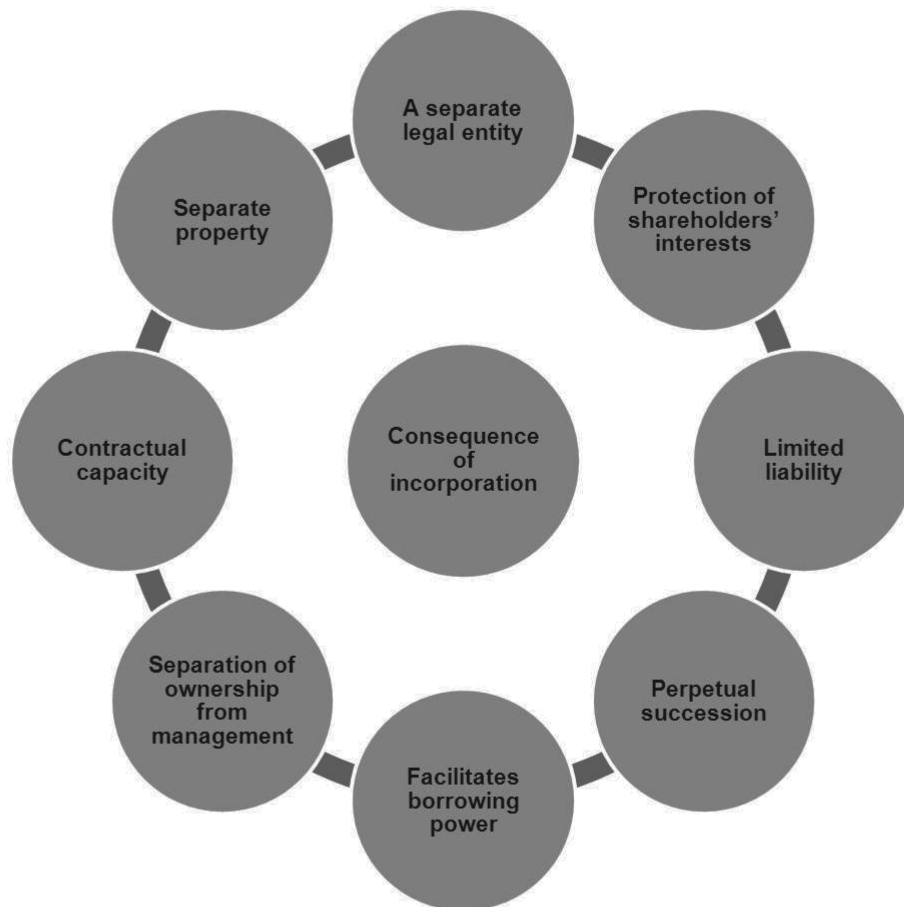
Learning Outcomes

a) State and explain the consequences of incorporation.
b) Explain the veil of incorporation and circumstances in which it may be lifted.

State and explain the consequences of incorporation.
[Learning Outcome a]

1. The concept of corporate legal personality

Diagram 1: Consequence of incorporation



Incorporation of a company has various legal effects towards its members and the public in general. These are discussed below.

1.1. A separate legal existence

The most important legal consequence of incorporation is the fact that upon incorporation, the company becomes a legal person distinct from its shareholders. This is a major difference between a company and a general partnership. In **Dulichand v Commissioner of Income Tax Nagpur [1956] AIR 354** it was held that the general concept of partnership established in both the English and Indian systems of law still is that a firm is not an entity or person in law but it is merely an association of individuals and the firm is only a collective name of those individuals who compose the firm.

Corporate personality is the engine behind corporate law and the business around companies. It is a long established principle under the case of Solomon v Solomon & Co Ltd where the House of Lords established the twin principles of corporate personality and limited liability. As such it was a new invention where by business community was relieved of the risk of investing their entire wealthy in a single business transaction; instead they could now portion and limits the extent of risk they would be ready to bear through companies. This is so even where one person, such as in a family based company, holds the vast majority of the shares. For instance, in **Lee v. Lees Air Farming Ltd [1960] UKPC 33**, Lee incorporated a company. He had himself appointed the managing director and chief pilot of the company. He was killed in an air crash while working for the company and his widow claimed compensation. It was held that Lee and Lees Air Farming Ltd were separate and as such a claim for compensation was valid. In the Solomons' case the court was of the opinion that;

> "The company is at law a different person altogether from the subscribers , 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 of them. Nor are subscribers, as members liable, in any shape "or form, except to the extent and in the manner provided by the Act."

1.2. Protection of shareholders' interests in the assets constituting their shares

The fact that incorporation creates an association into a separate legal personality from its members may also become disadvantageous to the members' interests. For example, a trader who enjoys insurable interests in his assets and then sells his business to the company may lose his right of insurable interest in the said asset.

In the case of **Macaura V Northern Assurance,** a trader who owned a business (timber estate) and also owned an insurance policy in his own name in favour of his business lost his right of insurable interest in the business after he transferred the business to company ownership without transferring the insurance policy to the company. When the estate was destroyed by fire and Macaura claimed to be indemnified by the insurer, it was held that Macaura could not claim under the policy because the assets that were damaged belonged to a different person, that is the company. Thus, Macaura as a shareholder had no insurable interest in the assets of the company.

The concept of separate corporate personality was further emphasized in **RE Attorney General's Reference** (No. 2 of 1982) where the Court of Appeal held that even persons in total control of the company were capable of stealing the company's property. In this case, the accused persons who had appropriated the funds of the various companies of which they were the sole shareholders and directors for their private purposes were found guilty of theft. Each director had acted with the consent of the other and hence raising a defence that they had appropriated their own property. Rejecting their defence and convicting them of theft the court found that it was irrational to treat the accused as having transmitted their knowledge to the company so as to regard the company as having consented to the appropriation. The view of the court, in such circumstances, is that the company should be regarded to have been the victim of the crime.

1.3. Limited liability

The phrase "limited liability" means the liability of members is limited while the liability of the company is unlimited in respect of the debts of the company. This means all companies have unlimited liability for their own debts. However, we saw at the beginning of this Study Guide, behind the company personality are the members who provide the share capital of the company. Thus, while for a limited liability company its members are not liable for the debts of the company, they may be called upon to contribute the full nominal value of each member's shares if they have not been paid up. This constitutes the limited liability of members to the debts of the company (contribution of the nominal capital of the member's shares). The extent of liability may vary, in cases for example, where a member has agreed to pay more than the nominal value of shares in which case his liability will be limited to the amount he has agreed to pay.

a) **Ownership of property**

The company, being a separate legal entity upon incorporation has ability to own property distinct from the property of its members. One advantage of this aspect of the effect of incorporation is when the membership of a company changes. As opposed to the position of partnerships, in companies members do not have any direct rights to the property of the company. The rights of members of a company is only limited to their shares. Hence, even if the shares are transferred, the company's property remains the same.

b) **Contractual capacity**

A company, possessing a legal personality, can enter into contracts just as a natural person subject to complying with other legal requirements under the law of contract. Since the law permits the company to enter into contracts, it follows that it can also sue and be sued in its own name.

1.4. Perpetual succession

A company enjoys continuity, irrespective of death or incapacity of some or all of its members. Different from a partnership which dissolves upon death of any of the members, a company survives its members.

1.5. Transferability of membership

Membership to the company is evidenced by the shares one holds in it. The extent of interest is signified by the amount of shares one holds in the company. Thus a certain member may demonstrate his interest in the company's business by holding majority shares or by holding minority shares. Thus the nature of a company allows some flexibility of transferring their shares, as circumstances may require, provided the memorandum of the company does not prohibit it.

1.6. Facilitates borrowing power

Incorporation of a company, as opposed to sole trader business names and partnerships, avail to the members through the corporate entity the greater possibility of borrowing. While for a layman, one would expect that business entities that allow for personal liability would attract more lenders for advancing loans, the opposite is actually the true. Companies have the advantage of giving a floating charge as security for a loan, something which is not available to an unincorporated trader or partnership. A floating charge is a mortgage over the constantly fluctuating assets of the company. While a charge does not prevent the company from dealing with assets of a company, in the ordinary course of business, it becomes very useful when the company has no fixed assets or property such as land which would otherwise be used as a normal mortgage. The company, while lacking fixed assets, may still have large and valuable stock-in-trade, thus increasing its capacity to borrow.

1.7. Separation of ownership from management

A company is administered and managed by its managerial personnel i.e. the Board of Directors. The shareholders are simply the holders of the shares in the company and need not be necessarily be the managers of the company.

Explain the veil of incorporation and circumstances in which it may be lifted.
[Learning Outcome b]

2. Meaning of the veil of incorporation

An ordinary statement that could be used to refer to the corporate veil could be a fictional wall or a curtain that separates the members of the company from the company itself. That is to say, regardless of the fact that a company is formed by association of individuals and yet the main advantages of the companies' activities benefits the individuals, still the company is a legal entity separate from those who formed it. Regardless of the fact that individuals are the one who benefits in this, the company does not cease from being an entity different from those who formed it.

3. Lifting of a corporate veil

In certain circumstances, it may be necessary to lift the veil of the company and legally access the members of the company who are otherwise shielded by the corporate veil from legal action. Alternatively, the law may overlook the separate corporate personality of merged companies in their individual capacities, in favour of the economic entity constituted by the group collectively. The situations in which the veil of the company may be lifted are established by case law as well as by statute. They include:

3.1. Formation of companies to pursue illegal objectives

This may include instances where evidence can be provided to show that a company was created to enable a person to avoid his legal obligations such as obligation under a contract or tax. For instance, in **Guilford Motors Ltd v Horne** there was a covenant between the employer and employee that upon termination of the employee's employment, the employee would not solicit the customers of his former employer. It transpired that when the employment was terminated, Horne formed a company. The company sent out circulars to the customers of the former employer of Horne. Asked by the company to lift the veil of the newly formed company, the court granted the application, granting an injunction thereby preventing both the former employee and the company from distributing the circulars notwithstanding that the company was not a party to the covenant on non-competition with Horne's former employer.

In another decision, the Court of Appeal in England showed strict adherence to the principle laid down in Salomon v Salomon. This was in the case of **ORD & Another v Belhaven Pubs**. In this case, a company, party to legal proceeding, transferred its assets to another associated company thereby altering the position of the company involved in a dispute. The plaintiff who was concerned that the remaining assets of the defendant company would be insufficient to meet the possible award for compensation applied to substitute the associated company as the then new defendant. Rejecting the application, the Court of Appeal held that in the absence of evidence indicating some fraud or sham, the principle of separate legal existence as laid down in Salomon v Salomon must be upheld.

3.2. Wrongful or fraudulent trading

Fraud is, or could be perpetrated, behind the veil of incorporation. Sometimes the business form of a company is used by individuals to do unlawful activities such as money laundering, tax evasion, and drug trafficking. In such cases the courts ignore the separate personality and lift the corporate veil in order to attach liability to the individuals who commit crimes or fraudulent dealings.

3.3. Determination of Holding and subsidiary character among companies

For the purposes of presentation of financial statements, the practice has been, in cases of holding and subsidiary companies, to treat such companies in a group as one, although all have separate corporate personalities.

This normally applies where the companies form other companies as their subsidiaries to act as their agents. In certain cases the courts have found that holding companies were in fact carrying on business through the agency of its subsidiary company. Where the activities of the subsidiary company are so closely controlled and directed by the parent company the latter can be regarded as merely an agent, conducting the parent company's business.

Example

To get tax advantages and protect itself from the stock exchange listing rules, a Tanzanian registered company set up a foreign subsidiary. This subsidiary company issued bonds to banks which were guaranteed by the holding company.

In this case, the company has acted as a nominee or as an agent either for another party or for its main shareholder. In these kinds of cases a court would ignore the law on separate personality and base its decisions accordingly.

3.4. Tax enforcement

At times tax legislations warrant the lifting of the corporate veil. The courts are prepared to disregard the separate legal personality of companies in case of tax evasions or liberal schemes of tax avoidance without any necessary legislative authority.

Case Study

A good example of the situation where the court lifted the veil of incorporation in Tanzania is the Court of Appeal decision in the case of **Yusuf Manji v Edward Masanja and Abdallah Juma** Civil Appeal No. 78 of 2002. In this case, the respondents were employed by Metro Investment Ltd as watchmen. They instituted a case claiming for overtime payment, transport and rent allowance. Their claims were awarded by the court. In the process of execution, the court ordered the applicant who was the director of the company to satisfy the decree. He appealed against that order claiming that it was improper to execute against the applicant, Yusufu Manji, the decree which was passed against the company, Metro Investment Limited. The argument was that a company being a separate legal entity from its shareholders as directors, the shareholders as directors should not be held liable for the debts of the company. In allowing the veil of incorporation to be lifted, the court stated that:

'having regard to the relationship of the company at the time with the appellant as the managing director, the alleged concealing of the assets of the company by the appellant which was not denied by way of counter - affidavit, we are satisfied that this was a proper case in which to apply the principle of lifting the veil of incorporation.

Test Yourself 1

Zigzag Ltd and Tin Tang Ltd are the two companies engaged in the business of manufacturing electronics goods?

Required:
Can Zigzag Ltd become a member of Tin Tang Ltd?

Answers to Test Yourself

Answer to TY 1

The law considers a company as a separate legal entity from its members. Hence, a company is a legal person in the eyes of law. It has all the powers that of a human. A company can enter into any contract in its own name and is liable on any such contract.

A company can buy shares of any other company. The company as a shareholder can exercise all the rights available to a member. Hence, Zigzag Ltd can become a member of Tin Tang Ltd.

SECTION B

LAW OF BUSINESS ORGANISATIONS

B4

STUDY GUIDE B4: THE CAPITAL OF THE COMPANY AND ITS MANAGEMENT

Get Through Intro

When a company commences its business it requires funds. A private company is not allowed to raise funds from the general public. So, the capital required by a private company, is obtained mainly from family members, relatives and friends.

However, a public company can raise capital by selling its shares to the public. This Study Guide will help students gain the requisite knowledge about the meaning of share capital, various classes of share capital, ways in which the capital of a company is maintained and protected and the requirements for share transfer and disclosure of ownership.

Qualified accountants have the responsibility to guide the company in the formation process, right from the promotion stage. Accountants have to advise clients about the relative advantages\disadvantages of the various types of shares that can be issued and guide them in selecting the most appropriate type of shares to be issued.

Learning Outcomes

a) State and explain the procedures for the issue of shares.
b) Identify and explain the ways in which the capital of a company is maintained and protected.
c) Identify and state the requirements for share transfer and disclosure of ownership.

State and explain the procedures for the issue of shares.

Learning Outcome a]

Companies may raise capital in various ways including issuing shares or borrowing. In modern company law the term capital is used to cover; share capital accruing from funds subscribed by members; loan capital involving funds provided by commercial finance providers and investors holding debentures or debenture stocks; and all funds whether provided by members, creditors or retention of profits plus the assets in which funds has been invested. The way by which the company raises its capital depends largely on whether it's a private company or a public company. If it's a private company, it will usually raise its capital from its own membership or a bank. On the other hand, public companies are usually formed when it is felt that there is a need to obtain funds by way of an issue of shares or debentures to the public.

1. Nature of Shares

Where a company is limited by shares, the capital of the company is divided into shares. Shares are units of a given amount defining a shareholder's proportionate interest in the company. The nature of a share was discussed in *Borland's Trustee v Steel Bros & Co Ltd* (1901) 1 Ch 279 where Farwell J said:

> The share is the interest of the shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se.*

Shares represent equal portions into which the capital is dividend whereas holders of shares are called shareholders. The amount of share capital of a company and the value of shares is normally stated in its memorandum of association. The amount of share capital must be raised at the time of formation of a company and must be retained in the business as far as that is practical. It is fixed in a sense that the prospective members of a company must decide how much ownership they want to maintain and thus agree to contribute to the company against their shares. It is this share capital as opposed to loan capital which entitles a party to membership in a company.

2. Main features of shares

The main features of a share are as follows:

a) a right to dividends declared on the shares;
b) generally (unless it is a non-voting share) a right to vote at general meetings;
c) on the liquidation of the company or on a reduction of capital, the right to receive assets distributed to shareholders of that class;
d) rights of membership attached to the shares as defined in the company's memorandum and articles;
e) a right to transfer the share in accordance with the articles of association.

3. Types of Share Capital

Share is divided into different types as discussed below.

3.1. Nominal or authorised capital

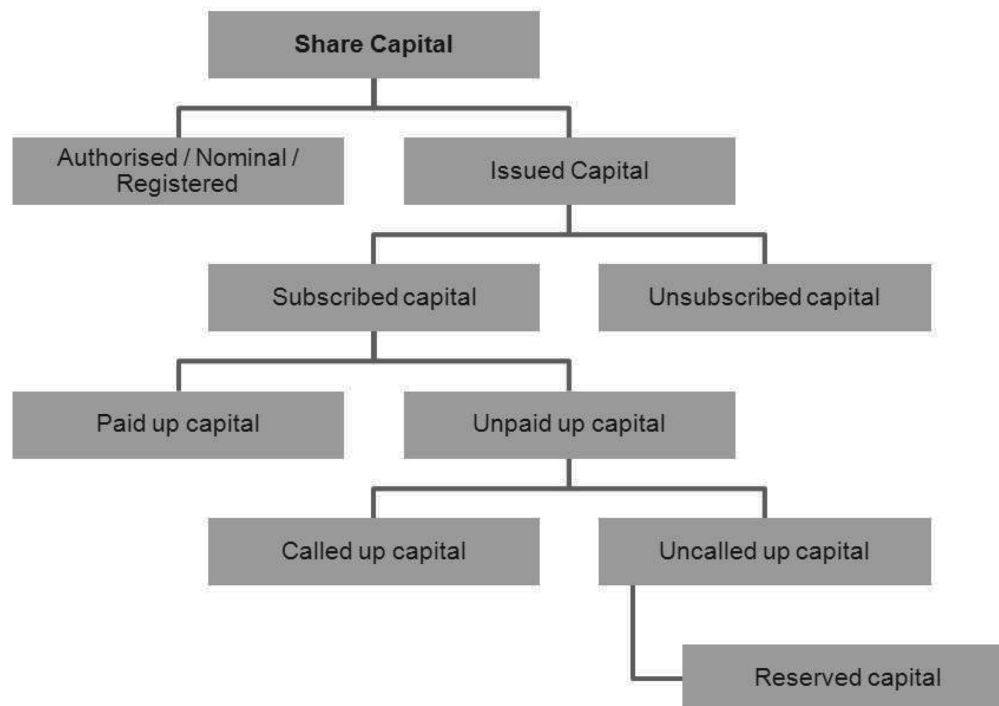
Nominal capital is the sum mentioned in the capital clause of Memorandum and articles of Association of a company. The amount so indicated implies that it is the maximum number of shares that the company can issue at any point in time and the nominal value of each share. In no way does this mean that any shares have been issued and/or paid for.

3.2. Issued capital

This refers to the nominal value of shares which are offered by the company for subscription by the members of the public. The nominal capital either in full or part must be issued in exchange for cash or the transfer of non-cash assets. Thus, issued capital is considered to be of greater importance as compared to nominal capital. This is because, it is on the basis of the issued capital that the shareholders are individually liable to pay the price of shares issued to them. Of greater interest and importance in this context, is the fact that it is the issued capital which constitutes a guarantee fund out of which creditors can expect to be paid from in future, albeit in theory.

Due to the importance of issued capital as stated above, issued capital should not be wrongfully reduced. For example, it is advised that issued capital should not be used to pay dividends to members. Nevertheless, issued capital may be reduced in the ordinary course of business trading.

Diagram 2: Share Capital



4. Procedures for the Issuing of Shares

4.1. Restriction in respect of private companies

Section 45 of the Companies Act generally prohibits a private company (other than a company limited by guarantee and not having a share capital) to offer, allot or agree to allot to the public any shares in or debentures of such a company in respect of those shares or debentures being offered for sale to the public. Thus, issuance of shares to the public is reserved for public companies with the exception of companies limited by guarantee and not having a share capital. Contravention of section 45(2) is an offence and any officer of the company who is in default of this provision shall be liable to a fine.

4.2. Offer documents by public companies

Definition

The phrase "offer document is defined in section 2 of the Companies Act to mean "any document, prospectus, notice, circular, advertisement, or other invitation offering to the public for subscription or purchase any shares or debentures of a company or any interest therein, or any right to acquire any shares or debentures or any interest therein."

Where offer documents for shares or debentures make untrue statements, some persons may be personally liable for civil liability to pay compensation to all who acquire any shares or debentures in reliance of the offer documents for the loss or damage they may sustain by reason of any untrue statement. These include the promoter, any person who might have authorised the issue of the offer document or its part, or any director of the company.

Moreover, section 48 of the Companies Act, 2002, requires an expert to give consent before his statement may be included in the offer documents, inviting persons to subscribe for shares in or debentures of a company. However, such consent does not constitute authorisation of offer document (section 51).

Offer documents inviting the members of the public to subscribe for shares in or debentures of a company, is not an offer in itself but an invitation to treat. This is done by way of a prospectus whereas an application for such shares by the members is the offer and allotment of the decided/determined shares to be issued on acceptance. This is subject to principles of contract law regarding offer and acceptance.

4.2.1. Contents of an offer document

The provisions regulating offer documents are contained under section 46-5 of the Companies Act. Reading from those provisions, an offer document must have the following contents:

a) The offer documents must be dated, the date which unless the contrary is proved, shall be taken as a date of publication (s. 46);

b) It must state the matters specified and contain the reports required to be included from time to time in regulations made by the Minister for the time being responsible for finance, or by the Capital Markets and Securities Authority or such other authority as may be designated by that Minister for the purpose. (s. 47 (1)).

4.3. Allotment of shares

The allotment of shares is the issuing of new shares to the existing shareholders or to third parties. Power to allot shares is normally given to Directors of the company through the articles of association. In the exercise of their powers for allotment of shares, Directors have act in accordance with the provisions of the Companies Act and the articles of association. Any authority conferred on the directors for allotting shares may be revoked or varied by the passing of an ordinary resolution in general meeting.

4.4. Return of allotment

Section 55(1) of the Companies Act requires any company limited by shares or limited by guarantee and having a share capital which makes any allotment of its shares, within sixty days following the said allotment, deliver to the Registrar for registration a return of the allotment and a contract constituting the title to the allotee. The said return of the allotments should state the number and nominal amount of shares comprised in the allotment, the names, addresses and descriptions of the allottees, and the amount, if any, paid or due and payable on each share. Failure to comply with the requirements of this section results into a fine on the defaulting officer (section 55(3) of the Companies Act).

Test Yourself 1

Differentiate offer documents from shares and explain their relationship:

4.5. Pre-emption rights

There is a general requirement to offer shares on a subsequent issue of shares after the first subscription to shareholders on a pre-emptive basis. This requirement is not found in the Companies Act but is contained in the English company law principles. The requirement applies in relation to equity shares that are fully paid up in cash. In essence this provision requires that where a company is proposing to allot the above shares for cash to any person, it shall not allot them unless it has made an offer by subscription, to each of the existing shareholders who holds these shares on the same or more favourable terms, of a proportion of the shares which is equal to the proportion in nominal value held by him of the aggregate of issued shares. In other words, the right gives that existing shareholder the opportunity to purchase enough of the new shares so that he will hold the same proportion of the issued share capital as he did before the new issue.

4.6. Classes of Share

Shares may be classified into two main categories: ordinary and preference shares.

4.6.1. Ordinary shares

This term is used to refer to the shares which are not given any special rights. If the company issues shares which all enjoy uniform rights, they will be ordinary shares. But, should the company confer special rights on some of its issued shares, then the shares not enjoying those rights will be classed as the ordinary shares. The usual position is that the ordinary shares would carry the voting rights in general meeting, carry an entitlement to any surplus assets in a winding up and have no fixed rate of dividend. This gives the ordinary shareholder the power to influence the policies of the company but makes his investment more speculative than the preference shareholder. In a financial year where the company makes a considerable profit and makes a large distribution by way of dividend, the ordinary shareholder has a right to participate after the preference shareholder rateably in the funds available. But, should the company have a poor year when little profit is made, the ordinary shareholder will receive very little or perhaps nothing.

4.6.2. Preference shares

The most notable feature of preference shares is that they will normally have an entitlement to a fixed rate of dividend, usually expressed as a percentage of the nominal value of the shares themselves. This fixed rate dividend will be paid in priority to the dividends payable to the ordinary shareholders. The distributable profit in a poor year can be exhausted entirely in satisfying the claims of the preference shareholders without the ordinary shareholders receiving anything

Identify and explain the ways in which the capital of a company is maintained and protected.
[Learning Outcome b]

5. Maintenance and Protection of the Capital of the Company

The doctrine of capital maintenance provides 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. This doctrine is a fundamental principle of company law. In fact, the doctrine emphasizes on a fundamental duty of the companies to keep the capital intact for the safety of the creditors giving the mandate to the courts to supervise whether the capital is dissipated lawfully or not.

The doctrine of maintenance of capital underpins the legal rules in the following important areas such as payment of dividends or other distributions to shareholders; reduction of a company's share capital and/or reserves; prohibition on the provision by a company of financial assistance for the purchase of its own shares; and a company's redemption or purchase of its own shares.

Due to the limited liability of shareholders, protection of creditors has always been a concern. To that end there developed the doctrine of capital maintenance which essentially is a collection of rules designed to ensure, firstly, that a company obtains the capital which it has purported to raise, and secondly, that the capital is maintained, subject to the exigencies of the business, for the benefit and protection of the creditors of the company. Thus, the objective of the doctrine of capital maintenance is to prevent fraudulence and to the creditors in companies by reducing share capital and to ensure liabilities of shareholders.

The doctrine of capital maintenance operates under the following principles, subject to exceptions provided by law:

a) a company generally cannot purchase its own shares unless it follows the strict procedures laid down by the Companies Act;
b) a subsidiary company generally must not be a member of its holding company;
c) it is generally unlawful for a company to give any kind of financial assistance for the acquisition by any person of its own shares or those of its holding company;
d) dividends must not be paid to the shareholders except out of the distributable profits;
e) where a public company suffers a serious loss of capital, a meeting of the company can be called to discuss the issue.

In accounting, capital maintenance involves two sub-concepts: the financial and the physical capital. On the one hand, the financial capital maintenance concept is that the capital of a company is only maintained if the financial or monetary amount of its net assets at the end of a financial period is equal to or exceeds the financial or monetary amount of its net assets at the beginning of the period, excluding any distributions to, or contributions from, the owners. On the other hand, the physical capital maintenance concept is that the physical capital is only maintained if the physical productive or operating capacity, or the funds or resources required to achieve this capacity, is equal to or exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, or contributions from, owners during the financial period. However, this article only involves the study on the financial capital maintenance.

Identify and state the requirements for share transfer and disclosure of ownership.
[Learning Outcome c]

Shares are said to be freely transferable but, in the case of private companies, it is often the case that there are various restrictions on transferability as provided in section 27(1) of the Companies Act. Section 74 of the Companies Act provides that shares or other interest of any member in a company shall be movable property transferable in manner provided by the articles of the company. Therefore, it is upon the drafters of the articles of association to prescribe the manner in which shares may be transferred to other members or to the public.

Transferability is an important feature of a share in a company registered under the Companies Act, from which emanates another feature of a company, perpetual succession. It endows a company with perpetual and uninterrupted existence. Transfer of shares is a transaction resulting in a change of share ownership. A shareholder, whether in public or private company, has a property in his share which he has a right to dispose of, subject only to any express restriction which may be found in the articles of the company. Transmission of shares is an automatic process when a shareholder dies (his shares immediately pass to the heirs) or when a member is declared bankrupt (their shares will vest in the trustee in bankruptcy).

6. Procedure for transfer of shares

Shares are moveable goods. The ownership of moveable goods may be transferred by delivery of possession. However, it should be noted incorporation of company creates a contractual relationship between the members and the company. When shares are transferred the contractual relationship is assigned to the transferee. As such, transfer of shares requires an instrument of transfer. Transferring a share involves a series of steps, first an agreement to sell, then execution of a deed of transfer and finally registration of the transfer and obtaining a certificate of transfer. Procedures for transfer of shares in Tanzania are described in section 77-81 of the Companies Act and include the following:

a) A transfer instrument must be executed by both the transferor and the transferee (s. 77)
b) The transfer instrument must be duly stamped and delivered to the company (s. 77)
c) Upon application of the transferor, the company shall enter in its register of members the name of the transferee in the same manner and subject to the same conditions as if the application for the entry were made by the transferee (s. 79)
d) If a company refuses to register a transfer of any shares or debentures, the company shall, within sixty days after the date on which the transfer was lodged with the company, send to the transferee notice of the refusal (s. 80(1))
e) Upon registration, the company shall certify the instrument of transfer by inserting the word "certificate lodged" which shall operate as evidence that the transferor held title to those shares (s. 81(1 &3).
f) Thereafter, the company shall within sixty dates after the date of transfer, issue share certificate to the new owner (s. 82(1)).

7. Share Certificate

Section 83(1) of the Companies Act provides that a certificate under the common seal of the company, specifying any shares held by the member, shall be *prima facie* evidence of the title of the member to the shares. It is *prima facie* because in appropriate cases the company deserves the right to dispute the authenticity of such certificate similar to the case under general law in respect to documents.

Thus, a share certificate is a document of title because it evidences ownership of shares according to section 83 of the Companies Act. Therefore, every member of the company whose name is entered in the register of members of the company has a right to receive a share certificate in respect of those shares he holds in the company according to section 82 of the Companies Act.

In terms of the form, a share certificate must be written and must bear the common seal of the company. In addition, the share certificate must specify the name and the number of shares held by a member of a company which are subject of that certificate. This is because by virtue of section 76 each share in a company having a share capital is distinguished by its number.

Answers to Test Yourself

Answer to TY 1

According to section 2 of the Companies Act, cap.212 an offer document is defined to mean "any document, prospectus, notice, circular, advertisement, or other invitation offering to the public for subscription or purchase any shares or debentures of a company or any interest therein, or any right to acquire any shares or debentures or any interest therein."

A share is a unit of capital.

The relationship of these two documents is that offer document is used to offer shares to the shareholders or subscribers to the memorandum of association. For companies converting from private to public an offer document intends to invite the public for subscription or purchase of shares issues by the company.

STUDY GUIDE B5: THE MANAGEMENT OF THE COMPANY, POWERS AND DUTIES OF DIRECTORS

Get Through Intro

A company is an artificial entity created under the provisions of the Companies Act 2002. Having a separate and distinct legal identity in law, once incorporated, a company has all legal capacity like a natural person. However, being an artificial person it needs people to act on its behalf.

The shareholders are collectively the owners of the company. However, it is very inconvenient and impracticable for all of them to manage the company. Hence, they elect their representatives to run the company on their behalf. These representatives of the shareholders are the company directors. The company directors are the brain through which the company functions.

The Companies Act places a number of responsibilities on the directors. Furthermore it also provides guidance on how they must function. Therefore to be an effective director, an individual needs to have managerial and leadership skills along with being fully acquainted with all the provisions of The Companies Act, relating to the directors.

Learning Outcomes

a) State and explain the duties of directors including fiduciary and other duties.
b) Explain how Directors may be appointed, re-appointed, removed or in any other way cease office.
c) Identify and state the powers of directors.
d) Identify and state how meetings of shareholders can be requisitioned and how voting operates.

Explain how Directors may be appointed, re-appointed, removed or in any other way cease office.

Learning Outcome b]

1. The office of director

The company is not a natural person. Therefore, somebody needs to act on behalf of the company. The powers to manage the company are given to directors. Section 181 of the Companies Act provides that 'the directors of a company have all the powers necessary for managing and for directing and supervising the management of, the business and affairs of a company'. As far as the legal requirements in the Companies Acts are concerned, every company is required to have at least two directors (s. 186) except for a single shareholder company which may have one director. The issue of appointment, re appointment and cessation of the office of a director is governed among others by sections 192, 193 and 194 of the Companies Act. Apart from the requirements of the Companies Act, it will be for the articles of association of the Company to lay down for how many directors the company should have and how the directors should be appointed, how their office is to be vacated and how they should be replaced.

2. Appointment of directors

The first directors will generally be appointed in writing by the subscribers to the company's memorandum. They may otherwise be appointed by a meeting of those subscribers. In any event, the incorporation of the company cannot be accomplished until a statement of the first directors and company secretary has been submitted to the registrar of companies (s. 14(2) of the Companies Act. Subsequent directors may be appointed in accordance with the articles. Table A provides for appointment of additional directors by ordinary resolution in general meeting. Where the articles provides for a requirement of share qualifications, then by virtue of section 191(1) of the Companies Act, it shall be the duty of every director who is by the articles of the company required to hold a specified share qualification, and who is not already qualified, to obtain his qualification within two months after his appointment, or such shorter time as may be fixed by the articles.

3. Removal of directors

Section 193 provides for the procedure to be followed in removing a director from the position of director. A company may by ordinary resolution remove a director before the expiration of his period of office, notwithstanding anything in its articles or in any agreement between the company and the director.

Moreover, a special notice shall be required of any resolution to remove a director under this section or to appoint somebody instead of a director so removed at the meeting at which he is removed. On receipt of notice of an intended resolution to remove a director, the company shall immediately send a copy thereof to the director concerned, and the director (whether or not he is a member of the company) shall be entitled to be heard on the resolution at the meeting (section 193(2)).

According to section 193(4) of the Companies Act, a vacancy created by the removal of a director under this section, if not filled at the meeting at which he is removed, may be filled as a casual vacancy. In addition, a person who is appointed director in place of a person removed under this section shall be treated, for the purpose of determining the time at which he or any other director is to retire, as if he had become director on the day on which the person in whose place he is appointed was last appointed director.

A person removed from the position of director in the manner prescribed uner section 193 may still claim and be awarded compensation or damages payable to him in respect of the termination of his appointment as director or of any appointment terminating with that as director or as derogating from any power to remove a director which may exist apart from this section in appropriate cases.

4. Qualification of directors

Section 194 sets the minimum age for appointment of directors and retirement. According to this section, the appointment age is twenty-one years whereas the retirement age is seventy years.

Identify and state how meetings of shareholders can be requisitioned and how voting operates.

[Learning Outcome d]

5. Company meetings

Companies conduct their affairs through meetings. Chapter IV of the Companies Act provides for meetings of the company to include annual general meetings and extraordinary general meetings. The company may have other meetings as it deems appropriate.

5.1. Annual General Meeting

Section 133(1) of the Companies Act provides that every company shall in each year hold a general meeting as its annual general meeting in addition to any other meetings in that year. While inviting members to the Annual general meeting the company shall specify the meeting as such in the notices calling it. At the Annual general meeting, the company shall, wherever practicable and subject to the provisions of the Act, transact the following business:

(a) to lay before the members the annual accounts;
(b) to lay before the members the directors' report;
(c) to lay before the members the auditors' report;
(d) to appoint auditors for the period up till the next general meeting at which accounts are laid;
(e) the re-election of any directors retiring and seeking re-election in accordance with any requirement in the company's articles of association;
(f) the election or confirmation of appointment of any directors in accordance with any requirement in the company's articles of association.

Therefore through such meetings members can question any transaction presented before in the accounts, director's or auditor's reports as the case may be and thereby influence the strategy or decision of the company. Moreover, it is at the same Annual General Meeting that the directors of the company are appointed, reappointed or confirmed. If the company defaults to hold its annual general meeting, section 133(7) of the Companies Act provides that the company and every officer who is in default would be liable to a fine.

By virtue of section 133(2) a company which holds its first annual general meeting within eighteen months of its incorporation need not hold it in the year of its incorporation or in the following year. In any case, the lapse of time allowed between two of the company's general meetings is fifteen months.

When default is made in holding a meeting of the company in accordance with subsection (3), the Minister may, on the application of any member of the company, call or direct the calling of a general meeting of the company and give such ancillary or consequential directions as the Registrar thinks expedient, including directions modifying or supplementing, in relation to the calling, holding and conducting of the meeting, the operation of the company's articles; and the directions that may be given under this subsection including a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

A general meeting held in pursuance of the foregoing shall, subject to any directions of the Registrar, be deemed to be an annual general meeting of the company; but, where a meeting so held is not held in the year in which the default in holding the company's annual general meeting occurred, the meeting so held shall not be treated as the annual general meeting for the year in which it is held unless at that meeting the company resolves that it shall be so treated.

Where a company resolves that a meeting shall be treated as the company's annual general meeting, a copy of the resolution shall, within fourteen days after the passing thereof, be forwarded to the Registrar for registration.

If default is made in holding a meeting of the company in accordance with subsection (1), or in complying with any directions of the Registrar under subsection (4) of section 133 of the Companies Act, the company and every officer of the company who is in default shall be liable to a fine and if default is made in complying with subsection (6), the company and every officer of the company who is in default shall be liable to a default fine.

5.2. Extraordinary General Meeting

All general meetings except for the annual general meetings and other statutory meetings are extraordinary meetings. Shareholders of a company have the right to request that the directors convene an extraordinary general meeting (EGM), and the directors are legally obliged to do so within a specified time. Section 134(1) of the Companies Act provides that 'the directors of a company, notwithstanding anything in its articles, shall, on a members' requisition, immediately proceed duly to convene an extraordinary general meeting of the company'. According to section 134(2) a members' requisition is a requisition of –

(a) Members of the company holding at the date of the deposit of the requisition not less than one-tenth of such of the paid-up capital of the company as at the date of the deposit carries the right of voting at general meetings of the company, or,

(b) In the case of a company not having a share capital, members of the company representing not less than one-tenth of the total voting rights of all the members having at the said date a right to vote at general meetings of the company.

The requisition must state the objectives of the meeting, and must be signed by the requisitionists and deposited at the registered office of the company. If the directors do not within twenty-one days from the date of the deposit of the requisition proceed duly to convene a meeting, the requisitionists, or any of them representing more than one-half of the total voting rights of all of them, may themselves convene a meeting. However, any meeting so convened shall not be held after the expiration of three months from the said date. A meeting convened by the requisitionists shall be convened in the same manner, as nearly as possible, as that in which meetings are to be convened by directors. Any reasonable expenses incurred by the requisitionists by reason of the failure of the directors duly to convene a meeting shall be paid to the requisitionists by the company, and any sum so repaid shall be retained by the company out of any sums due or to become due from the company by way of fees or other remuneration in respect of their services to such of the directors as were in default.

5.3. Class meetings

A class meeting is held following the order of court when the company or arrangement is proposed between the company and its creditors or any class of creditors or class of members. Section 229(1) of Companies Act provided that 'where a compromise or arrangement is proposed between a company and its creditors, or any class of them, or between the company and its members or any class of them, the court may, on the application (in a summary way) of the company or of any creditor or member of the company, or, in the case of a company being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members of the company or class of members, as the case may be, to be summoned in such manner as the court directs'.

6. Notice of meetings

For a meeting to be valid, it must be preceded by a valid notice calling for it. Section 135(1) of the Act requires that the meeting should be issued at least 21 days before the date of meeting. The exception is for an adjourned meeting which may be called at a shorter notice. The notice has to be in writing. The notice has to be served on every member required to attend the said meeting (section 136(a) of the Act). Further, it must specify the place, the day and hour of meeting. The manner of service of notices has to be specified in the articles of association.

7. Quorum of meetings

Quorum refers to the number of members required to be present at the meeting for the meeting to proceed. No business can be transacted at meeting unless the necessary quorum is present. Except where the articles of association of the company provide otherwise, the quorum necessary for a meeting is two members (section 136(b).

8. Voting in meetings

Decisions in a company are reached by way of voting. The decision so reached is called a resolution. Voting may be carried out by way of show of hands or by poll. A member may vote in person or by proxy. According to section 136(e) of the Act, in case of a company originally having a share capital each member shall have one vote in respect of each share. Therefore, it is the number of shares that a member holds which determines his/her voting power.

8.1. Appointment of a Proxy

Section 138(1) of the Companies Act provides that any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person whether a member or not as his proxy to attend and vote instead of him. The proxy so appointed has the same right as the member to speak and vote at the meeting. There are however exceptions to this general rule which may also be varied by the articles of association. According to the proviso to section 138 of the Companies the application of the general rule stated above is subject to the following exceptions:

a) this general rule shall not apply in the case of a company not having a share capital;
b) a member of a company shall not be entitled to appoint more than one proxy to attend on the same occasion;
c) a proxy shall not be entitled to vote except on a poll.

The appointment of a proxy has be done through a special instrument appoint such proxy. Articles of association have to specify the manner in which an instrument appointing a proxy may be executed. However, section 138(2) of the Companies Act provides to the effect that a notice of meeting issued by the company must also contain a statement indicating that a member entitled to attend and vote is entitled to appoint a proxy and that a proxy need not be a member. Not complying with this requirement may result into a fine on the defaulting officer of the company.

Thus, by virtue of section 138 a member who is unable to attend to the Annual General Meeting or any other meeting of the company described above, where important business of the company is to be transacted may still influence the composition of the directors and other strategies or decisions of the company by appointing a proxy.

8.2. Demand of a Poll, joining in demanding a Poll and Voting on a Poll

Shareholders attending a meeting of a company are entitled to demand a poll at a general meeting on any question other than the election of the chairman of the meeting or the adjournment of the meeting. The right of members to demand a poll cannot be taken away in any away by any clause in a company's articles. Section 139(1) provides that any provision contained in a company's articles shall be void in so far as it would have the effect either:

a) of excluding the right to demand a poll at a general meeting on any question other than the election of the chairman of the meeting or the adjournment of the meeting; or
b) of making ineffective a demand for a poll on any such question which is made either: by not less than five members having the right to vote at the meeting; or by a member or members representing not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting; or by a member or members holding shares in the company conferring a right to vote at the meeting, being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

The right to demand or join on demanding and voting on a poll extends also to a person appointed by a member through a proxy to be represented to at a meeting. Section 139(2) provides that an instrument appointing a proxy to vote at the meeting of a company shall be deemed also to confer authority to demand or join in demanding a poll. It states further that, and for the purposes of subsection (1), a demand by a person as proxy for a member shall be the same as a demand by the member.

Identify and state the powers of directors.
[Learning Outcome c]

9. Describing directors and their powers

Section 181 of the Companies Act, 2002 provides that "subject to any modifications, exceptions, or limitations contained in this Act or in the company's articles, the directors of a company have all the powers necessary for managing and for directing and supervising the management of, the business and affairs of a company." The position and powers of a director are not necessarily determined by the name or title one is called by but instead, persons who act as directors such as by attending board meetings and thereby taking part in board decisions will be directors even if they are called by another name, for instance,

manager or trustee.

Study Guide D2 contains detailed discussion on 'agency'

Save for exceptions discussed under the topic of 'veil of the company', a director of a company acts as an agent of the company as his acts (if fully sanctioned) bind the company who is in this case a principal and the director does not incur person liability.

The position of directors and their relationship with the company is also compared with the relationship between a trust and a trustee. The reason for this comparison is the fact that directors owe fiduciary duties to the company. However, directors notwithstanding the fiduciary relationship that exist between the company and the directors, they are not trustees because the legal title to the company's property is vested in the company and not in the directors.

State and explain the duties of directors including fiduciary and other duties.
[Learning Outcome a]

The duties of directors can be described in the following terms:

The basic legal duties of directors are to act in good faith in the interests of the company and for a proper purpose; and to exercise care and skill. These are derived from common law and are common to all directors. The duties are owed to the company, meaning generally the shareholders collectively, both present and future, not the shareholders at a given point in time.

Recently there have been suggestions that directors should look beyond the narrow interests of shareholders and rather their duties should be owed to the stakeholders of the company. This would include, for example, employees, creditors, customers and the environment in which the company was located. It is important to appreciate that, whatever duties the directors are subjected to, they owe those duties to the company and not to shareholders as individuals.

10. The Fiduciary relationship

According to the Merriam-Webster dictionary, a fiduciary relationship is a relationship in which one party places special trust, confidence, and reliance in and is influenced by another who has a fiduciary duty to act for the benefit of the party. Likewise, a fiduciary duty is a duty obligating a fiduciary (as an agent or trustee) to act with loyalty and honesty and in a manner consistent with the best interests of the beneficiary of the fiduciary relationship (as a principal or trust beneficiary).

The fiduciary relationship that exists between the company and the directors is in any other case like the relationships of agent and principal or trustee and settler. The principles of fiduciary relationship are based on the principle that the company entrusts the directors with its wellbeing, for managing and for directing and supervising the management of, the business and affairs of a company. It is therefore expected that the directors must display the utmost good faith towards the company in their dealings with the company or on the behalf of the company. This duty however, is limited to the actions of the director that they undertake without the concurrence of the company in the company's general meeting. On the basis of this guiding duty the specific duties of directors are as follows:

10.1. Duty of directors to act in good faith and in best interests of the company

Section 182 of the Companies Act provides that a director of a company when exercising powers or performing duties, must act honestly and in good faith. The director is also required by the same section to act in what he believes to be the best interest of the company.

It should also be noted that despite the fact that the power of directors to act is usually collective in that they do authoritative acts if they act collectively as a board of directors, the fiduciary duty is owed individually. Moreover the fiduciary duty is owed to the company as a whole and not to individual shareholders. This principle was set by the court in the case of **Percival v Wright** where the directors purchased shares from one of the shareholders without revealing that there was pending negotiations to sell shares in the company at a higher price. While no such sale ever took place the plaintiff sought to set aside the sale of shares to the directors on ground that they had not revealed about the negotiation of sale of shares. Rejecting the application the court held that the directors held no fiduciary duties to individual shareholders.

However in **Colin Gwyer & Associates Ltd v London Wharf (limehouse) Ltd** where the company was insolvent, the directors owed duty to creditors. In this case the directors agreed to compromise on a legal claim that a company had against Colin Gwyer & Associates Ltd. The said compromise was clearly detrimental to the company. The court held that the directors were liable for breach of fiduciary duty both to the company and the creditors since the company made such a compromise while knowing that the company was insolvent at that time.

There, however, exist some exceptions to this general rule on the director's duty to act in the best interest of the company. The exceptions are contained under section 182(2)-(4). For example where authorized by the articles and a director is acting in his powers in respect of a company which is a wholly-owned subsidiary, the director may act in a manner which he believes to be in the best interests of company's holding company even though it may not be in the best interests of the subsidiary company.

Also a director of a company that is a subsidiary (but not a wholly-owned subsidiary) may if authorized by articles of the company and when permitting or exercising duties as director and with the prior agreement of shareholders (other than its holding company) act in the manner which he believes it is in the best interests of that company's holding company even though it may not be in the best interest of the company.

Finally, a director of a company incorporated to carry out a joint venture between the shareholders may, when carrying out his duties in connection with the carrying out the joint venture, if expressly permitted to do so by the articles of the company, act in a manner which he believes is in the best interest of the shareholders, even though it may not be in the best interest of the company.

10.2. Director's duty in relation to Employees

According to section 183 of the Companies Act, the directors of a company have duty, in the performance of their functions in respect of matters relating to the interests of employees and members of a company. However the duty under this section on the directors is owed by them to the company and is enforceable in the same way as other fiduciary duties owed to the company by the directors.

By their nature the relationship of directors and shareholders and employees are different. Thus the law requires the directors to discharge their duties to members and employees through the company collectively. This enables the directors to act in the interests of employees without fear of being in breach of their duty to the company. The duty of the directors to the company remains higher in the hierarchy as compared to their duties to the employees.

10.3. Duty to exercise their powers for proper purpose

Despite the fact that the directors might have acted in good faith as persons of high calibre hold such a position in a company, director must know the limit of their powers. In other words the directors must use their powers for the purposes for which they were conferred. In **Hogg v Cramphorn** the directors issued shares carrying 10 vote each, to the trustees of an employee's pension fund. The shares were paid for by the trustees out of an interest free loan from the company. The directors did this so as to prevent a takeover bid which in their view would be bad for the company. It was held that the issue of shares to forestall a takeover bid as and not to raise the capital of the company which is the proper purpose for issuing shares, the issue of shares in this manner and for such a reason constituted the breach of the directors' fiduciary duties.

10.4. Duty to exercise reasonable care and skill

Section 185 of the Companies Act provides that a director owes a company the duty to exercise care, skill and diligence expected of a director or a person with special knowledge and experience as the director. The basis of the duty in law generally was first laid down in an English case of **Re City Equitable Fire Insurance Co.**

Recently, the Courts have shown a tendency to move towards a more objective standard of care and skill than that laid down in **Re City Equitable Fire Insurance Co** (1925). In **Re D'Jan of London (1994)** the judge made the recommendation that the general level of skill and care which a director is required to exhibit should be assessed through a two-stage process: firstly, determine what it might be reasonable to expect in terms of knowledge and skill of a particular director when compared with a similar director (this will establish an objective minimum standard); then, secondly, take account of the particular experience, skill and knowledge of the director concerned (this will allow the court to take account of the subjective factors of a particular director which may well raise the standard in one).

In another English case Re Barings Bank the court considered the third element of the duty of care and skill as laid down in Re City Equitable Fire Insurance Co concerning the ability of directors to delegate their duties. This case lays down a principle that where a director delegate his duties to other officers of the company such as managers, other directors, secretaries, officers and others a director will not escape liabilities arising from the wrongful acts of his delegates. Thus the Court held to the effect that all directors should acquire and maintain sufficient knowledge and understanding of the company's business so that they can be able to properly discharge their duties. The duty to acquire sufficient knowledge and understanding of the company's business extends to any delegated task. Thus even though the directors are permitted to delegate duties and responsibilities to others the act of delegation does not exonerate them from liability. Instead directors, after delegation must still supervise and keep themselves aware of the activities of those carrying out the tasks and duties delegated.

Other duties include the following:

a) General duty to make disclosure for purposes of section 205 concerning the Register of directors' shareholdings; section 206 concerning the particulars in accounts of directors' salaries, pensions; and section 207 on particulars in accounts of loans to officers.
b) Duty of directors to disclose interest in contracts. A director of company has a duty where he or any connected person is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company, to declare the nature of that interest at a meeting of the directors of the company.
c) Duty to furnish information in respect of section 215 of the Companies Act. According to section 215 of the Companies Act, if the Registrar believes and has reasonable cause to believe on perusal of any document which a company submits to him under the provisions of the Companies Act, that the document does not disclose a full and fair statement of the matters to which it purports to relate, he may, by a written order, call on the company concerned to produce all or any of the books of the company or to furnish in writing such information or explanation as he may specify in his order and such books shall be produced and such information or explanation shall be furnished by the company within such time as may be specified in the order. Failure to comply with section 216(1) is punishable by fine in respect of each offence.

Test Yourself 1

Dr. XY who was a managing Director of Company "X" resigned from Company "X", subsequently he established and headed a distribution agency in competition with Company "X".

Required:

Advise Company "X" whether it has a course of action against Dr. XY

Test Yourself 2

Tom, while occupying the position as managing director of the respondent company, allegedly exploited business opportunities that should have been exploited for the respondent's benefit.

Required:

Advise the company.

Answers to Test Yourself

Answer to TY 1

Directors must act with loyalty to the company at all times as such a no-conflict of interest rule and no-profit rule apply. There should not be conflict of interest between the Director's personal interests and that of a corporation he leads. Likewise, when a Director leaves one company to join another, he should not use potential market information, research or secrets of the former company to the advantages of the new company against the former. In the case above Company X can only be successful against Dr. XY if they can show existence of a real conflict of interests. In the absence of such evidence, company X can't have recourse against XY.

Answer to TY 2

Directors must act with loyalty to the company at all times as such a no-conflict of interest rule and no-profit rule apply. There should not be conflict of interest between the Director's personal interests and that of a corporation he leads. Where an individual is a director of two corporations, or is a director of one corporation and serves as staff or in another capacity with another organization, that have dealings with each other, the individual's duty to both entities can lead to a conflict of interest. This can arise if the interests of the two entities are not in harmony and the director cannot discharge his or her obligations to one without acting against the interests of the other. In the above scenario Tom has a conflict of interest with the company.

SECTION B

LAW OF BUSINESS ORGANISATIONS

B6

STUDY GUIDE B6: MEMBERSHIP OF THE COMPANY AND THE SHAREHOLDERS' RIGHTS AND DUTIES

Get Through Intro

Shareholders are people who have invested money in the company and have an interest in the ownership of the company. Their only involvement with the running of the organisation is electing its board of directors and participating in shareholder meetings. However given their ownership status, they have the ultimate authority over the organisation.

This Study Guide explains the methods of becoming a member of a company, the rights of members/ shareholders and how shareholders can influence the composition of the Board of Directors and strategy or decisions of a company.

In your career in the corporate world, you will have to interact with the shareholders of the company in which you are employed. Furthermore you could become a shareholder of a company. At such times knowledge of the contents of this Study Guide will be useful.

Learning Outcomes

a) Explain how a person can become a member of the company.
b) Identify the rights of shareholders of a company.
c) Identify and explain how shareholders can influence the composition of the Board of Directors and strategy or decisions of a company.

Explain how a person can become a member of the company.
[Learning Outcome a]

1. Membership of the Company

Membership to a company is a voluntary affair and thus a person becomes a member if he indicates that he has agreed to become a member and consequently his name is entered on the Company's Register of members. A member of a company includes those subscribers to the memorandum of association of the company. According to section 3 of the Companies Act, the minimum number of members in a company is two, except for a single shareholder company which can have a single member. Section 26 provides that 'if at any time the number of members of a company is reduced below two, and it carries on business for more than six months while the number is so reduced, every person who is a member of the company during the time that it so carries on business after those six months and knows that it is carrying on business with fewer than two members, shall be liable (jointly and severally with the company) for the payment of the whole debts of the company contracted during that time'. Ways for becoming a member of a company are as follows:

1.1. By subscription to the memorandum of the company

Section 24(1) of the Companies Act provides that 'the subscribers to the memorandum of company shall be deemed to have agreed to become members of a company, and on its registration shall be entered as members in its register of members'. Therefore by virtue of this provision the mere act of subscribing to the memorandum of a company indicates an intention and decision on the part of the subscriber that he has agreed to be a member of that company. This entitles the company, after having its memorandum registered, to enter the name of the subscriber into the company's register of members.

1.2. Agreement and registration

Section 24(2) of the Companies Act provides that "every other person who agrees to become a member of a company, and whose name is entered in its register of members, shall be a member of the company". A member may express his agreement to become a member of the company in the following ways:

i. By application and allotment

Some persons may not have subscribed to the memorandum at a time of its registration but afterwards apply for allotment of shares. Persons who have been allotted shares take them directly from the company. This grants them membership status in a company.

ii. By purchasing shares

Persons may become members of a company by purchasing shares from an existing member after which the purchased shares are transferred into the name of the purchaser. The name of the purchaser must be entered into the company's register of its members.

iii. Transmission of membership

Acquisition of company membership through transmission occurs as a result of the death or bankruptcy of an existing member. In such cases, the survivor of the deceased or the trustee of the bankrupt member takes over as members of the company.

iv. Purchase of qualification shares

Where the articles of the company require a director to take qualification shares to qualify for appointment as director, the acquisition of those shares entitles such director the status of a member of the company.

v. Estoppel

This occurs where a person's name is entered on the register in error as a member, or is not deleted when he transfers his shares and such a person knowing an error fails to take steps to rectify the register, a person may be stopped from denying that he is a member.

Identify the rights of shareholders of a company.

[Learning Outcome b]

2. Rights of shareholders of a company

Ordinarily, shareholders may enforce their rights through voting in company meetings. Likewise, if meetings are not convened, the shareholders may requisition a meeting. The rights of shareholders include;

- Rights to vote,
- Rights to demand a poll,
- Rights to transfer of shares,
- Rights to participate to appoint a director, auditors, and
- Rights to receive dividend when declared

3. Protection of minority rights

The general rule is that decisions in companies are passed by the majority. Essentially, this means that the member(s) holding the majority shares have the majority vote and the decision making powers. This rule may be detrimental to minority shareholder in situations where the majority shareholders decided against the interests of the minority. In order to protect minority rights, various principles have been established by courts to limit the powers of the majority. The majority rule has no application in the following situations:

i. *Ultra vires and illegality* – the majority rule has no application is the company is proposing to do an ultra vires or illegal act, since the shareholders cannot, even by a unanimous vote, ratify an ultra vires or illegal act.

ii. *Special majorities* – the majority rule does not apply where what is done or proposed to be done can only be a special majority or special resolution

iii. *Personal rights* – the majority rule does not apply in relation to the shareholder's right to enforce personal rights which accrue to him as a shareholder.

Case Study

Foss v Harbottle (1843)

Two minority shareholders of a company claimed that the directors have fraudulently misappropriated the assets of the company. They initiated proceedings on behalf of the shareholders (other than the directors) against the directors of the company.

Court's decision: it was held that in the case of a company being wronged by its own directors, then it is only the company who can sue the directors. Hence, the claim of the minority shareholders was rejected.

STUDY GUIDE B7: THE COMPANY'S ACCOUNTS AND AUDIT

Get Through Intro

The most common definition of an audit is an evaluation of an organisation, system, process, project or product. Audits are performed to ascertain the validity and reliability of information, and also to provide an assessment of a system's internal control. An audit gives assurance to the users that the financial statements of the company 'fairly' present the company's financial position and the results of its operations.

Audits are performed by a competent, independent and objective person or persons, known as auditors, who then issue a report on the results of the audit. These auditors must adhere to generally accepted standards set by governing bodies that regulate businesses. Likewise, companies are required to keep books of accounts which are sufficient to show the company's transactions.

This Study Guide deals with the procedure for appointment, the duties and powers of the company auditors as provided in the Companies Act 2002. A qualified CPA is eligible to be appointed as an auditor of a public limited company. Hence one needs to be well-vested with knowledge of the accounting and auditing requirements for companies.

Learning Outcomes

a) Define an auditor and explain the appointment, remuneration, powers, rights and duties, termination and liability of auditors of companies.
b) Describe the requirements for preparing and keeping books of accounts, preparing the directors' reports and submission of auditors' reports and directors' reports.
c) Identify requirements and conditions as to signing books of account, auditors' reports and directors' reports.
d) State accounting periods and circumstances under which extensions of accounting periods can be granted.
e) Explain rights and duties of directors and members of a company in relation to the books of accounts, auditors' reports and directors' reports.
f) Describe exemptions as to the requirement of preparing group accounts and submission of accounts by unlimited companies.

Define an auditor and explain the appointment, powers, rights and duties, remuneration, termination and liability of company auditors.

[Learning outcome a]

1. **Meaning of auditor**

An auditor is an examiner of accounts. A company is required to appoint an auditor or auditors at every annual general meeting who will hold office until the next annual general meeting (section 170(1) of the Companies Act. An auditor is a person who makes an independent report to the company's members as to whether its financial statements have been properly prepared in accordance with the Companies Act 2006 and whether the directors' report is consistent with those accounts.

2. **Appointment of auditors**

The provisions of the Companies Act provide to the effects that the first auditors of the company may be appointed by the directors at any time before the first annual general meeting (s. 170(5)). If the directors do not exercise their powers to appoint the first auditors, they will be appointed at the first annual general meeting and the powers of the directors shall thereupon cease (s. 170(5)(b)). All subsequent auditors have to be appointed at ever annual general meeting of the company. If at a general meeting no auditor is appointed or re-appointed, the Registrar may appoint a person to fill in the vacancy (s. 170(3)). A retiring auditor may be re-appointed at a general meeting even without a resolution being passed unless:

a) he is not qualified for re-appointment; or
b) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
c) he has given the company notice in writing of his unwillingness to be re-appointed.

Section 175(1) of the Companies Act provides that a person shall not be qualified for appointment as auditor of the company unless he is a certified public accountant. For the case of firms, every partner of the firm must be a certified public account for that firm to qualify as auditors of a company. Section 175(2) states the kind of people who do not qualify for appointment as auditors of a company. These include an officer or employee of the company or a person who is a partner of or in the employment of an officer or employee of the company. Also a person shall be disqualified from being appointed as auditor if he is disqualified for appointment as auditor of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company, or would be so disqualified if the body corporate were a company (s. 175(3) of the Act).

3. **Duties and rights of auditors**

Section 161 of the Companies Act provides that auditors have responsibility to make a report to the company's members on all annual accounts of the company of which copies are to be laid before the company in general meeting during their tenure of office. In performing such duties, the auditor has right to access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the officers of the company such information and explanation as he thinks necessary for the performance of the duties of the auditors (s. 176(1)). Likewise, auditors of the company have right to attend any general meeting of the company and to receive all notices of and other communications relating to any general meeting which any member of the company is entitled to receive and to be heard at any general meeting which they attend on any part of the business of the meeting which concerns them as auditors (s. 176(3)).

The report submitted by auditors shall state whether in the Auditors' opinion the annual accounts have been properly prepared in accordance with this Act, and in particular whether a true and fair view is given -

a) in the case of an individual balance sheet, of the state of affairs of the company as at the end of the accounting period;
b) in the case of an individual profit and loss account, of the profit or loss of the company for the accounting period;
c) in the case of the cash flow statement, the cash flow of the company for the accounting period;
d) in the case of group accounts, of the state of affairs as at the end of the accounting period, and the profit or loss for the accounting period, of the undertakings included in the consolidation as a whole, so far as concerns, members of the company.

In preparing the report, the auditors must carry out an investigation and exercise his professional skills to form an opinion on the accounting records of the company and the company's individual accounts against accounts records and returns. In particular, the auditor must investigate to establish whether proper accounting records have been kept by the company and proper returns adequate for their audit have been received from branches not visited by them (s. 163(1) of the Companies Act). It should also establish whether the company's individual accounts are in agreement with the accounting records and returns. If the answer to the above posed questions are in the negative section 163(2) requires the auditors to state that fact in their report.

The auditor's report must contain the names of the auditors and their signature (s. 162(1) of the Act). Likewise, every copy of the auditor's report which is submitted to the general meeting, or the Registrar or otherwise circulated or published must state the names of the auditors and be signed accordingly. A default on this provision attracts fines to the defaulting officer.

4. Remuneration of auditors

According to section 170 (8) of the Companies Act, the remuneration of the Auditors appointed by the directors of by the Registrar shall be fixed by the directors of the company or by the Registrar as the case may be. Alternatively, the remuneration of auditors may be fixed by the company in a general meeting or in such manner as the company deems fit. The remuneration of the auditors shall be stated in a note to the company's annual accounts.

5. Termination of auditors

An auditor of the company may be terminated in the following ways:

a) by an ordinary resolution at the company's general meeting (s.170(5)(a) and s. 170(7).

b) by a resolution at a general meeting for removal of the auditor before expiration of his tenure (s. 174(1)(d). Such resolution must be preceded by a special notice.

c) By the auditor's resignation. Section 177(1) of the Companies Act provides that an auditor of a company may resign his office by depositing a notice in writing to that effect at the company's registered office.

Section 179(1) of the Act requires that where an Auditor ceases for any reason, to hold office, he shall deposit at the company's registered office a statement of any circumstances connected with his ceasing to hold office which he considers should be brought to the attention of the members or creditors of the company or, if he considers that there are no such circumstances, a statement that there are none. Where the auditor ceases to hold office as a result of failure to obtain a re-appointment the statement shall be deposited not less than fourteen days before the end of the time allowed for next appointing auditors. In any other case the statement shall be deposited not later than the end of the period of fourteen days beginning with the date on which he ceases to hold office.

Test Yourself 1

In order to remove the auditor, the following is required:

A Consent of all shareholders
B Statement of circumstances
C Consent of all board members
D All of the above

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6. Exemption from audit for qualifying private companies

Section 171(1)(a) and (b) provides that a private company shall be exempt from the requirement to appoint an auditor under section 170 in relation to an accounting period if the qualifying conditions set out in the regulations set out by the Minister. The exemption applies for private companies where the company has a turnover and gross assets specified in the regulations made by the Minister.

7. Books of Accounts

Section 151(1) provides that every company shall keep in English or Swahili proper books of account which are sufficient to show and explain the company's transactions and are such as to disclose with reasonable accuracy at any time, the financial position of the company, at that time and enable the directors to ensure that any balance sheet, profit and loss account and cash flow statement prepared complies with the requirements of the Companies Act. Books of accounts should be maintained in respect of:

a) entries from day to day of all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place;
b) all sales and purchases of goods by the company;
c) assets and liabilities of the company.

The books of accounts must be kept at the registered office of the company and must at all times be available for inspection by the directors (s. 151(3) of the Act). The books of accounts have to be preserved for at least six years from the date they were made.

7.1. Accounting period

Directors are required to present before a general meeting an account of profit and loss or an account of income and expenditure (for a not-for-profit company) within 18 month after incorporation or at least once in every calendar year. This is technically referred to as the accounting period (section 152 of the Companies Act). This section provides that an accounting period shall be a period of twelve months from the end of the previous accounting period. The directors of a company whose accounting period is due may apply to the Registrar of companies for extension of accounting period (s. 157 of the Act).

7.2. Duty to submit accounts

According to section 166 of the Companies Act, directors are required to prepare and present before the company's general meeting the company's annual accounts, the director's report and the auditor's report on those accounts. The period allowed for laying and delivering accounts and reports is seven months for public companies from the completion of the accounting period and ten months for private company from the completion of the accounting period. Further, the directors of a company are required to deliver to the Registrar a copy of the company's annual accounts together with a copy of the Directors' Report for that accounting period and a copy of the Auditors' Report on those accounts (section 167(1)). According to section 153 of the Companies Act, the accounts prepared by directors have to indicate:

a) a profit and loss account or, in the case of a company not trading for profit, an income and expenditure account;
b) a balance sheet as at the last day of the accounting period; and
c) a cash flow statement.

The contents of the cash flow statement, balance sheet and profit and loss account must give a fair and true view of the company's transactions. The annual accounts must be approved by the Board of Directors and signed by a director of the company on behalf of the Board (s. 158).

7.3. Preparation of group accounts

Directors of a parent company have an obligation, in addition to preparing individual accounts of the parent company, to prepare group accounts for the subsidiary and the parent company. The group accounts shall be consolidated accounts and have to comprise of a consolidated balance sheet dealing with the state of affairs of the parent company and all its subsidiaries to be dealt with in group accounts; a consolidated profit and loss account dealing with the profit or loss of the parent company and those subsidiaries; and a consolidated cash flow statement.

A parent company is exempt from preparing group accounts if it is itself a subsidiary of another company that prepare group accounts or if it a company to which the conditions under section 171(2) of the Companies Act apply.

Test Yourself 2

Identify the option requiring a special resolution at a general meeting where accounts are laid:

A Appointment as auditor a retiring auditor
B Filling a casual vacancy in the office of auditor;
C Resignation of an auditor
D Retirement of an auditor

Answers to Test Yourself

Answer to TY 1

The correct option is **B.**

In order to protect the interest of the shareholders and the auditor, the auditor has a duty to give a statement of **c**ircumstances, stating the reasons for removal.

Answer to TY 2

The correct option is **B.**

STUDY GUIDE B8: REGISTRATION OF CHARGES

Get Through Intro

A company can raise funds by means of borrowing from sources other than its members which includes; bank loans, public deposits, and issue of debentures. Some of these borrowings are secured by a charge on the fixed assets of the company. So if the company fails on payment of the principal or interest amount its assets may be sold to repay the liability to the creditors.

This Study Guide explains the forms of debentures that the company may issue, types of charges and the distinct characteristics of the charges. Knowledge of this Study Guide will be useful to accountants when guiding client companies the different sources of company financing.

Learning Outcomes

a) Explain features of debentures and the registration process
b) Identify and explain the types of charges that can be effected by a company

1. Meaning of Debentures

Debenture refers to a long-term security yielding a fixed rate of interest, issued by a company and secured against its assets. A debenture is a type of debt instrument that is not secured by physical assets or collateral. Debentures are backed only by the general creditworthiness and reputation of the issuer. Both corporations and governments frequently issue this type of bond to secure capital. Debentures have no collateral. Bond buyers generally purchase debentures based on the belief that the bond issuer is unlikely to default on the repayment. Debentures are the most common form of long-term loans that can be taken out by a corporation. These loans are repayable on a fixed date and pay a fixed rate of interest. A company normally makes these interest payments prior to paying out dividends to its shareholders, similar to most debt instruments. In relation to other types of loans and debt instruments, debentures are advantageous in that they carry a lower interest rate and have a repayment date that is far in the future.

According to section 94 of the Companies Act, 'a contract with a company to take up and pay for any debentures of the company may be enforced by an order for specific performance'. A debenture contains a promise by the company to pay the loan amount. Similarly, instead of a company issuing separate debenture as evidence of distinct debts, it may create a loan fund known as debenture stock. Section 88(1) of the Act requires companies to keep a register of debentures at its registered office. Likewise, companies are obliged to notify the Registrar as to the place where the register of debentures is kept in case it is distinct from the company's registered office.

2. Classification of debentures

Debentures may be classified according to negotiability, security or performance. According to negotiability there are bearer debentures and registered debentures. According to security there are secured debentures and unsecured debenture. According to permanence there are redeemable debentures and irredeemable debentures.

a) Secured debentures

They are those which are secured by some charge on the property of the company. The charge or mortgage may be 'fixed' or 'floating. Hence there may be 'fixed mortgage debentures' or 'floating mortgage debentures' depending upon the nature of charge.

b) Unsecured or naked debentures

They are those that are not secured by any charge on the assets of the company. The holders of such debentures are just like ordinary unsecured creditors of the company. Such debentures are not common.

c) Registered debentures

The names of such debenture-holders are found in the register of debenture-holders of the company. They are payable to registered holders and their transfer is to be registered with the company in accordance with the conditions of their issue endorsed on their back by means of a regular transfer deed. No restrictions, howsoever reasonable, can be placed on their transferable.

d) Bearer debentures

The company keeps no record of the debenture-holders in this case. Such debentures are similar to share warrants in that they too are negotiable instruments, transferable by mere delivery free from equities. The interest on them is paid by means of attached coupons which are cashed by the holder as each falls due. On maturity the principal sum is paid to the bearers.

e) Redeemable debentures

They provide for payment of the principal sum on a specified date or on demand or notice.

f) Irredeemable debentures

In this case the issuing company does not fix any date by which they should be redeemed and the holders of such debentures cannot demand payment from the company so long as it is a going concern. Such debentures are also called perpetual debentures because usually they are repayable after a long period of time or on winding up.

3. Charges on the assets of the company

Whenever a company has power to borrow, it has also powers to security for the debt by a charge on all or any of its properties. Charge means an interest or right which a lender or creditor obtains in the property of the company by way of security that the company will pay back the debt. A **charge** is a security created in favour of a creditor at the time of accepting a loan for the payment of a debt by the company. It is important to note that creation of charge does not pass 'property' or any right to possession of the property to the person to whom the charge is given. The ownership and possession of the property remains with the company. However, the right of the borrower company to deal in the property charged becomes subject to the rights of the lender. The lender is entitled to recover his money by selling the property charged if the company fails to repay the loan according to the agreed terms.

A charge is a right given to the creditor / lender to have a designated asset of the debtor appropriated to the discharge of the indebtedness, but not involving any transfer either of possession or ownership. In case of company, the charges over assets are usually granted to the debenture holders who provide loan capital to the business.

Section 97(5)(a) provides that a charge shall be deemed to be created in the case of an instrument creating a charge on the date of the execution thereof by or on behalf of the company. This may be done, by signing and affixing a common seal of the company. Also, in the case of the charge created by deposit of title deeds on the date of the deposit thereof the charge will also be deemed to be created. Section 97 of the Companies Act provides a list of assets and properties of the company in which a charge may be created. They include, uncalled share capital, bills of sale, land, book debts, undertaking of the company, good will, intellectual property among others which belong to the company. This creates an advantageous position on part of the company as it need not necessary to have specified asset like fixed/immovable property to increase its borrowing capacity.

3.1. Types of charges

There are mainly two types of charges: floating charge and fixed charge

a) Fixed charge

A fixed charge is also known as a specific charge. This is a charge which is created on some specific and definite assets of the company such as land, buildings, machinery and plant, on uncalled capital etc. Once the fixed charge is created on any asset of the company, the company is not entitled to: sell or otherwise transfer that asset even though the possession of that asset remains with the company, or to create a subsequent charge (either fixed or floating) having priority over such charge. In the event of non-payment of the loan amount, the charge holder can dispose of the asset and recover his dues. A fixed charge implies that the company loses the right to dispose of the said property. Thus, the company can transfer the property charged only subject to the charge. In this sense, the charge holder must first be paid whatever is due to him.

b) Floating charge

A floating charge is a charge that does not affect the assets charged until some event 'crystallises' (fixes) the charge to a certain point in time. A floating charge is a charge which is not attached to any definite or particular asset. It is a charge on the ‘undertaking and the assets of the company’ e.g., debtors or stock-in- trade. However it is not restricted to current assets only and applies to future assets. The essence of such charge is that it remains inactive (dormant) until the undertaking charged ceases to be a going concern.

This is an equitable charge on the assets for the time being of a going concern. It has been also defined as a debenture which is not referring to any specific property, but is kind of “hovering” or floating in the air over the property of the company. It allows the borrower to continue to deal with the property which is the subject of charge in the ordinary course of trade. For instance, in the case of stock in trade the borrower will continue selling and buying new stock until the charge becomes fixed through crystallisation.

Government Stock & other Securities Investment Co v. Monila Railway Co (1897) AC 81

Lord Mc Naughten observed that, a floating charge is an equitable charge on the assets for the time being of a going concern which attaches to the subject charged in the varying condition from time to time. In the view of the court, it is important that such a charge remains dormant until the undertaking charge ceases to be a going concern or until the person in whose favour the charge is created intervenes. It went further to observe that, the right of a charge holder may of course be suspended by agreement but if there is no agreement for suspension, he may exercise his right wherever he pleases after default.

Thus, a floating charge may be defined as an equitable charge which is created on some class of property which is constantly changing. The company can deal with such property in the normal course of its business until the charge becomes fixed on the happening of an event. The main idea behind a floating charge is to allow the company to carry on its business in the ordinary course as if no charge had been created.

Characteristics of floating charge

The following characteristics of describe a floating charge:

a) It is a charge on a class of assets of that company both present and future
b) That class of assets is one which in the ordinary course of the business of the company is changing from time to time;
c) Until the creditors take steps to enforce the charge, the company may continue to deal with the assets charged in an ordinary course of business i.e. the company can sell the entire asset.
d) The company can create a subsequent fixed charge which will have priority over the floating charge already created.

3.2. Crystallisation of a charge

Crystallisation refers to the conversion of a floating charge into a fixed charge. When a charge holder takes some steps to enforce his charge, a floating charge becomes a fixed charge on the assets covered by that charge. At this time the company cannot dispose of the charged assets without first paying off the charge holder. A floating charge will become fixed upon the following conditions: cessation of the business of the company; upon the commencement of winding up of the company; if a debenture holder, having become entitled to realize the securities by the reasons of the fact that the principal money has become payable (due).

Example

Creditors of Chocochips Ltd has a floating charge on its stock and due to a problem, the company ceases to carry on its business. In that case crystallisation of the floating charge occurs. So thereafter the company cannot sell the stock and cannot create a subsequent charge on stock (whether fixed or floating) having priority over this charge.

Test Yourself 1

Explain the concept of crystallisation of a floating charge. When does crystallisation occur?

Difference between fixed and floating charge

Basis of distinction	Fixed charge	Floating charge
1. Who can create?	Any person can create a fixed charge on any asset owned by it.	Only an incorporated body (e.g. a company) is authorised to create a floating charge.
2. Type of property in which it is created	Is created on some identifiable (i.e. specific) property of the company. In other words, the asset on which the charge is created is definite e.g. a charge on a particular land owned by company.	A floating charge is created on a class of assets, present as well as future. In other words, a floating charge is created on a category of assets, e.g. a charge on company's inventory.
3. Nature of assets on which charge is created	Fixed charges are generally created on fixed assets, e.g. land and building, plant and machinery etc.	Floating charges are generally created on such assets as are always circulating, i.e., the assets which keep on changing

4. Power to deal in the asset charged	The company cannot deal in the asset charged in case of a fixed charge e.g. if a company has created a fixed charge on its warehouse, it cannot sell that warehouse as there is a fixed charge on it.	The company can deal in the asset charged in the ordinary course of business e.g., if a charge is created on company's inventory, the company can sale or use the goods from inventory. The inventory need not be kept at exact quantity/value as it was at the time of creation of charge.
5. Crystallisation	There is no question of crystallisation in case of a fixed charge.	A floating charge crystallises when the right of the company to deal in the asset charged comes to an end. For example, if the company is ordered to wind up then the floating charge created on its inventory crystallises and then it becomes a fixed charge of creditors on inventory. After that, the company is not entitled to deal in the inventory.

3.3. Registration of charges

Section 96(1) of the Companies Act, 2002 provides for a mandatory requirement for registration of charges created by a company registered in Tanzania. According to section 97(1) of the Companies Act the requirement of registration of charges under section 96 applies to the following types of charges:

a) A charge for the purpose of securing any issue of debentures;
b) A charge on uncalled share capital of the company;
c) A charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale;
d) A charge on land, wherever situated, or any interest therein;
e) A charge on book debts of the company;
f) A floating charge on the undertaking or property of the company;
g) A charge on calls made but not paid;
h) A charge on a ship, or aircraft, or any share in a ship;
i) A charge on goodwill, or on any intellectual property

The particulars for registration are: the date of creation of the charge, the amount secured, and brief particulars of the property charged. It is the duty of directors of the company to deliver the particulars of the charges created by the company to the Registrar for registration (s. 100(1) of the Act). However, any other person with interest in the charge may apply for registration of the charge in case the company directors have not done so. Failure to comply with the registration requirements invalidates the charge to the extent that the money secured thereby becomes immediately payable (section 96 of the Companies Act).

Test Yourself 2

Jolly Jelly Ltd issued 1,000 debentures to Afro Bank against a loan £100,000. The company has created a charge on its book debts. The agreement with the debenture holders contains the following terms:

(a) It was agreed that the company will not be entitled to dispose of any of the uncollected debts.

(b) The company will be free to collect the book debts, the proceeds of which will be deposited into an account in its name with the bank. This account could be with Afro bank or any other bank. After that the company will not be authorised to access that account unless written permission from the bank is obtained.

(c) It was agreed that the company will not be entitled to create other charges over them without the consent of the bank.

Required:

Decide whether the charge created over the book debts of the company are a fixed charge or a floating charge?

Answers to Test Yourself

Answer to TY 1

The conversion of a floating charge into a fixed charge is known a crystallisation. After crystallisation, the charge becomes subject to all the restrictions applicable to fixed charge. Hence, once the charge is crystalised:

- The asset under charge cannot be sold by the company.
- No subsequent charge having priority of the crystallised floating charge can be created.

Events causing crystallisation include the following:

- the liquidation of a company
- the company ceases to carry on its business
- the creditors have appointed a receiver
- an event occurs that amounts to the crystallisation of charge according to the terms and conditions of the charge created.

Answer to TY 2

A **charge** is a security created in favour of a creditor at the time of accepting a loan for the payment of a debt by the company. Charges can be either fixed or floating A fixed charge is one which is created on the specific asset i.e. asset is ascertained and defined at the time of creating the charge. It is generally created on the fixed assets, for example, land or plant and machinery or building. A floating charge is a charge which is not attached to any definite or particular asset. It is a charge on the 'undertaking and the class of asset' of the company which is changing from time to time, in the ordinary course of business ' for example, debtors or stock- in-trade. This however it is not restricted to current assets only and applies to fixed as well as to current assets.

The essence of such charge is that until the creditors take some steps to enforce the charge, the company may continue to deal with the assets charged in an ordinary course of business i.e.:

(a) The company can sell the entire asset.

(b) The company can create the subsequent fixed charge which will have priority over floating charge already created.

In the given case, as the charge is on book debts i.e. a fluctuating asset, one may form an opinion that it must be a floating charge.

The same issue was dealt with in Siebe Gorman and Co Ltd v Barclays Bank Ltd (1979). It was argued that the charge on book debts of the company with the similar provisions as in the above question was a floating charge. The case argued that this was a floating charge as it was a charge on fluctuating assets because:

Concept of charges: a charge on a fluctuating asset is always a floating charge.

Commercial: book debts are part of circulating capital and a vital source of cash flow. Hence, creation of a fixed charge on them will adversely affect the business.

However, the court took a different stand. It was clear from the facts of the case that company was only permitted to receive payment of book debts and could not assign, factor, discount, sell, charge or otherwise deal with them. Slade J found that, on a proper construction of the debenture, the company was not free to draw on its account without the consent of the bank even when the company was in credit. Accordingly it held that the charge on the uncollected book debts and their proceeds was a fixed charge.

In Re Keenan Bros Ltd (1986), McCarthy J confirmed that “mere terminology” was not determinative of whether a charge was fixed or floating. One had to look “not to the declared intentions of the parties alone, but to the effect of the instruments whereby they purported to carry out that intention.”

In the given case, the company was prevented from disposing of and from creating any other charges over its book debts without consent from the bank. This was set out in the terms of debenture. The company could collect the book debts, but it had to pay all the proceeds into a special bank account with the bank. The company where not permitted to withdraw money from this bank account unless the bank gave them written consent. Again this was all set out in the debenture deed. Hence on the basis of decisions given in **Gorman and Co Ltd v Barclays Bank Ltd (1979) and In Re Keenan Bros Ltd (1986),** the charge is more likely to be a **fixed charge** than to be a floating charge.

STUDY GUIDE B9: WINDING UP OF A COMPANY

Get Through Intro

This Study Guide deals with the methods of winding up of a company. Winding up can be either voluntary or compulsory. This study guide also deals with the consequences of insolvency and State the functions of a receiver manager, administrator and trustee in bankruptcy.

As we have studied earlier, a company is a separate legal entity having a perpetual existence. A company comes into existence by the operation of law. Hence a company's existence can be brought to an end by following the procedure prescribed by law.

In your position as a company accountant or company auditor, you will have to play an important role in the liquidation process of the company.

Learning Outcomes

a) Explain the meaning of liquidation and distinguish its types.
b) State the procedures for winding up of a company.
c) Identify and explain the consequences of winding-up.
d) State the functions of a receiver manager and administrator in bankruptcy.

Explain the meaning of liquidation and distinguish its types
[Learning Outcome a]

1. Meaning of liquidation

You must have frequently come across two words: ‘winding up’, ‘liquidation’ and ‘dissolution’. Winding up and liquidation are synonyms, they carry the same meaning. Winding up or liquidation is the process of bringing to an end the life of a company. Winding up of a company is the stage, where by the company takes its last breath. It is a process by which the business of the company is brought to an end and the company ceases to exist.

Liquidation is a legal process by which the affairs of a limited company are wound up. After the company is properly wound up, the name of the company is removed from the register of companies and the company is dissolved, which means it ceases to exist.

Winding up always precedes dissolution. In winding up, the assets are realised and liabilities are paid, but the corporate status of the company continues. Dissolution brings an end to the company’s existence as a legal entity. The liquidator can represent the company in winding up proceedings. Once the order of dissolution is passed, the liquidator cannot represent the company. Creditors can prove their debts in the winding up proceedings but not after an order of dissolution has been made. Proceedings can be started against a company which is being wound up but not against a company which has been dissolved.

2. Types of liquidation

Liquidation can be either voluntary liquidation or compulsory liquidation.

2.1. Voluntary liquidation

This occurs when the members or creditors of the company decide to put an end to the life of the company. Members' voluntary liquidation happens when the shareholders of a company decide to put the company into liquidation while there are enough assets to pay all the debts of the company, i.e. the **company is solvent.**

Tip

Solvent company: A company is solvent if it is not insolvent. A company is insolvent if:

(i) it is unable to pay its debts
(ii) if its liabilities exceed its assets.

Creditors' voluntary liquidation occurs when the shareholders of a company decide to put the company into liquidation, but there are not enough assets to pay all the creditors, i.e. the **company is insolvent.** In addition, section 333(1) of the Companies Act provides that a company may be wound up voluntarily in the following circumstances:

a) **On completion of duration of the company**

When the period (if any) fixed for the duration of the company by the Articles expires and the company at the general meeting has passed an ordinary resolution requiring it to be wound up, it may be voluntarily wound up.

Example

Jimmy and Jerry are twin brothers. They incorporated a private limited company on 1 January 1964 at the age of 20. They decided that when they turn 65 then they will close the company and retire from work. Hence they put a clause in the Articles of the company that the duration of the company will be up to 1 January 2029. In that case, the company can be wound up voluntarily from 1 January 2029.

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b) **On occurrence of some event**

If some event occurs, on the occurrence of which the articles provide that the company is to be dissolved, and the company at the general meeting has passed an ordinary resolution requiring it to be wound up voluntarily, it will be so wound up.

Example

Best Builders Ltd is a company formed with the objective of constructing three flyovers in the city. The members of the company can decide to voluntarily wind up the company after the construction of flyovers is complete and project has ended.

c) **On any other ground**

If the company resolves by special resolution that it be wound up voluntarily. The **special resolution** may be passed on any grounds.

d) **On liabilities exceeding its assets**

If the liabilities of the company exceed its assets and by reason of its liabilities it is not feasible to continue its business, then the company may decide to wind up its operations by passing an **extra-ordinary resolution.**

2.2. Compulsory/involuntary liquidation:

This occurs when the court makes an order for the company to be wound up on the petition of an appropriate person. Section 279(1) of the Companies Act identifies the circumstances under which a company may be wound up by the court are as, if:

a) the company has by special resolution resolved that the company be wound up by the court;
b) the company does not commence its business within a year from its incorporation or suspends its business for a whole year;
c) the number of members falls below two;
d) the company is unable to pay its debts;
e) the court is of the opinion that it is just and equitable that the company should be wound up.

A body corporate may also be wound up by the court if incorporated outside Tanzania and carrying on business in Tanzania and winding up proceedings have been commenced in respect of it in the country of its incorporation or in any other country in which it has established a place of business.

Tip

Ordinary resolutions: resolutions which are passed by a **simple majority of votes** of members who are entitled to vote at a meeting

Extraordinary resolutions: resolutions which are required to be passed by **at least 75% of the members** who vote on the motion, in person or by proxy at a general meeting. At least 14 days' notice must be given.

Special resolutions: resolutions passed at a general meeting of which at least 14 **days' notice** specifying the intention to propose a resolution as a special resolution has been given. Special resolution requires a 75% majority.

Difference between voluntary and compulsory winding-up

	Voluntary liquidation	**Compulsory liquidation**
Commencement	A voluntary winding up commences on the day when the resolution for liquidation is passed by the company.	Compulsory liquidation has a retrospective effect i.e. once the appeal for compulsory liquidation is accepted by the Court; it stands commenced from the date of petition and not only from date of court
Receiver	No receiver is appointed.	A receiver is appointed by the court.
Liquidator	A liquidator is appointed by the members and creditors in the meeting at which the resolution for winding up is discussed.	The receiver arranges for the meeting of members and creditors to appoint a liquidator to replace him.
Employees	The employees are not automatically dismissed by the commencement of voluntary liquidation.	The compulsory liquidation has effect of automatic repudiation of employee's employment contract.

Test Yourself 1

Explain the circumstances under which a company may be wound up by the court.

State procedures for winding up of a company

[Learning Outcome b]

3. Procedure for voluntary winding up

Where a company has passed a resolution for voluntary winding up, it should within fourteen days forward a copy of the resolution to the Registrar of companies. In addition, the company is required to publish the notice of the resolution in the Government Gazette and in a newspaper that has circulation in Tanzania (section 333(3) & 334(1) of the Act). Voluntary winding up is deemed to commence at the time of passing the resolution for winding up. The consequence of winding up voluntarily is that the company ceases to carry on its business from the commencement of the winding up, except so far as may be required for the beneficial winding up thereof. Despite the commencement of winding up, the corporate state and corporate powers of the company continue until it is dissolved (section 336). During the process of winding, any transfer of shares or alteration of members of the company will be declared void (s. 337 of the Act).

3.1. Appointment of a Liquidator in Voluntary Winding up

Appointment of a liquidator depends on the type of winding up involved. In case of a members' voluntary winding up, the liquidator shall be appointed by the company in general meeting for the purpose of winding up the affairs and distributing the assets of the company, and may fix the remuneration to be paid to him or them (s. 340(1)). On the appointment of a liquidator, all the powers of the directors shall cease, except so far as the company in general meeting or the liquidator sanctions the continuance thereof (s.340(2)). In case of a creditors' voluntary winding up, the liquidator for voluntary winding up may be nominated by the creditors and the company may appoint a liquidator at their respective meetings (s. 349). If the company and the creditors nominate different persons to be liquidator, a person appointed by the creditors shall be the liquidator. The nomination is subject to challenge by any interested party such as creditors, directors or company to the court whose decision shall override the prior appointments.

3.2. Powers of liquidator

A liquidator is a person appointed to carry out the winding up of the company. The liquidator in a winding up has wide powers as provided for by section 301 of the Companies Act. They include power to bring or defend any action or other legal proceeding in the name and on behalf of the company; to carry on the business of the company so far as may be necessary for the beneficial winding up of the company; to appoint an advocate to assist him in the performance of his duties; to pay any classes of creditors in full; and to make any compromise or arrangement with any creditors or such like persons with possible claims of any nature against the company or where the company may be rendered liable among others.

In addition to the above powers of the liquidator it is also important to note the additional powers of a liquidator which he is entitled to exercise without the express sanction of the court in a winding up by court. These include power to: sell the movable and immovable property and other things in action of the company by public auction or private contract with power of transfer of title in property; do all acts and execute, in the name and on behalf of the company, all deeds, receipts and other documents and for that purpose to use, when necessary, the company's seal; and draw, accept, make and endorse any bill of exchange or promissory note in the name and on behalf of the company. The actions taken by the liquidator in the respect described in this paragraph have the same effect with respect to the liability of the company as if the bill or note had been drawn, accepted, made or endorsed by or on behalf of the company in the course of its business;

3.3. Controlling/oversight mechanism on the powers of liquidator

Considering the wide powers conferred on the liquidator, section 301(3) provides that the exercise of the powers of the liquidator shall be subject to the control of the court. Thus any creditor or contributory may apply to the court with respect to any exercise or proposed exercise of any of those powers.

Moreover, another control measure of the powers of the liquidator in a winding up of a company by court is contained in section 302(1). By virtue of this, the liquidator while he is exercising his powers in the administration of the assets of the company and in the distribution thereof among its creditors, he is required to have regard to any direction that may be given by resolution of creditors or contributories at any general meeting or by the committee of inspection.

In the exercise of the powers described above the liquidator shall take into account the interests of creditors and contributories. The interests and wishes of creditors may be ascertained in general meetings either at the time when he is appointed or in subsequent meetings of the creditors and contributories summoned by the liquidator at a later date. The creditors and contributories may pass resolutions requiring and directing the liquidator to summon meeting creditors' and contributories directives. The creditors and contributories may also request the liquidator to summon meetings in writing by one tenth in value of the creditors or contributories as the case may be. Any directions given by the creditors and contributories at any general meeting shall, if conflict with the directions of the committee of inspection, override the latter.

In addition to the directions the liquidator gets from the creditors and contributories, the liquidator may also apply to the court in a manner prescribed for directions in relation to any particular matter arising under the winding up. It appears the direction are merely guiding because subsection (4) to section 302 provides that the liquidator shall use his own discretion in the management of the estate and distribution among the creditors. Yet the discretion of the liquidator is not without control.

Any aggrieved person by any act of the liquidator or his decision may apply to the court and the court acting on the application may confirm, reverse or modify any act or decision in dispute and order accordingly. Thus in such circumstances it is the decision of the court that is final.

Such control of the court on the liquidator appointed by the court shall include the power of the court to remove the liquidator upon cause being shown (and of course the liquidator may also resign). Moreover the law empowers the official receiver to exercise control over the liquidator of the companies which are being wound up by the court. Section 306(1) provides that the official receiver shall take notice of the conduct of liquidators of companies which are being wound up by the court. If it is observed that a liquidator does not faithfully perform his duties and duly observe all the requirements imposed on him by statute, rules or otherwise with respect to the performance of his duties the official shall inquire into the matter. The creditors and contributories may also make a complaint over the conduct of the liquidator to the official receiver and if the official receiver after having taken into account all the circumstances of the case including making an inquiry into the matter complained of, may take such action thereon as he may think expedient.

In the course of the official receiver investigating the matter in respect of the liquidator's conduct, or ordinary monitoring of the liquidator's conduct, the official receiver may at any time require any liquidator of a company which is being wound up by the court to answer any inquiry in relation to any winding up in which he is engaged. The official receiver may also if he thinks fit, apply to the court to examine him or any other person on oath concerning the winding up.

Test Yourself 2

Explain the circumstances likely to lead to voluntary winding up.

Identity and explain the consequences of winding-up.

[Learning Outcome c]

4. The Consequence of Voluntary Winding up

The consequences of voluntary winding up are as follows:

a) The company from the commencement of winding up shall cease to carry on its business. It can however be allowed to carry on business in so far as it may be required for its beneficial winding up;
b) The Corporate state and corporate powers of the company shall continue until it is dissolved. This status cannot be changed by any provision/clause contained in the articles of the company;
c) No ordinary transfer of shares to the company except the transfer made to or sanctioned by a liquidator after commencement of liquidation can be valid. Any purported such transfer except as described above or any alteration in the status of members of the company after commencement of liquidation shall be void;
d) If the company is insolvent the company's servants are automatically dismissed;
e) Moreover, if no liquidator has been appointed or nominated by the company the directors may not exercise any of their powers except as allowed by the court. The director may however be allowed to dispose of perishable goods that might fall in value and they may do anything necessary to protect the company's assets.

5. Consequences of a (Compulsory) Winding up Order

The consequences of compulsory winding up are as follows:

a) A copy of the Winding Up order must be immediately forwarded by the company or otherwise as may be prescribed to the Registrar for registration;
b) No action or proceeding can be proceeded with or commenced against the company except by leave of the court and subject to such terms as the court may impose;
c) The order shall operate in favour of all the creditors and of all the contributories of the company as if made on the joint petition of the creditor and of a contributory;
d) The official receiver becomes the liquidator and continues so unless and until another person is appointed to assume the office of liquidator;
e) The liquidator assumes the powers of the directors and most of the directors duties cease except the
f)
g) duty not to disclose confidential information as this duty continues even after the Winding Up order been issued.
h) The employment of employees automatically terminates.

Test Yourself 3

Identify the option which explains the consequence of compulsory winding-up.

A company can be allowed to carry on business in so far as it may be required for its beneficial winding up.
B If no liquidator has been appointed or nominated by the company the directors may not exercise any of their powers except as allowed by the court.
C If the company is insolvent the company's servants are automatically dismissed.
D The employment of employees automatically terminates.

State the functions of a receiver manager and administrator in bankruptcy.
[Learning Outcome d]

6. Receiver manager

The remedy of the appointment of official receiver is traditionally sought by debenture holders when a debenture interest has not been paid. In such cases the debenture holders will seek the appointment of a receiver in order to realize the assets subject to the charge and repay the debenture holders.

6.1. Meaning of Receiver

The term receiver is a general term which applies to any person who administers any type of receivership. Where the powers of a receiver include the power to manage the business of the company the person assuming such functions is known as a receiver manager or receiver and manager. An ordinary receiver has powers and may exercise them as conferred on him by the trust deed that appointed him.

Section 290 of the Companies Act defines an official receiver in relationship to the winding up of the companies by the court to mean the official receiver attached to the court for bankruptcy purposes. The court may appoint the official receiver if it considers it necessary for purposes of securing the more convenient and economical conduct of the winding up. The official receiver appointed under section 291 is other than the one provided for under section 290.

6.2. The duties of receiver

6.2.1 Immediate submission of a preliminary report on the position of the company

Section 293 provides for the duties of the official receiver where a winding up order is made. The official receiver must, as soon as possible after the receipt of the statement submitted under section 292, if any, unless dispensed with by the court, and after the date of the order submit a preliminary report to the court.

The immediate preliminary report shall include the following:

a) The amount of capital issued, subscribed and paid up, and the estimated amount of assets and liabilities;
b) If the company has failed, identify the cause(s) of the failure; and
c) State whether in the official receiver's opinion there is a need to carry out further inquiry in respect of any matter relating to the promotion, formation or failure of the company of the manner in which the company conducts or ought to conduct its business.

6.2.2 Subsequent report after the initial preliminary report

The official receiver after submitting the initial report if he considers fit may make further report or reports as the circumstances make it necessary and or require. Such subsequent report may give a proper and possibly more detailed account of the formation of the company. The report may also contain information on the determination of whether any fraud has been committed by any person by any person in the promotion or formation of the company.

A determination that fraud has been committed in respect of the company entitles the court to order public examination of promoters and officers of the company under section 325 in respect of which the receiver's subsequent report has found fraud.

7. Administrator and administration order

Definition

An administration order is an order directing that, during the period for which the order is in force, the affairs, business and property of the company shall be managed by a person ("administrator") appointed for that purpose by the court.

7.1. Appointment of the Administrator

Accordingly, section 247(1) provides for the powers of the court to make an administration order. It provides the court may make an administration order if it is satisfied that the company or is unlikely to be unable to pay its debts and considers that making an order is a better option for the company in accordance with section 247(3) of the Companies Act.

Section 252(1) of the Companies Act provides for the appointment of Administrators. The administrators of a company shall be appointed either by the administration order or by an order under subsection (2) to section of 252 of the Companies Act. If the vacancy in the office of administrator occurs by death, resignation or otherwise the court may by order fill the vacancy. The order of the court may be issued upon application made by any continuing administrator of the company, for example in the case of a continuing administrator's resignation. The application to the court may also be made by, in case there is no such continuing administrator, for instance in the case of a vacancy occurring as a result of death, by creditors' committee established under section 264 of the Companies Act. If both committee and continuing administrator are not present, the application may be made by the company or the directors or by any creditor or creditors of the company.

7.2. Powers of administrator

The administrator of a company is vested by section 253(1) with powers to do all such things as may be necessary for the management of the company. The list provided under section 153 is such extensive. The administrator is endowed with powers to do such things in respect of the affairs, business and property of the company. In particular, the administrator shall have the following powers among others:

a) To take possession of, collect and get in the property of the company and, for that purpose, to take such proceedings as may seem to him expedient;
b) To sell or otherwise dispose of the property of the company by public auction or private contract;
c) To raise or borrow money and grant security therefore over the property of the company;
d) To bring or defend any action or other legal proceedings in the name and on behalf of the company;
e) To appoint a solicitor (advocate) or accountant or other professionally qualified person to assist him in the performance of his functions;
f) To bring or defend any arbitration on any question affecting the company;
g) To effect and maintain insurances in respect of the business and property of the company;
h) To use the company's seal;
i) To do all acts and execute in the name and on behalf of the company any deed, receipt or other document;
j) Ta draw, accept, make and endorse any bill of exchange or promissory note in the name and on behalf of the company;
k) To appoint any agent to do any business which he is unable to o himself or which can more conveniently be done by an agent and power to employ and dismiss employees;
l) To do all such things (including the carrying out of works) as may be necessary for the realisation of the property of the company;
m) To make any payment that is necessary or incidental to the performance of his functions;
n) To carry on the business of the company

In the exercise of his powers and carrying out of his duties the administrator may apply to the court for directions. In any case, the powers of the administrator overrides the powers of the company and its officer whether such powers are conferred on the company or its officers by the Companies Act, memorandum of the company or articles of the company unless the administrator consents either generally or in relation to a particular case to relinquish his powers.

7.3. Purpose of making administration order

The purposes for whose achievement the administrative order may be made are mentioned in section 247(3) of the Companies Act. In other words the Administrator must perform his functions with an objective in mind to realize these purposes. The purposes are as follows:

a) Achieving the survival of the company, and the whole or any part of its undertaking, as a going concern;

b) The sanctioning under section 229 of a compromise or arrangement between the company and any such persons such as creditors or any class of them, members or any class of them; and,
c) A more advantageous realisation of the company's assets than would be effected on a winding up.

Thus, logically flowing from the above mentioned purposes, section 247(4) specifically provides that an administration order shall not be made in relation to a company after it has gone into liquidation.

7.4. Mode of applying an administration order

By virtue of section 248(1) an application for administration order shall be by way of a petition. Such a petition can be presented either by the company or the directors. It can also be presented by a creditor (including any contingent or prospective creditor or creditors). All or any of those parties herein mentioned (in this paragraph (may present a petition, together or separately).

7.5. The Effect of application for an administrative order

By virtue of section 249(1) (a)-(b) the effect of an application for an administrative order is as follows:

a) No resolution may be passed or order made for winding up the company. In other words, the company cannot be wound up after the application has been lodged;
b) No agreement relating to any charge, hire purchase or retention of title may be enforced against the company without the leave of the court, and in case of such leave of the court, enforcement shall be subject to such conditions as imposed by the court; and
c) No other proceedings, and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property without the leave of the court and subject to such terms as the court may impose.

7.6. The effect of the order

The issuing of an administration order has the following consequences according to section 250(1)-(3):

a) Any petition, if any, for winding up of the company shall be dismissed;
b) Any administrative receiver of the company shall be dismissed;
c) Any receiver of the part of the company's property shall vacate office when so required by the administrator;
d) No resolution may be passed or order made for the winding up of the company;
e) No administrative receiver of the company may be appointed;
f) No any agreement relating any charge, hire purchase or retention of title may be enforced against the company without the consent of the administrator or the leave of court, and in case of such leave of the court, enforcement shall be subject to such terms as imposed by the court; and
g) No other proceedings, and no execution or other legal process may be commenced or continued, and no distress may be levied against the company or its property without the consent of the administrator or the leave of the court and subject to such terms as the court may impose in case of the leave of the court.

7.7. The status of the administrator in relation to outsiders

Section 253(5) provides that the administrator, in the exercise of his powers is deemed to act as the agent of the company. Thus a person dealing with the administrator in good faith and for value need not to inquire whether the administrator is acting within his powers.

Test Yourself 4

(a) What is the difference between an official receiver and a liquidator?

(b) To whom does the liquidator owe duty in the performance of his function of liquidation of a company?

Answers to Test Yourself

Answer to TY 1

S.279 identifies the circumstances under which a company may be wound up by the court are as follows:

(a) the company has by special resolution resolved that the company be wound up by the court;
(b) the company does not commence its business within a year from its incorporation or suspends its business for a whole year;
(c) the number of members falls below two;
(d) the company is unable to pay its debts;
(e) the court is of the opinion that it is just and equitable that the company should be wound up.

A body corporate may also be wound up by the court if incorporated outside Tanzania and carrying on business in Tanzania and winding up proceedings have been commenced in respect of it in the country of its incorporation or in any other country in which it has established a place of business.

Answer to TY 2

Section 333(1) of the Companies Act provides for grounds or circumstances under which a company can be voluntarily wound up. The circumstances are as follows:

- If a the articles of a company provide for a certain specific fixed life of the company and such fixed period expires;
- If the articles provide that in the event of occurrence of a certain specific event the company shall be wound up if such even\\t occurs and in both cases the company in general meeting passes a resolution requiring the company to be wound up voluntarily.
- If the company passes a special resolution resolving that the company should be wound up voluntarily;
- Where a company resolves by special resolution to the effect that it cannot by reason of its liabilities continue its business, and that it is advisable to wind up.

Answer to TY 3

The correct option is **D**.

All other options relate to consequences of voluntary winding-up.

Answer to TY 4

(a) A liquidator is a person appointed for the purpose of winding up the affairs of the company and distributing the assets thereof following the creditors voluntary winding up, while an official receiver is an officer of the court, appointed following a petition in the court to wind up the affairs of the company. He is also a liquidator who takes into custody and under his control all the property of the company while the company is being wound up.

(b) The Liquidator owes his duty to the court that appointed him

SECTION C

ETHICAL CONDUCTS FOR PROFESSIONAL ACCOUNTANTS

C1

STUDY GUIDE C1: ETHICAL CONDUCTS FOR PROFESSIONAL ACCOUNTANTS

Get Through Intro

A professional accountant has both moral and legal obligation to his employer, to any person dealing with the accountant's clients and employer as well as to the public at large. Accounting is a specialised profession whose knowledge while is very important to everybody who uses money (meaning every sane human being and institution) is possessed by few. Thus it is important that those aspiring to be professional accountants know their moral duties, legal duties and the scope as well as impact of their actions and omissions. This Study Guide is aimed at explaining such obligations.

Learning Outcomes

a) Explain the salient features of the codes of ethics for accountants and auditors.
b) Identify sources of codes of ethics for accountants and auditors and describe their applicability in Tanzania.
c) Compare and contrast effectiveness of ethical codes against law-based mechanisms.
d) Identify professional misconducts committed by accounting professionals.
e) State consequences of non-compliance of the codes of ethics for accountants and auditors.
(f) Examine the enforcement procedures of codes of ethics for accountants and auditors in Tanzania

Identify, contrast and explain laws, ethics and ethical codes for accountants.
[Learning Outcome a]

1. Introduction

Section 2 of the Accountants and Auditors (Registration) By-Laws, 2017 defines a professional accountant to mean a person who: has expertise in the field of accountancy, achieved through formal education and practical experience; demonstrates and maintains competence; complies with a code of ethics; is held to a high professional standard; and is subject to enforcement by a professional accountancy organization or other regulatory mechanism. In particular, section 4(1) of the Accountants and Auditors (Practising) By-Laws, 2017 provides that person shall not be issued with the practicing certificate or have his certificate renewed unless that person, among others, adheres to the code of ethics and conduct issued by the Board. Therefore, adherence to the code of ethics and conduct is paramount to professional accountants.

According to section 26(1) of the A certified Public Accountant or certified Public Accountant in Public Practice has to comply with the requirements enshrined in the IFAC Code of Ethics for professional Accountants. From this provision, it can be noted that the applicable code of ethics for professional accountants in Tanzania is the IFAC Code. The most recent version of this code is the 2018 edition issued by the International Ethics Standards Board for Accountants (IESBA). It is therefore pertinent to examine the salient features of this code.

IFAC stands for the International Federation of Accountants. IFAC is the worldwide organisation for the accountancy profession. Founded in 1977, its mission is to serve the public interest by continuing to strengthen the worldwide accountancy profession and contributing to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards, and speaking out on public interest issues where the profession's expertise is most relevant.

One of IFAC's main activities is publishing a uniform set of auditing standards to serve as a benchmark for professional accountants around the world. IFAC heavily promotes these standards as it believes that their adoption will lead to a uniform quality of auditing across the globe.

2. Adherence with regulatory framework and accounting standards

Every country has a regulatory body that produces local accounting standards or generally acceptable accounting practices that all its accountants must follow. The main role of a regulatory system is to help ensure that accountants produce comparable, consistent, accurate and easily understandable financial statements and reports.

Whenever an entity operates in more than one country, it has to comply with the accounting requirements of each of these countries. This often results in organisations having to produce multiple financial statements and reports. However with the adoption of the International Financial Reporting Standards (IFRS), an organisation can produce one set of statements that would satisfy the statutory requirements of all concerned countries.

3. Introduction to ethics and ethical codes for accountants

Ethics are the underlying morals and behaviours of a person which govern his conduct in the performance of his duties. Ethics are associated with a particular class or group of people such as professionals depending on the nature of their profession and the surrounding circumstances. Thus ethical requirements may differ from one profession to another depending on the nature of the services offered by that profession and the kind of people or group of individuals in need of the services of that profession. Thus even though ethics as part of required moral behaviour and as minimum standard may generally be the same, different professions tend to set specific standards of ethics applicable to a certain profession.

A Code of Ethics is a set of rules obligatory on the member of the professional body. Some of the important ethical principles most relevant to accountants are integrity, objectivity, independence, and competence. Some authors state that, "integrity means being honest and forthright in dealings and communications with others; objectivity means impartiality and freedom from conflict of interest".

Ethical codes applicable for auditors is discussed in detail in Paper B3

Accountants are usually likely to be faced with a

situation where there exists a conflict of interest between for example the employer of the accountant and the client or any persons who may rely on the financial information provided by the accountant for decision making. If the employer is interested in attracting an investor, or a bank requires knowledge of the financial status of a company before advancing a loan they will all rely on the accounting information prepared by an accountant to succeed.

The employer or client may succeed if he is portrayed by the financial report that his enterprise is in a sound financial position. On the other hand the investor or lending bank will succeed if the accounting report or audit report reveals the liabilities and all audit queries if any so that the investor or bank may not “pour its money” in the said enterprise to avoid loss. Thus an accountant in such a case is supposed to make a professionally sound judgment in accordance to the knowledge and skills while being independent and not acting under any pressure.

From the foregoing, it is obvious that competence is another necessity in the accounting profession like in other professions. Mastery of the accounting profession will enable the accountant to make sound judgment of records of accounting presented to him for analysis and declaration of the financial status of a respective organization for instance. Failure to possess sufficient skills and knowledge in the required area of profession will jeopardise the ability of a person to give required advice at the detriment of his client, and the public at large. As we may be aware, the accountant’s primary duty is the public at large.

Another ethical obligation which is independence requires accountants to choose between practicing as accountants or auditors. This is because the ethical obligations require accountants and auditors to be independent of the organization to which they are providing accounting and auditing services. Take for instance an accountant who is an employee of the organization for which he is performing accounting/auditing services. There is every possibility that the accountant will be pressured by the employer to manipulate financial data to make the company seem more financially sound than it is in actual fact.

However, considering the importance of the ethical requirements of different professions, the practice has been to enact the ethical principles into law. This makes the observance of such professional ethical conduct to be mandatory and capable of them being enforced in a court of law. Moreover, enacting ethics into law helps to determine when has a conduct of a professional transcended boundary and amounted into a criminal offence.

For instance while it is unethical for an accountant to perform his duties while he is himself a beneficiary of the positive outcome of his audit report, or where it is an ethical requirement for an account to be independent and produce true accounting information of a respective company, it is illegal if his independence is vitiated by bribe. Observing ethical standards is increasingly important in the current era where fraud and bribe is rampant. Managers rely on accounting information prepared by accountants to make decisions about the future of their business enterprises. Major corporations also attract investments from a wider spectrum in society. Such investors rely on the financial information of the said corporations.

If the financial information is deceiving as a result of failure to observe one or more of the ethical requirements, the results can be as devastating as loss of jobs, shares, pension among others in the society. Thus it is therefore the overall ethical requirement individually and collectively to confront any unethical behaviour and practice demonstrated by a particular professional.

Kasim was invited by Company XY to conduct audit of the company. He realised in the course of the audit that the Managing Director had authorised money to be paid to the company run by his wife for the supply of stationeries.

What is the obligation of Kasim upon such a discovery?

Wema, when auditing a company, discovered that the assistant accountant dealing with record keeping for purposes of preparing financial statement had not entered some entries for money received. He decided to ask the relevant officer and requested to be provided with the books so as to enter the entries, admitting that the omission was inadvertent. Assume that the auditor has been tipped to allow access to the accounting books by the officer on one hand and that the auditor did this *suo motto* (on his own motion).

Required:
State in each case whether there was a breach of code of ethics or whether there was commission of an offence by the auditor.

The IFAC Code of Ethics identifies the fundamental principles to be observed by accountants. There are five fundamental principles of ethics for professional accountants:

(a) Integrity – to be straightforward and honest in all professional and business relationships.

(b) Objectivity – not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.

(c) Professional Competence and Due Care – to:

> (i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
>
> (ii) Act diligently and in accordance with applicable technical and professional standards.

(d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships.

(e) Professional Behavior – to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know might discredit the profession.

A professional accountant is required to comply with all these fundamental principles. For leaning purposes an extract of these fundamental principles is reproduced below. This has been extracted from the International Code of Ethics for Professional Accountants, 2018 edition.

INTEGRITY

R111.1 A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships.

111.1 A1 Integrity implies fair dealing and truthfulness.

R111.2 A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information:

> **(a)** Contains a materially false or misleading statement;
>
> **(b)** Contains statements or information provided recklessly; or
>
> **(c)** Omits or obscures required information where such omission or obscurity would be misleading.

111.2 A1 If a professional accountant provides a modified report in respect of such a report, return, communication or other information, the accountant is not in breach of paragraph R111.2.

R111.3 When a professional accountant becomes aware of having been associated with information described in paragraph R111.2, the accountant shall take steps to be disassociated from that information.

OBJECTIVITY

R112.1 A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

R112.2 A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

PROFESSIONAL COMPETENCE AND DUE CARE

R113.1 A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:

> **(a)** Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
>
> **(b)** Act diligently and in accordance with applicable technical and professional standards.

113.1 A1 Serving clients and employing organizations with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities.

113.1 A2 Maintaining professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.

113.1 A3 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.

R113.2 In complying with the principle of professional competence and due care, a professional accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision.

R113.3 Where appropriate, a professional accountant shall make clients, the employing organization, or other users of the accountant's professional services or activities, aware of the limitations inherent in the services or activities.

CONFIDENTIALITY

R114.1 A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and business relationships. An accountant shall:

(a) Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member;

(b) Maintain confidentiality of information within the firm or employing organization;

(c) Maintain confidentiality of information disclosed by a prospective client or employing organization;

(d) Not disclose confidential information acquired as a result of professional and business relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;

(e) Not use confidential information acquired as a result of professional and business relationships for the personal advantage of the accountant or for the advantage of a third party;

(f) Not use or disclose any confidential information, either acquired or received as a result of a professional or business relationship, after that relationship has ended; and

(g) Take reasonable steps to ensure that personnel under the Accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

114.1 A1 Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in the knowledge that the information will not be disclosed to a third party. Nevertheless, the following are circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

(a) Disclosure is required by law, for example:

(i) Production of documents or other provision of evidence in the course of legal proceedings; or

(ii) Disclosure to the appropriate public authorities of infringements of the law that come to light;

(b) Disclosure is permitted by law and is authorized by the client or the employing organization; and

(c) There is a professional duty or right to disclose, when not prohibited by law:

(i) To comply with the quality review of a professional body;

(ii) To respond to an inquiry or investigation by a professional or regulatory body;

(iii) To protect the professional interests of a professional accountant in legal proceedings; or

(iv) To comply with technical and professional standards, including ethics requirements.

114.1 A2 In deciding whether to disclose confidential information, factors to consider, depending on the circumstances, include:

● Whether the interests of any parties, including third parties whose interests might be affected, could be harmed if the client or employing organization consents to the disclosure of information by the professional accountant.

● Whether all the relevant information is known and substantiated, to the extent practicable. Factors affecting the decision to disclose include:

a) Unsubstantiated facts.
b) Incomplete information.
c) Unsubstantiated conclusions.

● The proposed type of communication, and to whom it is addressed.

● Whether the parties to whom the communication is addressed are appropriate recipients.

R114.2 A professional accountant shall continue to comply with the principle of confidentiality even after the end of the relationship between the accountant and a client or employing organization. When changing employment or acquiring a new client, the accountant is entitled to use prior experience but shall not use or disclose any confidential information acquired or received as a result of a professional or business relationship.

PROFESSIONAL BEHAVIOR

R115.1 A professional accountant shall comply with the principle of professional behavior, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession. A professional accountant shall not knowingly engage in any business, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

115.1 A1 Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

R115.2 When undertaking marketing or promotional activities, a professional accountant shall not bring the profession into disrepute. A professional accountant shall be honest and truthful and shall not make:

(a) Exaggerated claims for the services offered by, or the qualifications or experience of, the accountant; or

(b) Disparaging references or unsubstantiated comparisons to the work of others.

115.2 A1 If a professional accountant is in doubt about whether a form of advertising or marketing is appropriate, the accountant is encouraged to consult with the relevant professional body.

2. Misconducts committed by accounting professionals.

[Learning Outcome b]

Accountants who do not discharge their services professionally may find themselves committing various misconducts which may attract criminal penalties. These misconducts are as follows:

a) Breach of trust

The auditor not maintaining the confidentiality of information or not using client information for the benefit of the client amounts to breach of trust.

Example

Dvyne PLC has recently tendered for a catering contract with Cat Airlines. The partner informed his brother-in-law (who was a caterer) about the value of the tender. This is a professional misconduct involving a breach of trust since confidentiality is not maintained i.e. information about the client was passed to the auditor's brother-in-law and client information was not used for the benefit of the client i.e. it was used for the benefit of the auditor's brother-in-law.

b) Insider trading

When the accountant or auditor makes use of unpublished price sensitive information (like acquisitions or change in profits) to obtain personal benefit, this amounts to insider trading which is a professional misconduct. Auditors generally should avoid purchasing shares in the client company so that the probability of insider trading will not occur.

Example

Tanya is the auditor of Tiptoes PLC, a shoe company. Tanya accesses confidential information during the course of audit. The information is that the company will be issuing bonus shares next month. Tanya wants to purchase shares in Tiptoes so that she will be allotted the bonus. However Tanya cannot purchase shares in her own name as this will hamper her independence. Therefore she decides to purchase the shares in the name of her mother. This is insider trading since Tanya is using price sensitive market information for her personal benefit.

Test Yourself 3

State the principles that an accountant must observe when preparing financial records.

4. Consequences of non-compliance with code of ethics, laws and regulations

According to the IFAC Code of Ethics, non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations. Non-compliance may be committed by the professional accountant's employing organization; those charged with governance of the employing organization; Management of the employing organization; or other individuals working for or under the direction of the employing organization.

Non-compliance might result in fines, litigation or other consequences for the employing organization, potentially materially affecting its financial statements. Importantly, such non-compliance might have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees or the general public.

Answers to Test Yourself

Answer to TY 1

Since an auditor's duty is tripartite he has an underlying obligation to disclose that fact to the company's board of directors so that steps may be taken to rescue the company from the risk of ceasing to be a going concern. This should be done without regard to the fact that the Managing Director acting on behalf of the company is the one who employed him to conduct an audit. His ethical duty requires him to act independently and impartially.

Answer to TY 2

An auditor is supposed to make a professionally sound judgment in accordance to the knowledge and skills he possess while being independent and not acting under any pressure. Upon discovery of this fact, Wema is supposed to decide whether the omission to make entries for money received is inadvertent or malicious. Where he is tipped to allow access to the accounting books for correction, this is a clear case of malicious omission, which in this case Wema is supposed to strictly observe her code of ethics. However, where in his motion he allows access then this implied may show that the omission was not intentional. In this regard the auditor did not commit any offence.

Answer to TY 3

While preparing financial records for his clients an accountant should observe the following cardinal principles.

(i) Avoid a conflict of interest with a client or his own interest with that of the beneficiaries of the audit. This conflict may arise from his relationship with a client or his being a beneficiary of the outcome of his work.

(ii) He should avoid negligent misstatement by using all his skills and knowledge. He must ensure his statements comply with acceptable standards of accounting practice, failure of which may result into professional liability.

(iii) He should not audit financial statements prepared by him

(iv) He should not assume the role of an employee or of management conducting the operations of the entity

SECTION C

CRIMINAL WRONGS ASSOCIATED WITH ACCOUNTING PROFESSION

C2

STUDY GUIDE C2: THEFT, FRAUD AND FORGERY

Get Through Intro

Any person who fraudulently and without claim of right takes anything capable of being stolen, or fraudulently converts to the use of any person other than the general or special owner thereof anything capable of being stolen, is said to steal that thing (s. 258 of the Penal Code).

Fraud is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

Forgery involves making of a document by effecting or altering contents such as name and signature so as to cause others to think a name and or signature is that of the authorized person.

Theft, fraud and forgery, which are discussed in this Study Guide, are some of the ways by which an organisation may be defrauded. Knowledge of these concepts will enable accountants and auditors to identify such occurrences in their place of work, which in turn will enable to find out preventive and corrective actions to prevent their occurrences.

Learning Outcomes

a) Explain the meaning of theft, fraud and forgery.
b) State the basic elements of theft, fraud and forgery.
c) Identify and state the basic laws relating to theft, fraud and forgery.
d) Distinguish between fraud and forgery.

Explain the meaning of theft, fraud and forgery.
State the basic elements of theft, fraud and forgery.
Identify and state the basic laws relating to theft, fraud and forgery.
Distinguish between fraud and forgery.
[Learning Outcomes a, b, c and d]

1. Theft

1.1. Meaning

Section 258(1) of the Penal Code defines the offence of theft. The section provides that any person who fraudulently and without claim of right takes anything capable of being stolen, or fraudulently converts to the use of any person other than the general or special owner thereof anything capable of being stolen, is said to steal that thing. Section 257 of the Penal Code describes things capable of being stolen. These are every inanimate thing whatever, which is the property of any person, and which is movable, is capable of being stolen.

Also every inanimate thing which is the property of any person, and which is capable of being made movable, is capable of being stolen as soon as it becomes movable, although it is made movable in order to steal it. Thus something may not be usually movable but if it is made movable so that it can be stolen it will be deemed capable of being stolen, even provided at a time of alleged theft it was movable.

1.2. Basic elements of theft

For an offence of theft to be established, the following elements must be proved.

a) Taking or conversion
b) the property of another person
c) a thing capable of being stolen
d) fraudulently and without claim of right

Theft may be committed by any person from within or without the organisation. For instance, section 272 of the Penal Code provides punishment for them when the offender is a director or officer of a corporation or company and the thing stolen is the property of that corporation or company.

According to section 258(2) a person who takes or converts anything capable of being stolen is deemed to do so fraudulently if he does so with any of the following intents:

a) an intent permanently to deprive the general or special owner of the thing;
b) an intent to use the thing as a pledge or security;
c) an intent to part with it on a condition as to its return which the person taking or converting it may be unable to perform;
d) an intent to deal with it in such a manner that it cannot be returned in the condition in which it was at the time of the taking or conversion;
e) in the case of money, an intent to use it at the will of the person who takes or converts it, although he may intend afterwards to repay the amount to the owner.

Test Yourself 1

While doing your revision and searching through the internet you come across a statement to the effect that the website of the parliament of Tanzania has been stolen, and that the office of the Director of Public Prosecution has been asked to undertake a study to locate required evidence and identify possible culprits for purposes of initiating prosecution.

Required:

Do you think a charge sheet with a count of theft is likely to succeed? Justify your answer.

Test Yourself 2

Is a Cow or Goat capable of being stolen?

Substantiate your answer with the appropriate legal provision, and if possible with case law.

2. Fraud

Definition

Fraud is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Two types of intentional misstatement are relevant to the auditor: misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

Fraudulent financial reporting involves intentional misstatement, including omissions of amounts or disclosures in the financial statements, to deceive financial statement used.

Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more capable of disguising or concealing misappropriations in ways that are difficult to detect.

IFAC Glossary of terms

The term fraud refers to the intentional misrepresentation of financial information by one or more individuals among management, employees or third parties. Fraud may involve manipulation of records or documents, misappropriation of assets, suppression or omission of the effects of transactions from records or documents, recording of transactions without substance or misapplication of accounting policies.

Misstatement is difference between the amounts, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. A misstatement of financial statements can arise from fraud or error.

A misstatement may result from the following: inaccurate collection and processing of data in the financial statements; omission of an amount or non-disclosure of any fact; incorrect accounting estimates by overlooking or misinterpreting facts; management's accounting estimates considered unreasonable by the auditor; or management's adoption and application of accounting policies considered inappropriate by auditor.

Fraud is covered under sections 314-318 of the Penal Code. In particular in this Study Guide we will cover fraudulent false accounting and false accounting by public officers. Section 316 provides that any person who, being a promoter, director, officer or auditor of a corporation or company, either existing or intended to be formed, makes, circulates or publishes, or concurs in making, circulating or publishing, any written-statement or account which, in any material particular, is to his knowledge false, with intent thereby to effect any of the following purposes:

a) to deceive or to defraud any member, shareholder or creditor of the corporation or company, whether a particular person or not;
b) to induce any person, whether a particular person or not, to become a member of, or to entrust or advance any property to, the corporation or company, or to enter into any security for the benefit thereof,

is guilty of an offence of fraud, and upon conviction is liable to imprisonment for seven years.

Therefore, fraud involves misrepresentation or making of untrue statement (including concurring to such untrue statement made by another person) whereas the maker of such statement such as an auditor or another person concurring with such statement knows that the statement made is false. The intention of making such a written statement or account must be to either deceive or defraud or to induce any person to do something of value on reliance of a statement whose maker or defender knows it to be false.

Therefore the three elements are: untrue statement made, circulated or published, with intent to defraud, deceive or induce a person whether in particular or not. This can be done by preparing (making) false financial statement, publishing untrue financial position of the company while knowing that the said company does not have such (healthy) financial position.

Also section 318 of the Penal Code provides that any person who, being an officer charged with the receipt, custody or management of any part of the public revenue or property, knowingly furnishes any false statement or return of any money or property received by him or entrusted to his care, or of any balance of money or property in his possession or under his control, is guilty of an offence of fraud and shall be upon conviction liable to imprisonment for seven years.

3. Forgery

Forgery involves making of a document by effecting or altering contents such as name and signature so as to cause others to think a name and or signature is that of the authorized person Forgery is defined by section 333 of the Penal Code as the making of a false document with intent to defraud or to deceive. Therefore there are three important elements in forgery namely: a document, containing false or untrue statement, and made with a fraudulent intent.

Since a document is key for establishing the offence of forgery section 334 describes alterations that do not amount to forgery and those that amount to making false documents for purposes of section 333 (that is forgery). A document first of all does not include a trade mark or any other sign used in connection with articles of commerce, though they may be written or printed**.** Section 335 describes incidents where a false document is made to be when a person:

a) makes a document which is false or which he has reason to believe is untrue;
b) alters a document without authority in such a manner that if the alteration had been authorized it would have altered the effect of the document;
c) introduces into a document, without authority whilst it is being drawn up, matter which if it had been authorized would have altered the effect of the document;
d) signs a document:
    i. in the name of any person without his authority whether such name is or is not the same as that of the person signing;
    ii. in the name of any fictitious person alleged to exist whether the fictitious person is or is not alleged to be of the same name as the person signing;
    iii. in the name represented as being the name of a different person from that of the person signing it and intended to be mistaken for the name of that person;
    iv. in the name of a person personated by the person signing the document, provided that the effect of the instrument depends upon the identity between the person signing the document and
    v. in the name of the person whom he professes to be.

Forgery may occur in daily life in respect of negotiable instrument such as a cheque, signing a letter in the name of a person without his authority etc. An intent to defraud may be presumed to exist if it appears that at the time when the false document was made there was in existence a specific person ascertained or unascertained, capable of being defrauded thereby, and this presumption is not rebutted by proof that the offender took or intended to take measures to prevent such person from being defrauded in fact, nor by the fact that he had or thought he had a right to the thing to be obtained by the false document.

Example

For instance if a wife signs a cheque in the name of her husband, the husband who is a signatory of an account kept by the drawee (Banker) without the authority of the husband, this will amount to forgery. This is because by signing a cheque in respect of a specific amount, a wife intended that a specified amount be debited from the husband's account by using a signature of the wife or presented as husband's signature and without the consent of the husband.

The person intended to be defrauded whether is the husband or the bank provided in any case there is a person to be defrauded (notwithstanding the position in such cases as who will be defrauded, the wife has commited forgery.

Distinguishing between fraud and forgery

Fraud	Forgery
Fraud involves entering untrue entries or evidencing untrue fact by issuing of receipts or representing a company or any other institution that it has a financial calibre which in fact it does not have while being aware of the false nature of the position or statement pretended.	Forgery involves making of a document by effecting or altering contents such as name and signature so as to cause others to think a name and or signature is that of the authorized person,
The three elements are: untrue statement made, circulated or published, with intent to defraud, deceive or induce a person whether in particular or not.	Three important elements in forgery are a false or untrue statement, fraudulent intent and a document
Fraud is covered under Section 314 to 318 of the Penal Code.	Forgery is covered under Section 333 to 335 of the Penal Code.

Answers to Test Yourself

Answer to TY 1

In order to answer this question, we must first ask ourselves whether a website is a property of someone, and if so, whether it is capable of being stolen. A property can be tangible or intangible. A website is an intellectual property belonging to the parliament of Tanzania. It therefore suffices the test of being a property of someone. The definition of theft under section 258(2) uses the words “takes” or “fraudulently converts”. Since a website is intangible it cannot be taken rather it can be fraudulently converted to the use of another person with intent to permanently deprive use or access by the owner or an intent to deal with it in such a manner that it cannot be returned in the condition in which it was at the time of the taking or conversion. In this regard a charge sheet of constructive theft may stand to the culprits, however it will fail test of moving and thus the DPP may not be successful.

Answer to TY 2

A cow or Goat is a tame animal and therefore capable of being stolen, as stipulated under section 257 of the Penal code cap.16. “Every tame animal, whether tame by nature or wild by nature and tamed, which is the property of any person, is capable of being stolen.”

STUDY GUIDE C3: BRIBERY, CORRUPTION AND ALLIED OFFENCES

Get Through Intro

Bribery and corruption affects the quality of the financial statements. Existence of such practices in a company also indicates that there is no honesty in dealings with shareholders and the concerned entity is not adhering to the corporate governance principles of transparency and honesty.

This Study Guide identifies the basic laws relating to bribery, corruption and allied offences. Knowledge of this Study guide will help you in advising your employer when faced in a situation involving bribery.

Learning Outcomes

a) Identify and state the basic laws relating to bribery and corruption.

1. Identify and state the basic laws relating to bribery.
[Learning Outcome d]

1. Meaning of bribery

Bribery is said to have taken place when a financial or another advantage: is provided / offered to another person to perform a function/activity inappropriately; is provided (directly / through a third person) to a public official to obtain a business advantage; is received by a person to perform a function / activity inappropriately. For example, a public servant may be paid some money (by a construction company) in order to be awarded the contract to build a bridge.

2. Adverse effect of bribery on financial information

Corruption and bribery are illegal. So, when entities pay/receive bribes or undertake any corrupt practices, such transactions cannot be reported honestly. However, as the inflow/outflow of cash affects the company, the entity generally uses creative accounting (like payment of bribe is recorded as an expense and the receipt of bribe may not be recorded in the books of accounts) to record such transactions. This in turn affects the accuracy of the financial information provided to the users of financial statements.

The laws which criminalise bribery, corruption and allied offences include:

a) The Anti-Money Laundering Act, No. 12 of 2006;
b) The Prevention and Combating of Corruption Act, No.11 of 2007;
c) The Economic and Organised Crimes Control Act Cap 200 R.E. 2002;
d) The Public Procurement Act No. 9 of 2011;
e) The Public Procurement Regulations, 2013
f) Evidence Act, Cap. 6 R E 2002;
g) Election Expenses Act, No. 1 of 2010;
h) Political Parties Act Cap. 258 R E 2002;
i) Mutual Legal Assistance Cap. 254 R E 2002;
j) Criminal Procedure Act, Cap. 20 R E 2002;
k) Penal Code Cap. 16 R E 2002;
l) The Finance Act, No. 4 of 2017.

3. Root causes of corruption in the business sector

For many years, corruption has been defined as the abuse of public office for private gain. This definition has recently been criticised as being narrow in scope as it excludes corruption in the private sector. The Prevention and Combating of Corruption Act requires private sector entities to develop measures to fight corruption in their places. A World Bank expert Daniel Kaufmann, has provided an illustrative list of the key areas that involve governmental discretionary powers that attract. The list includes:

a) Issuing licenses, permits, quantitative import restrictions (quotas), passports, customs and border-crossing documentation, and banking licenses.
b) Implementing price controls.
c) Blocking new firms and investors from entry to markets and providing monopoly power.
d) Awarding public procurement contracts.
e) Granting subsidies, soft credits, tax exemptions, and inflated pensions and allowing tax evasion.
f) Imposing foreign-exchange controls resulting in multiple exchange rates, the over-invoicing of imports, and the flight of capital.
g) Allocating real estate, grain storage facilities, and telecommunications and power infrastructure.
h) Selectively enforcing socially desirable regulations such as those that apply to public health and the environment.
i) Maintaining obscure or secret budgetary accounts or otherwise facilitating "leakages" from the budget to private accounts.

4. Some measures for reducing and combating corruption in the private sector

Businesses can play a substantial role in helping to make this developmental goal a reality. Transparency International has suggested six ways in which business can help to fight corruption:

i. By being conspicuously transparent, operating with integrity and accountability in all operations.
ii. By publically disclosing and regularly monitoring strong anti-bribery and anti-corruption systems throughout all operations and those of subsidiaries.
iii. By publishing financial accounts for each country of operations and publishing clearly what is paid to each government in taxes, concession fees and other contributions. This not only builds trust in the company but is also a deterrent to extortion and people can see if the money paid by business to governments is accounted for.

iv. By listing who the real beneficial owners of their company and their subsidiaries are, and by promoting with governments the establishment of public registers of beneficial owners.

v. By supporting and promoting governance reforms in all state institutions at all levels including at the local level to ensure that they perform well and for the betterment of society.

vi. By initiating and supporting collective action with civil society organisations, labour, academic institutions and governments, business can multiply the capacity for action.

SECTION C

CRIMINAL WRONGS ASSOCIATED WITH ACCOUNTING PROFESSION

C4

STUDY GUIDE C4: MONEY LAUNDERING

Get Through Intro

Money laundering means bringing illegally obtained money into the mainstream legal economy. Money launderers, from dishonest traders to terrorists, aim to deposit their illegally-obtained money into financial institutions and banks. If they succeed in doing this without being caught then they can use the money for any transaction.

Auditors have an ethical and, at times, legal obligation to prevent, detect and report money laundering activities to the appropriate authorities. This Study Guide is important as it deals with the accountant's duties with reference to money laundering.

Not only does money laundering deprive the government of taxes but it is also a way by which organised crime flourishes and terrorists source money to fund their activities. International efforts to combat money laundering are increasing and the accountant must perform his role accordingly

Learning Outcomes

a) Identify and state the basic laws relating control of money laundering in Tanzania.
b) Identify and state stages of money laundering, state sources and techniques of money laundering.
c) Explain the duties of an accountant in anti-money laundering legislation.

Identify and state the basic laws relating to money laundering.
[Learning Outcome a]

1. Laws relating to money laundering

The basic laws relating to money laundering are as follows:

1.1. The Anti-money laundering Act

This is the main law relating to anti-money laundering. The Act makes provisions for prevention and prohibition of money laundering, the disclosure of information on money laundering, the establishment of a Financial Intelligence Unit and the National Multi-Disciplinary Committee on Anti- Money Laundering and provides for other matters related to the fight against money laundering. The financial intelligence unit is central for receiving reports on suspicious transactions whereas the national multi-disciplinary committee is a supervisory and advisory body for the money laundering scheme law enforcers.

1.2. The Proceeds of crime Act

This Act creates a legal mechanism for combating the proceeds of crime and for recovering stolen assets.

1.3. Mutual Assistance in Criminal Matters Act

This Act provides for mutual legal assistance in criminal matters involving more than one country. Most importantly the assistance relates to request for enforcement of forfeiture orders, pecuniary penalties and interdicts against property. This Act also contains definition of money laundering in relation to serious narcotics offence.

1.4. The Economic and Organized Crime Control Act

This Act makes provision for the control and eradication of certain crime and culpable non-criminal misconduct through prescription on modified investigation and trial procedures. In 2016, this Act was amended by Act No. 3 of 2016 to establish the Corruption and Economic Crimes Division of the High Court which has powers to try economic offences.

Identify and state stages of money laundering, state sources and techniques of money laundering.
[Learning Outcome b]

2. Stages of Money Laundering, Sources and Techniques of Money Laundering

The term "money laundering" is defined under section 3 of the Anti-Money Laundering Act as engagement of a person or persons, direct or indirectly in conversion, transfer, concealment, disguising, use or acquisition of money or property known to be of illicit origin and in which such engagement intends to avoid the legal consequence of such action and includes offences referred in section 12. Elsewhere, the term "money laundering" has been defined as "the criminal practice of filtering ill-gotten gains or "dirty" money through a series of transactions, so that the funds are "cleaned" to look like proceeds from legal activities".

The people who carry out money laundering include drug traffickers, corrupt politicians and public officials and terrorists, amongst others. However, it could also be companies selling obsolete goods for a decent price, but not recording the money in the official books.

Example

Ron obtained money from smuggling. In order to clean this money, he went to an antiques shop and bought an antique piece of furniture for $120,000 in cash. He then sold this piece of furniture for $90,000 (being quite prepared to suffer the apparent loss). This time Ron asked for a cheque that could then be paid innocently into a bank account, making the money look legitimate.

Money laundering is driven by criminal activities and conceals the true source, ownership, or use of funds. The International Monetary Fund has stated that the aggregate size of money laundering in the world could be somewhere between 2 and 5 per cent of the world's gross domestic product. Money laundering is a diverse and often complex process that need not involve cash transactions.

2.1. Stages of money laundering

Money laundering basically involves three independent steps that can occur simultaneously: placement, layering and integration.

Placement: the launderer inserts the illegitimate money into a legitimate financial institution. This can be done by breaking up large amounts of money into less conspicuous smaller sums that are then deposited directly into a bank account or by purchasing a series of monetary instruments (cheques, currency exchange, money orders, etc.) that are then collected and deposited into accounts at another location.

Layering: layering involves moving the money through various financial transactions to change its form and make it difficult to locate the original source. Layering may involve several bank-to-bank transfers, wire transfers between different accounts in different names in different countries, making deposits and withdrawals so that the amount of money in the accounts varies continually, or purchasing high value items such as diamonds to change the form of the money

Layering conceals the audit trail and provides inscrutability.

David, who has illegitimate money, opened a bank account in a foreign country where the anti-money laundering legislation is not so strict. He first put his money into a shell bank (see below) and then wire transferred $8 million into the newly opened bank account.

After some days, he gave $7.5 million to Ill Co (which is not a genuine company) and then Ill Co repaid $8 million including interest.

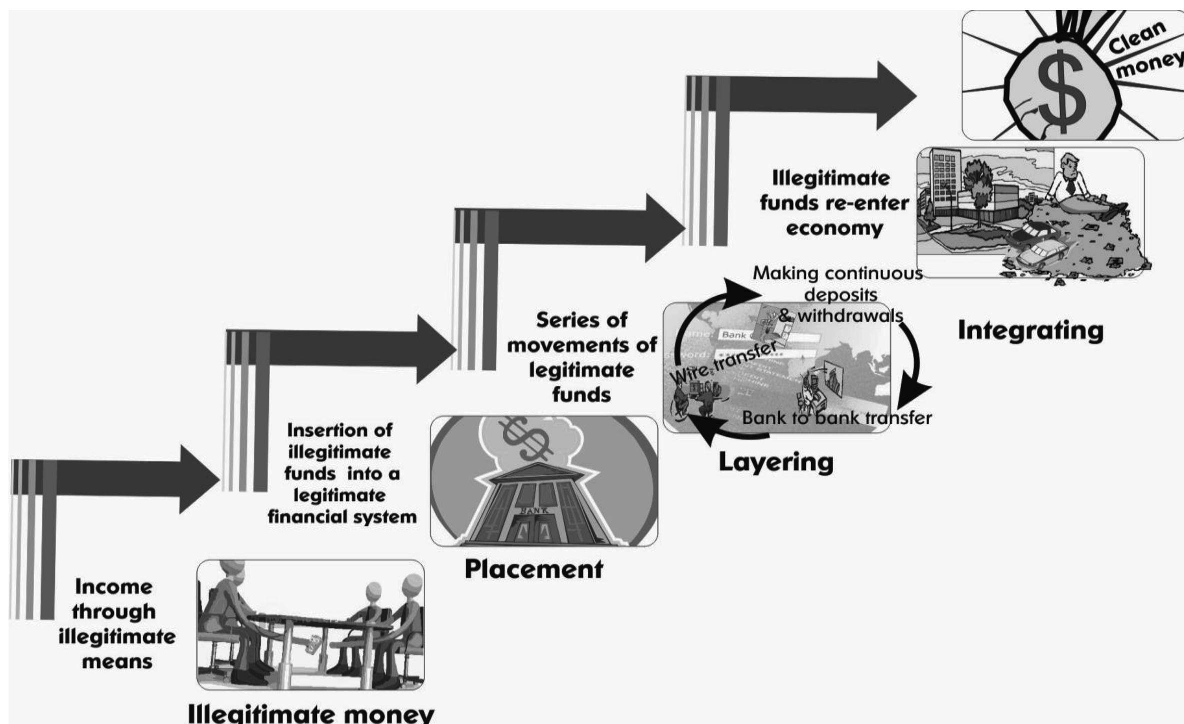
In this way, David layered money obtained from illegitimate sources through a shell bank, another genuine bank and Ill Co so as to conceal the audit trail.

"**Shell bank**" means a bank incorporated in a jurisdiction in which it has no physical presence and which is unaffiliated with a regulated financial group.

Integration: the illegitimate funds re-enter the legitimate economy in a legitimate form. At this stage, it becomes very difficult to catch a launderer if there is no documentation during the previous stages. Therefore launderers can use the money without getting caught. The launderer might choose to invest the funds into real estate, luxury assets or business ventures.

The steps can also be known by the terms, hide, move and invest.

Diagram 1: Money laundering process

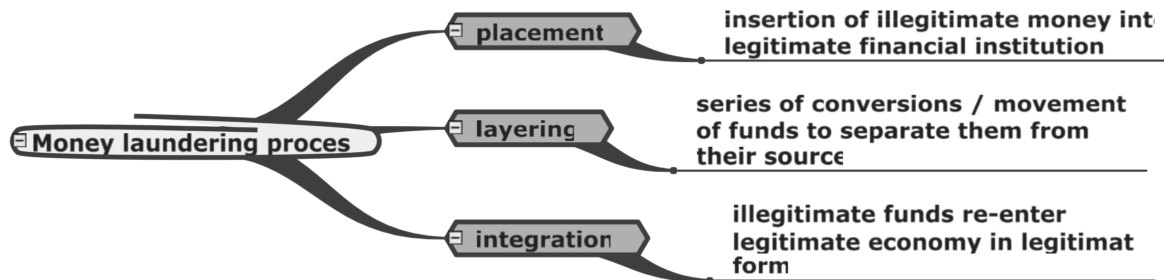


Earlier, the term money laundering was used to describe only the financial transactions with respect to organised crime. The definition has now expanded to include any financial transaction which generates an asset or a value as the result of an illegal act such as tax evasion or wrong accounting.

Example

Tom trades in cement. Jerry is his auditor. While auditing the financial statements, Jerry noticed that some of the supporting documents for purchases and expenses were missing. In addition, Tom cannot provide explanations for some large deposits in his personal account. In this case, Jerry has reason to suspect that Tom has been laundering money by overstating expenses.

SUMMARY



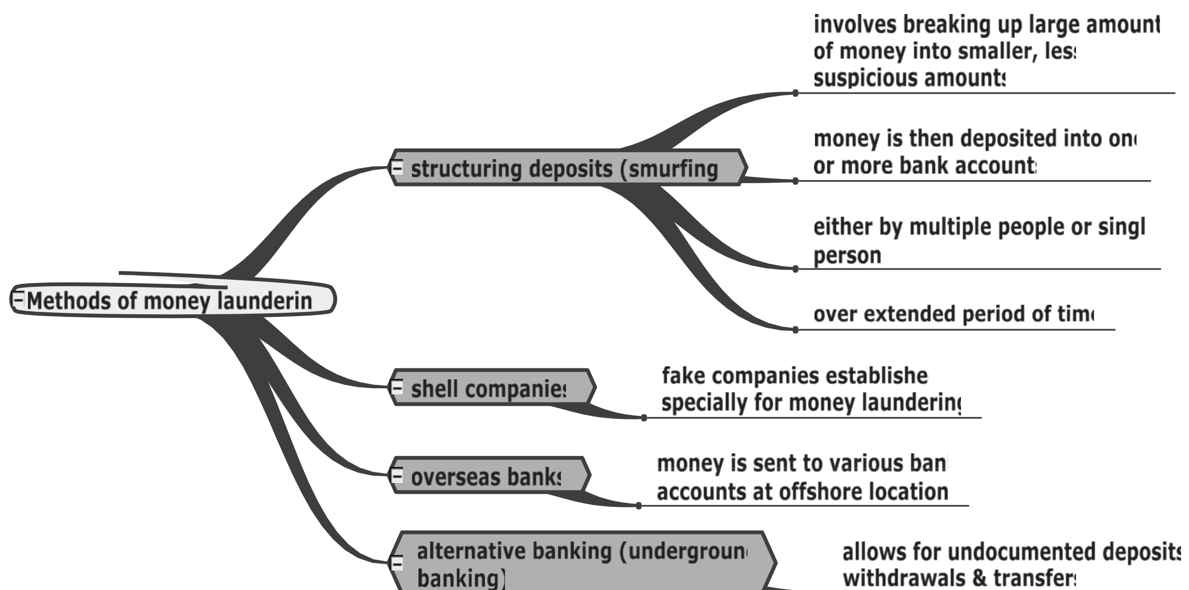
2.2. Money laundering sources and techniques

Certain methods of money-laundering are known to the regulatory authorities and several others have yet to be uncovered. The following are some well-known and common methods of money laundering:

1. **Structuring deposits (smurfing):** this method entails breaking up large amounts of money into smaller, less suspicious amounts. The money is then deposited into one or more bank accounts either by multiple people (smurfs) or by a single person over an extended period of time. This method is also known as smurfing.
2. **Shell companies:** these are fake companies that exist for the sole purpose of money laundering. They accept illegal money as "payment" for goods or services but no goods or services are actually provided. These companies simply create the appearance of legitimate transactions through fake invoices and SOFP.
3. **Overseas banks:** money launderers often send money through various bank accounts in certain offshore locations / countries. These locations / countries allow anonymous banking for all purposes. A complex money laundering scheme could involve hundreds of bank transfers to and from offshore banks. According to the International Monetary Fund, the major offshore centres include the Antilles, the Bahamas, Bahrain, the Cayman Islands, Singapore and Panama.
4. **Alternative banking (underground banking):** some countries have well-established, alternative banking systems that allow for undocumented deposits, withdrawals and transfers. These are trust-based systems with ancient roots that leave no paper trail and operate outside the control of government. Examples include the “Hawala” system in India and the “fie chen” system in China.

Smart launderers use a combination of these methods to make it more difficult for others to trace the transaction.

SUMMARY



Test Yourself 1

Sara works as a senior lecturer in a renowned educational institution. The institution credits her salary directly into her salary (bank) account. In addition, she gives private tuition to students at her home. She accepts the tuition fees only in cash and deposits the cash in another bank account in small amounts.

For household and other expenses, she withdraws money from the bank account in which her salary is deposited. She has disclosed the salary income to the income tax department and therefore paid tax only on her salary income.

At regular intervals, she withdraws money from the bank account in which she deposits the tuition fees and uses it to purchase jewellery.

Last year, she sold some jewellery and bought a flat in an expensive area.

Required:

Explain the meaning and process of money laundering with reference to Sara's case.

Explain the duties of an accountant in anti-money laundering legislation.
[Learning Outcome c]

3. Duties of an Accountant in Anti-Money Laundering legislation

Section 3 of the Anti-Money Laundering Act places an accountant in the categories reporting persons for the purposed of anti-money laundering. Under section 15 of the Anti-Money Laundering Act any reporting person including an accountant as the case may be has the following obligations:

a) take reasonable measures to satisfy himself as to the true identity of any applicant seeking to enter into a business relationship with him or to carry out a transaction or series of transactions with him, by requiring the applicant to produce an official record reasonably capable of establishing the true identity of the applicant;
b) in relation to politically exposed persons, in addition to performing normal due diligence measures an accountant as a reporting person has obligation to:

    i. have appropriate risk management systems to determine whether the customer is a politically exposed person;
    ii. obtain senior management approval for establishing business relationship with such customer;
    iii. take reasonable measures to establish the source of wealth and source of funds; and
    iv. conduct enhanced on-going monitoring of the business relationship.
c) establish and maintain customer records,
d) report suspicious transactions,
e) establish and maintain internal reporting procedures, and
f) ensure that no person shall open or operate an account with a bank, financial institution or any other reporting person in a false, disguised or anonymous name.

Suspicious transactions have to be reported to the Financial Intelligence Unit (FIU). The functions of the FIU include and are related to: receiving and analyzing reports of suspicious transactions submitted by the reporting persons pursuant to section 17; disseminate any such reports to the appropriate law enforcement agencies if, after having considered the report, FIU has reasonable grounds to suspect that, the transaction involves money laundering or any other predicate offence; disseminate to the appropriate law enforcement agencies any information derived from a suspicious transaction report if it gives the FIU reasonable grounds to suspect that, a transaction involves the proceeds of crime or financing of terrorism.

Test Yourself 2

John deals in narcotic drugs and obtains a lot of money out of that business; as a result John is a renowned dealer of real estate in the state of United Republic of Wajanja Wasafi.

Required:

With reasons state whether John is involved in money laundering

Answers to Test Yourself

Answer to TY 1

Money laundering is the act of changing the appearance of money that comes from illegitimate sources so that it appears to be legitimate money.

Money laundering refers to any financial transaction which generates an asset or a value as a result of an illegal act. This includes tax evasion.

The money laundering process involves three steps.

1. **Placement:** after earning illegal money, the launderer inserts the illegitimate money into a legitimate financial institution. This can be done by breaking up large amounts of money into less conspicuous smaller sums that are then deposited directly into a bank account or by purchasing a series of monetary instruments (cheques, money orders, etc.) that are then collected and deposited into accounts at another location.

   In this case, Sara deposited the tuition fees in a separate account. She did not disclose this income to the income tax authorities and therefore avoided paying tax on it. Sara's intention must have been to hide the money in order to avoid the tax liability. She deposited the money in a separate bank account in small lots and thereby placed the money in a legitimate financial institution.

2. **Layering:** it involves moving the money through various financial transactions to change its form and make it difficult to locate the original source.

   Sara deposited the money in small lots and withdrew the money at regular intervals. She used this money to purchase jewellery (and finally she purchased a flat using that money). This shows that she is layering i.e. trying to move money through various channels so as to make it difficult to trace the source.

3. **Integration:** the illegitimate funds re-enter the legitimate economy in a legitimate form. At this stage, it becomes very difficult to catch a launderer if there is no documentation during the previous stages therefore launderers can use the money without getting caught. The launderer might choose to invest the funds into real estate, luxury assets or business ventures.

Using the money she received from selling the jewellery, Sara purchased a flat. In this way she integrated her money in one place.

Answer to TY 2

John is involved in money laundering because he is involved in illegal business of selling narcotics and thereafter cleans his money by dealing in real estate so as to disguise authorities and the public that his money is legal and clean.

SECTION D

CIVIL LAW FOR BUSINESSES AND PROFESSIONAL ACCOUNTANTS

D1

STUDY GUIDE D1: LAW OF CONTRACT

Get Through Intro

The law of contract is one of the very basic and essential subjects in the field of business law. This is because it forms the foundations of all principles of contractual relations applicable in other areas of business law such as law of agency, law of sale of goods, law of higher purchase, law of negotiable instruments and law of partnership among others.

This Study Guide discusses the various features of a contract, the consequences of breach of a contract, how a contract is terminated and so on.

Law of contract also forms the foundation for understanding the various principles of the law of consumer protection. Therefore, students studying business law must take keen interest in this subject. By understanding the basic principles of the law of contract, students, and later practitioners, will be able to make sound decisions in other types of specialised contracts, some of which are mentioned above.

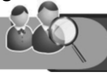
Learning Outcomes

a) Explain what a contract is and how it differs from an agreement.
b) State the essential elements of a valid contract.
c) State the remedies for breach of contract.
d) State the ways in which a contract can be discharged

Explain what a contract is and how it differs from an agreement.
[Learning Outcome a]

1. Meaning of a contract

A contract is an agreement enforceable by law (s. 2(1)(h) of the Law of Contract Act). It is an agreement between two or more parties intended to have legal consequences. An agreement is defined under 2(1)(g) to mean every promise and every set of promises forming the consideration for each other. Therefore a contract is an agreement with legal force. It should be noted that not all agreements amount to a contract; it is only those agreement which have legal binding nature that are contracts.



Example

Ajay and Ben enter into an agreement. Ajay promises Ben to sell his house for £15,000 and Ben accepts to purchase it for the said amount.

This is a contract between Ajay and Ben where Ajay is the Offeror and Ben is the offeree.
The promise to pay £15,000 is the consideration by Ben.
The promise to sell the house is the consideration by Ajay.

Definition

Contract is “an agreement enforceable by law for a specific consideration”.

Tip

Contract = Agreement + Enforceability + Consideration

1.1. Understanding the terms 'contract' and 'agreement'

As a general rule, a contractual relationship is the relationship that comes into being as the result of two voluntarily consenting parties coming to an agreement to enter into such a relationship. Traditionally, parties who wish to enter into serious business are expected to have an idea of what each part is willing to give and/or take in exchange for a promise from the other party. In doing so, such parties are expected to accept or reject the terms of a contract proposed by the other side.

Upon consideration of facts and all surrounding circumstances, one party is expected to make a voluntary decision to be bound or not by the terms of the contract against the other party. However, this approach to understanding the law of contract has been challenged on the basis of some developments in this field of law. These include:

(a) Situations where terms of contract and existence of a contract are determined by the court on the basis of what parties have said, written or done through an objective test and not necessarily by the express intentions of their minds.

(b) Existence and legal recognition of standard form of contract such as in cases of mass supply of public services such as electricity or water where terms are fixed by the respective boards leaving customers with no option of negotiating terms of such contracts.

(c) Some laws relevant to public policy or consumer protection mandate the modification of freedom of contract. Examples may include public policy on rent under the Land Acts.

(d) Some terms of contract are implied by the law to the contract irrespective of the fact that parties to the contract have negotiated and agreed on such terms. These include some implied terms under the Employment and Labour Relations Act No.6 of 2004 on hours of work, overtime pay, types of leaves and terms under the Sale of Goods Act Cap. 214 R.E. 2002.

(e) If the agent operates within the orbit of his apparent authority, his acts will bind the principal under the law of agents even in the absence of actual authority from the principal. In such circumstances, if an agent enters into a contract in the circumstances described, might bind the principal whereas the principal never intended to enter into such contract.

Nevertheless in legal terms, a term 'contract' refers to an agreement which is enforceable by law. The phrase 'enforceable' has also been interpreted differently. For example Abbott *et al* refer to the term as meaning the ability of parties to the contract forcing a party to the contract to perform his part of bargain under the terms of a contract through the mechanisms of a court of law. Looked at in this context, the author's challenge this definition arguing that it is not always the case that parties will secure a remedy of specific performance from a court but rather a common remedy which is damages. However another way of understanding the phrase 'enforceable by law' is that the agreement must be capable of being secured by the operation of law through various means because not all agreements can be secured by law.

1.2. Difference between contracts and agreements

A contract must result from agreement. But not all agreements are contracts because not all agreements can be secured by the operation of law. Section 2(1) (e) of Cap 345 provides that 'every promise and every set of promises, forming consideration for each other, is an agreement'.

The criteria for determining contracts which are secured or enforceable by law are stated in section 10 of the Law of Contract Act. It provides that all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.

What is important to draw from this provision is that for an agreement to be enforceable by law it must meet some prescribed tests including those mentioned under section 10 of the Law of Contract Act and others recognized by common law. Thus the next part discusses the essential elements of a valid contract.

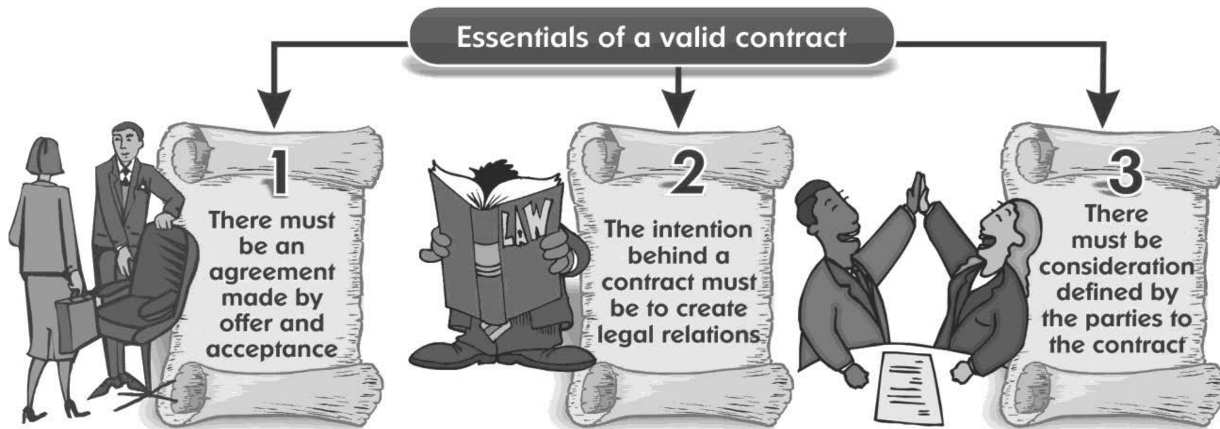
State the essential elements of a valid contract.

[Learning Outcome b]

2. Essentials of a valid contract

There are three essential elements**,** which would be examined by a court as evidence of any contract. These are: by offer and acceptance, intention to create legal relations and consideration. In addition to these, there are other elements such as capacity to contract, legality of object and certainty of terms.

Diagram 1: Essentials of a valid contract



2.1. Offer and an acceptance

A contract is a bilateral agreement between two or more parties. Every contract has to go through the following stages of:

a) an offer being made
b) negotiations among the parties which lead to a settlement
c) acceptance of the offer for a consideration

Therefore, the presence of an offer and its acceptance are of utmost importance for any contract to take place.

Example

Lee promises Chee to sell his car for £5,000 and Chee accepts to purchase it for that amount. Lee is said to be the offeror and Chee, the acceptor. An offer becomes a promise when it is accepted.

An offer must be distinguished from an invitation to treaty. On the one hand Invitation to treat refers to terms which aim at inviting people to approach the owners of the goods or to respond to the advertisements by making an offer.

Its terms are usually uncertain, ambiguous such that it is not known exactly as to whether the proposer intends to be bound by them and they tend to beg for further questions i.e. not capable of acceptance. Common example here include auctions, display of good even with price tags, advertisements and tenders.

On the other hand the terms must be clear and certain. Clarity and certainty are essential because the person to whom the proposal is made must be in a position to know what the offer constitutes. Things such as Price, description, quantity are very important. Section 29 of the LCA provides for the relevancy of certainty, lack of it renders the contract void.

Further, an offer must be firm and final expression by the proposer of his willingness to be bound should his offer be accepted. Where, the offeror keeps on changing the statement, in law that is not an offer. An offer may be made either expressly or impliedly. It must be communicated to the person for whom it is intended. Communication of an offer becomes effective when it is complete i.e. when comes to the knowledge of the person to whom it was made, S.4 (1).

2.2. Intention to create legal relations

A contract which is governed by the law of contract must be made with a view to creating legal relations.

Example

David is leaving for a business trip. He promises his daughter that he will bring her a camera. This cannot be considered a contract as he does not intend to bind himself legally.

However, if David, while leaving the office, makes a written agreement with James that he will bring goods according to his description for a given price then this can be considered a contract. This is because both parties mutually intend to bind themselves legally.

Case Study

(a) Balfour v Balfour (1919) 2 KB 571

In this case, the defendant, who was working in Ceylon, went on a holiday to England with his wife. At the end of the holiday, his wife fell ill and was advised to remain in England for medical treatment. Before returning to Ceylon, the husband promised to pay £30 a month to his wife for her maintenance. Initially, he sent the amount regularly. However, he stopped paying as certain differences between them led to their separation. By the time of the separation, the allowance had fallen into arrears, so the wife brought an action to recover the arrears.

Court's decision
The wife's action was dismissed. It was held there was no indication that the arrangement was intended to be a contract. While rejecting the wife's claim, Lord Atkins observed: "there are agreements between parties which do not result in contracts within the meaning of that term in our law. The ordinary example is where two parties agree to take a walk together, or where there is an offer and acceptance of hospitality. However, they are not a contract because the parties did not intend that they shall be attended by legal consequences."

(b) Jones v Padavatton (1969) 1 WLR 328

In this case, a mother made an offer to her daughter that she would pay for her daughter's expenses if she lived in England and went to a law school there. The daughter returned to England and lived in a house purchased by her mother. The daughter also collected maintenance on behalf of her mother, for the rent collected from the tenants of the house. Later, the mother tried to break the agreement and repossess the house.

Court's decision
It was held that there is insufficient evidence to rebut the presumption against domestic arrangements. There was no intention of the mother and daughter to create a legal relationship. Hence, there was no binding contract between the mother and the daughter.

2.3. Consideration

Consideration is necessary for the formation of every contract. Consideration is the incentive, price or motive that causes a party to enter into an agreement or contract. It is something of value that is given in exchange for receiving something from another person.

An informal promise without consideration is not actionable in law even though the promisor may have acted upon it to his detriment.

Example

John wanted to go for an important meeting. David promised John to drive him to the station at the right time. However, David failed to keep his promise, as a result of which John missed the train and ultimately missed the meeting.

In this situation, John cannot take any action against David for the loss of potential benefits from the meeting as the promise made by David was an informal promise, without consideration.

Tip

Every contract is an agreement between two or more parties. Hence all the parties to the contract must have some agreed consideration.

Example

Alden enters into a contract with Bayol whereby he agrees to pay £500 to Bayol if Bayol's horse wins the race. Bayol's horse wins the race and he claims £500 from Alden.

Bayol is not entitled to get £500 from Alden because there is no consideration from his side. The contract contains no condition because of which Bayol will have to pay Alden some consideration. Hence this is not a valid contract.

2.4. Capacity to contract

The parties must be competent to contract. Capacity refers to a person's ability to enter into a contract. In general, all adults of sound mind have full capacity to contract. However the capacity of certain individuals is limited. Section 11(1) of the Law of Contract Act provides that every person is competent to contract if he is of the age of majority, is of sound mind and is not disqualified from contracting by any law to which he is subject. Any agreement with a person who is incompetent to contract is void.

a) **Contracts with a minor**

A minor is a person below the age of 18 years. The contractual capacity of minors is restricted by law to prevent them from entering into disadvantageous agreements. However, not all contracts entered into by a minor are void. Agreements entered into by minors may be classified within three possible categories: valid contracts, voidable contracts and void agreements.

Definition

Valid contracts: a valid contract is one which has all the essential elements of contract i.e. agreement, intention to create legal relations, and consideration, and which is legally enforceable.

There are two types of valid contracts which can be enforced against a minor: contracts for supply of necessaries and beneficial contracts of service. Necessaries refer to things that are necessary to maintain a minor. However, whether any particular goods supplied are necessary or not will depend upon the facts and circumstances of each case. Generally it refers to goods and services which are most essential for the survival of human life. It includes food, clothing, shelter, medical and legal aid.

It also varies from person to person subject to his social status and family background. What is a luxury to one person may be a necessary to another.

Example

A car is a luxury for a poor boy whereas it may be a necessary for a prince who hails from a royal family.

The necessaries must be things which the minor actually needs. It is not enough that they be of a kind which a person of his condition may reasonably want for ordinary use. Items, which are generally necessaries, will prove to be unnecessary if the minor is already supplied with items of that kind. Whether the other party knows this fact or not will be held immaterial.

Case Study

Nash v Inman (1908)

In this case, a tailor supplied an undergraduate minor with some clothing. The minor was studying at Cambridge University. The clothing consisted of 11 fancy waistcoats at the price of two guineas each. It was proved that the Cambridge undergraduate already had a sufficient supply of clothing for his position in life.

It was held by the Appellate Court that the tailor was not entitled to be reimbursed for the supply of clothing as he failed to prove that the clothing was suitable to the minor's actual requirements at the time of sale and delivery. The crux of the case is that, although the clothes were suitable according to the minor's station in life, they were not necessary, as he already had sufficient clothing. This shows that the supply of more than adequate clothing can be considered not to be supply of necessaries.

Beneficial contracts of service

A minor is bound by a contract of apprenticeship or employment, as long as it is, on the whole, for his benefit.

Case Study

Doyle v White City Stadium (1935)

Doyle, a minor, was granted a professional boxer's licence, which was treated as a contract of apprenticeship. The licence provided that he would be bound by the rules of the Boxing Board of control. According to one of the rules, the Board had the power to retain any prize money if he was ever disqualified in a fight. Doyle claimed that the licence was void, as it was not for his benefit.

Court's decision

It was held that, in spite of the penal clause, the licence, taken as a whole, was beneficial to him. Hence the conditions of the licence were held enforceable.

There are some contracts which may bind the minor. They remain valid until cancelled by the minor. These contracts are binding on the minor, unless they are expressly disclaimed by the minor during the period of minority or within a reasonable time after attaining the age of majority.

Example

Fancy, a minor and a very famous child artist enters into a contract with a film producer to do a lead role in his film after she becomes a major. However, this contract is voidable at the option of Fancy on becoming a major.

If she does not expressly disclaim fulfilling the contract within a reasonable time after attaining majority, then the contract will be binding on her.

---

a) Mental incapacity and intoxication

A contract entered into by a person who is of unsound mind or under the influence of drugs, or drunk is *prima facie* invalid. Such a contract can be held void if the person in contract proves that: at that time his mind was so affected that they were incapable of understanding the nature of their actions. That other party either knew or ought to have known of their incapacitation. In any case, however, the person claiming such incapacity must pay a reasonable price for the goods supplied to them.

Test Yourself 1

Sunny went to a bar. There he met Bobby, who was a painter. Sunny made an offer to Bobby that he paint his farm house for £500. Bobby accepted the offer. Sunny gave him the address of the farm house, the keys and £100 as an advance.

The next day Bobby went to Sunny's farm house and painted the farm house. However Sunny refused to pay the balance amount. He claimed that he was under the influence of alcohol and hence was unable to make a rational decision. In your opinion, is the contract valid?

---

b) Disqualifications by law from contracting

A person may be disqualified from entering into a contract by any law to which he is subjected. For instance, section 137(1)(t) of the Bankruptcy Act provides that it is an offence for a person who has been adjudged bankrupt to contract any debt without having reasonable expectation of being able to pay it.

2.5. Free consent

Section 13 of the Law of Contract provides that two or more persons are said to consent when they agree upon the same thing in the same sense. Consent is said to be free when it is not caused by duress (coercion), undue influence, misrepresentation, fraud or mistake. These are technically known as vitiating factors to a contract.

a) **Duress (Coercion)**

Duress is some element of force, either physical or economic, which is used to override one party's freedom to choose whether to enter into a particular contract or not. Such contracts are voidable at the insistence of the innocent party. In order rely on the doctrine of duress the claimant must prove that the pressure exerted against his will resulted in an absence of choice on their part. The pressure must be of such a nature as is forbidden by the Penal Code (s. 15 of the LCA).

Example

Armstrong threatened to kill Barton if he did not sign a contract. This contract will be set aside due to duress to Barton.

b) Undue influence

A contract is said to be influenced by 'undue influence' when all the essential elements of undue influence are satisfied. As per section 16 of the LCA, the elements of undue influence are that: the relationship between the parties is such that one of the parties is in a position to dominate the will of the other; the influence has been used by one of the parties to obtain an unfair advantage over the other; and unfair advantage is in fact obtained.

Example

Alan advances some money to his son Bobby because Bobby has financial problems in his business. When Bobby's financial problems end, Alan obtains a contract from Bobby for a greater amount than the sum due in respect of the advance.

The facts of the case need to be compared with the essential elements of undue influence that:

1. The relationship between the parties is that of father and son. The father is in a position to dominate the will of his son.

2. The father uses his influence to obtain a greater amount than the sum which is due.

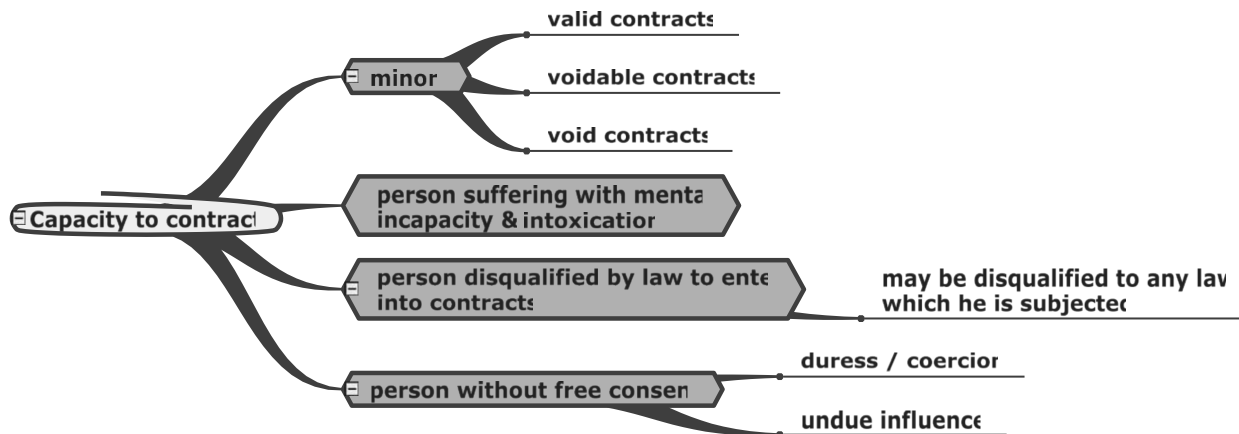
3. Unfair advantage has been obtained as there is already a contract between Alan and Bobby.

As all the essential elements of undue influence are satisfied, this is a case of undue influence.

Tip

While considering this example, the important points that are essential for undue influence are briefly summarised in the answer. It is recommended that you follow this technique in the exam. This gives the examiner an idea of your understanding of the topic and will earn you more marks

SUMMARY



Test Yourself 2

Brown approaches a bank for a loan at a time when banks generally are not giving loans. The bank declines to give the loan except at an unusually high rate of interest. Brown accepts the loan on these terms. Do you consider this to be a case of undue influence?

2.6. Legality of object

A contract that breaks the law, or whose object is carry out unlawful object is void. The courts have recognised that any contract that tends to prejudice any social or economic interest of the country must be forbidden. However, contracts that would be contrary to public policy depend on the facts and circumstances of the case under consideration. Some examples of illegal contracts are:

a) Contracts prohibited by statute.

Example

A contract to employ a child in a factory is illegal since the Employment and Labour Relations Act prohibits employment of children in hazardous environment.

b) Contracts to defraud tax authorities

Example

A contract showing a sale price which is less than the actual price and accepting the difference in cash without disclosing it to tax authorities is an illegal contract.

c) Contracts involving commission of crime

Example

A contract to smuggle narcotics

d) Contracts against the interests of Tanzania.

Example

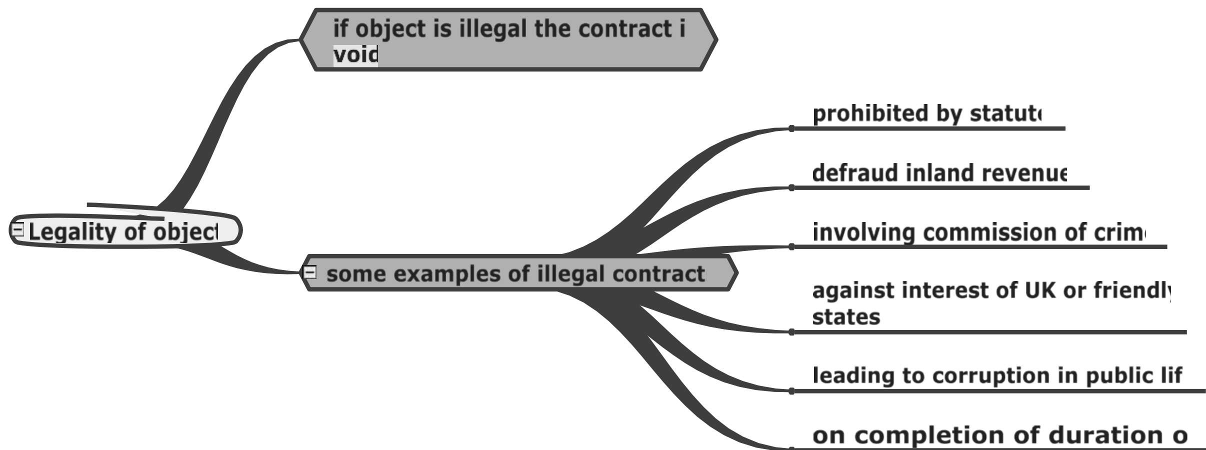
A contract to sell weapons to an enemy state

e) Contracts which interfere with the court of justice

Example

A promise to indemnify a person who will not appear to testify in court is considered illegal.

SUMMARY



2.7. Certainty of terms of contract

The terms of the contract need not be vague. They must be certain and definite. The intentions of the parties to a contract must be clearly indicated by the terms of contract.

Example

Annie makes an offer to Bob to supply her with 100 metres of cloth. Here, the terms of offer are not clear since the type of cloth, colour, and price is not mentioned.

Case Study

Taylor v Portington (1885): a contract is not enforceable if the terms are vague and uncertain.

The claimant in this case, promised to take the defendant's house on lease for a period of three years provided, "it was thoroughly repaired and the drawings in the rooms are decorated according to the latest style.

It was held that the contract was not enforceable, since the terms were vague and uncertain. The latest style is a vague term and what amounts to a through repair could be uncertain.

Test Yourself 3

Is an agreement for service with relatives or friends legally enforceable?

Test Yourself 4

David, a man enfeebled by disease and age, is induced by his medical attendant, Baul's influence over him, to agree to pay Baul an unreasonable sum for his professional services. Is the contract affected by undue influence?

State the remedies for breach of contract.

[Learning Outcome c]

3. Meaning and effects of breach of contract

Whenever there is a contract there are different indicators of performance of such contract against which one can determine whether a contract has been performed, breached or is about to be breached according to the nature of things. Thus the terms of a contract may specify the deliverables of a contract or what is to be done such as painting a house, building a house, ship etc. Not only do contracts specify what is to be done but also the time within which the agreed action is to be performed and the required quality. In construction of a house for example, the contract may specify the quality of materials to be used. For goods the terms of contract may specify the amount (quantity), quality of goods, the time of delivery and place of delivery.

Failure to comply with any of the above conditions depending on the nature of each case amounts to breach. Thus breach of contract means failure of a party to a contract to perform any of his obligations under the contract as required by the terms of contract. Breach of contract also includes an indication by a party to a contract before the set date for full performance of contract that he will not perform his part of bargain on the agreed date. Breach of contract in simple terms means breaking or violating a law, right, or duty, created by a contract either by commission or omission.

Definition

Breach of contract is an unjustified failure to fulfil the duties under the contractual terms when the performance is due.

A breach of contract occurs when one of the parties to the contract fails to perform its part of the agreement either fully (completely fails to perform) or partially (performs in a defective manner). The court may award remedies against the party committing the breach of contract.

Tip

The most common remedy awarded by the courts is damages.

A contract can be breached in the following ways:

1. When one party does not perform as promised

Example

June promised Melinda that she would handle all the financial accounts of Melinda's boutique for a monthly payment of Tsh 20,000. At the end of the month, Melinda refuses to pay.

This is breach of contract because Melinda did not perform as she had promised.

2. When one party does something that makes it impossible for the other party to perform its duties under the contract.

Example

Sam, who is a baker, entered into a contract with Tom to sell 500 pastries to Tom on Christmas day. However, Tom declared himself bankrupt on 21 December.

In this case, Tom has breached the contract by Tom. Sam could not sell Tom the pastries as Tom was bankrupt and not in a position to pay for the pastries.

3. When one party makes it clear that it does not intend to perform its contractual duties.

Example

Ron promised Rosa that he would sell her a set of diamond jewellery on the first day of the next month. However, he sold the same set to Rosemary on the twenty fifth of the current month.

This is a breach of contract by Ron as, by selling the set of diamond jewellery to Rosemary, Ron made it clear that he does not intend to perform his contract with Rosa.

Not all breaches of contract are necessarily "contract killers" which would end up in a lawsuit. Much would depend on whether the breach is "material" or "minor" and who the parties are.

4. Types of Breach

a) **Minor breach**

A minor breach is a partial breach or an immaterial breach. The non-breaching party is not discharged from performing the contract but is entitled to damages arising from the breach.

A homeowner hires a contractor to install new plumbing and insists that the pipes, which will ultimately be sealed behind the walls, are red. The contractor uses blue pipes instead. The blue pipes function just as well as the red pipes.

Although the contractor breached the literal terms of the contract, the homeowner cannot compel the contractor to take out the blue pipes and fit the red pipes. However, he can recover the amount of his damages. If no damage is caused by the contractor, the homeowner receives nothing.

b) **Material breach**

A material breach is any failure to perform the obligations under a contract that permits the other party to the contract to either compel performance or to sue for damages because of the breach. Material breach is also referred to as fundamental breach. When it occurs, it permits the innocent party to terminate the contract and sue for damages.

Consider the example given in minor breach above. If the contractor was instructed to use copper pipes but instead he used iron pipes which do not last as long as copper pipes the homeowner can recover the cost of correcting the breach i.e. taking out the iron pipes and replacing them with copper pipes.

Photo Production Ltd v Securicor Transport Ltd (1980)

In this case, the claimants (Photo Production Ltd) hired the defendants (Securicor Transport**)** to guard Photo Production's building. The contract between Securicor and Photo Productions contained an exclusion clause that relieved Securicor Transport from any liability for “damages caused by any employee of the company."

One of the security guards of Securicor Transport, while patrolling Photo Production’s building, intentionally started a fire that destroyed the whole building. The issue was whether Securicor could rely on the exclusion clause to escape liability for their employee's conduct.

Photo Productions argued that the exclusion clause could not apply. They claimed that Securicor Transport had entirely failed to perform their contract. Therefore, the doctrine of fundamental breach was applicable whereby the whole agreement became invalid.

Court’s decision

It was held that the exclusion clause precluded all liability even when harm was caused intentionally. Hence, Photo Production’s claim for fundamental breach was rejected.

In the above case, if the exclusion clause had not been inserted in the contract, then the claimant’s claim for fundamental breach of contract might have succeeded.

c) **Repudiatory breach**

To repudiate means to reject or to disclaim. Where a party to a contract, either by words or by conduct, indicates that he does not intend to honour his contractual liability, this is a repudiatory breach of contract. The repudiatory breach does not automatically discharge the contract but gives the aggrieved party the choice of either affirming the contract or to treat the contract as repudiated by the other party.

Case Study

White & Carter v McGregor (1961)

McGregor contracted with the claimant to have advertisements placed on litter bins which were supplied to local councils. He then wrote to cancel the contract but the claimants opted to advertise as agreed. They produced and displayed the adverts as required under the contract and then claimed the payment**.**

Court's decision

It was held that the claimants were not obliged to accept the defendant's repudiation. Repudiation does not, of itself, bring the contract to an end. It gives the innocent party the choice to affirm or reject the contract. The claimants were entitled to recover the agreed price for their services.

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d) **Anticipatory breach**

Anticipatory breach arises when one of the parties to a contract repudiates the contract before the time of performance. There is indication that the party will not perform when performance is due, or a situation in which future non-performance is foreseeable.

Example

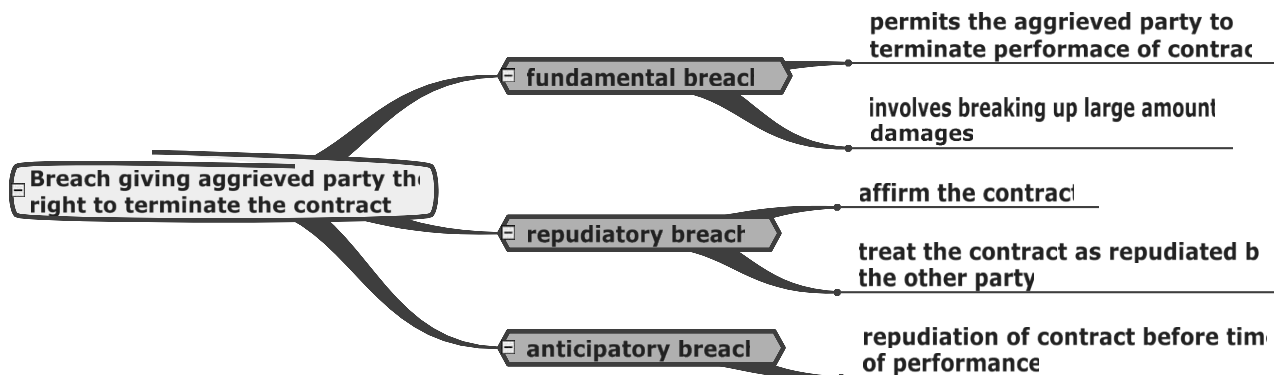
Lara, a singer, enters into a contract with John, the manager of the theatre, to sing at his theatre on Christmas Eve. The contract was entered into on 1 November. John agrees to pay her Tsh5,000 for the performance. However, on 15 November, John enters into a similar contract with a celebrity singer. The invitation cards and advertisement boards of the event do not mention Lara's name. Moreover, John does not even call Lara for rehearsals for the event.

John's conduct indicates that he does not intend to honour his contract with Lara. This is an anticipatory breach of contract.

Anticipatory breach may be express or implied. Express anticipatory breach occurs when the party who breaches the contract declares expressly that they will not perform the act **(Hochster v De La Tour (1853)).** Implied anticipatory breach occurs when a party carries out some act which makes the performance impossible **(Omnium Enterprises v Sutherland (1919)).** An anticipatory breach gives the non-breaching party the option to treat the breach as immediate, and, if repudiatory, to terminate the contract and sue for damages (without waiting for the breach to actually take place).

In **Hochester v De La Tour (1853)**, the claimant was engaged by the defendant to serve as his courier and accompany him on a tour. The claimant was to begin service on 1 June. On 11 May he was informed by the defendant that his services were no longer required. The claimant brought an action on 22 May i.e. even before the scheduled time of performance had arrived. The defendant claimed that any action against him can be taken only after 1 June. It was held by the court that the claimant was entitled to bring the action even before the time of performance.

SUMMARY



5. Consequences of a Breach of Contract

As opposed to discharge of contract which may be lawful or mere fulfilment of the contractual obligations by each party to the contract, breach connotes a legal wrong entitling the innocent party to some rights. When the innocent party accepts the breach of contract he becomes relived from contractual obligations. Since the party breaching the contract commits a civil wrong the innocent party is entitled to remedies which may defer in nature depending on the circumstances of each case.

Remedies can be defined as the means by which an innocent party to the contract may get relief from the pain (damage caused or likely to be caused by the breach of contract, albeit, as far as law can do. Nditi defines remedies as means by which the violation of a right is prevented, redressed or compensated. The following are different remedies for breach of contract available to the innocent party.

5.1. Damages

Damages are legal means to compensate an innocent party for loss suffered as a result of breach of contract. It is legal means because it may be sometimes impossible to put the injured person into exactly the same position as he would be had the contract been performed. It is implemented in the form of money as compensation to the injured party "in so far as money can do". Damages are a right of a party who has suffered damage as a result of breach of contract in order to compensate him for the damage suffered.

5.2. Restitution

Restitution arises in a situation where the innocent party claims back his performance or the value thereof from the party who breaches the contract without performing any part of his contractual obligations. Restitution provides right of the innocent party to be placed in the same position as if the contract had never been entered.

5.3. Equitable remedies

Equitable remedies are typically granted when legal remedies or monetary compensation cannot adequately resolve the wrongdoing. It is often a requirement that legal damages be unavailable before a court will decide to issue equitable relief. These remedies include specific performance, injunction, and recession.

i. **Specific performance**

The remedy of specific performance means the party in breach is ordered by court to perform his obligations under the contract. As stated earlier, breach of contract does not automatically discharge a contract and relieve parties from obligations. The innocent part may, instead of accepting breach and become relieved of the obligations of the contract, decide to apply to court to obtain an order forcing the defaulting party to perform his part of the bargain. The remedy of specific performance is not readily available. According to the case of **Fothergill v. Rowland**, it is available only where the remedy is capable of enforcement by the court. For example such a remedy is not readily available for contracts which require personal services such as the obligation to play a piano. It is may also not be available for contracts requiring extensive supervision such as building contracts especially when a person with the required skills in both cases is unable to do the part of bargain. This remedy is usually obtainable at the discretion of the court especially in circumstances where money (damages) is not a practical remedy.

ii. **Injunction**

An injunction is an order of the court restraining a party to the contract from doing a certain action. For example, where there is anticipatory breach, a party who is supposed on a certain date to perform at a ceremony, buys an air ticket to travel abroad whereas it is known there are no means for him to return and perform on a fixed date by the contract, an innocent party may apply to the court for an order to restrain him from travelling abroad.

Also an injunction may be issued ordering a party to take down an advertising sign erected in breach of contract. This could occur for instance as a result of contract between employer and employee that should the employee terminate employment, employee shall not engage in similar business as that of employer or solicit employer's customers by any means.

In **Warner Brothers v Nelson** an actress entered into an agreement with the plaintiff that during the period she was acting for the plaintiff she would not act for someone else without the written consent of the plaintiff. It was held that a remedy of injunction was available to the plaintiff to restrain the defendant from breaking this undertaking. Thus it can be said that injunctions may be grouped as mandatory; that is, an injunction forcing a party to a contract to do something like taking down an advertising sign if a court makes a finding that such a sign was erected in breach of contract; or prohibitive injunction where the court issues an order to prohibit a person from doing something. For instance court may issue an order to prevent the breach of a reasonable restraint of trade clause.

Test Yourself 5

Explain briefly the remedy of specific performance.

State the ways in which a contract can be discharged

[Learning Outcome d]

6. Discharge of Contract

Discharge of contract means bringing a contract to an end. Contracts give rise to serious obligations imposing restraint on the freedom of the parties to it on the way they can conduct themselves during the period within which a contract is in force. A person may conclude a contract today and realise there was a better deal tomorrow than the one he has contracted for and so on.

Thus it is relieving to hear that contracts are never without doors out. It is said that if parties get into contracts voluntarily through their free consent, there should be ways of bringing contracts to an end. The following part deals with the means by which a contract may be discharged or terminated.

6.1. Discharge by agreement

Contract may be discharged by agreement when both parties agree to bring the contract to an end and release each other from their contractual obligations. Discharge by agreement may be in the following ways:

(a) Release/waiver

Waiver may be defines as the intentional abandonment (giving up) of the rights by one party who is entitled to claim performance of the contract. Upon waiver, the other party is discharged from performing his obligations under the contract.

Case Study

Williams v. Raffey Bros&Nicholls Contractors Ltd

In this case the defendant engaged the plaintiff as carpenter and the two agreed on the price. The plaintiff commenced work but soon after commencement realised that the agreed price was too low and could not work under such terms and complete the work on time as agreed and required by the defendant's clients.

The defendant promised to pay the plaintiff an additional amount as part of fees. Soon after the defendant has paid a certain sum of the additional amount the plaintiff stopped working and the defendant had to complete the work himself. Nevertheless the plaintiff sued for the additional sum and the court held that the defendant having waved his right under the original contract and having received the benefit of completing the work in time as a result of paying the additional sum to the plaintiff the claim of the plaintiff was enforceable.

Thus discharge by waiver or release occurs where a party forbears, for instance to insist on performance at the agreed time unless there is a clear indication by the forbearing party that the original terms have to be restored.

(b) Accord and satisfaction

Accord and satisfaction occurs where there is a release supported by fresh consideration. In this case, the agreement to the effect that the contractual obligation is discharged is the 'accord' whereas the consideration which makes the agreement enforceable is the satisfaction and such satisfaction may be executory. Section 63 of the Law of Contract Act provides that every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may accept instead of it any satisfaction which he thinks fit.

In **British Russian Gazette and Trade Outlook Ltd v. Associated Newspapers Ltd,** it was held that **"**Accord and satisfaction is the purchase of a release from an obligation arising under contract or tort by means of any valuable consideration, not being the actual performance of the obligation itself. The accord is the agreement by which the obligation is discharged. The satisfaction is the consideration which makes the agreement operative".

(c) New agreement (novation): s 62 LCA

Novation occurs when a party to a contract agrees to release the other party to the contract by substituting that contract with a new one either between themselves or with a third party. All of the three parties must agree to such arrangement. Section 63 of the Law of Contract Act provides that if the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed.

In M**/s Musilanga Engineering v. Rf. Nyakutonga Nyamgesera** and Another, Musoma Foodstuff Trading Company owned by the sons of the first defendant, were indebted to the plaintiffs for timber supplied to the company. The defendants by a letter undertook to pay the plaintiff the company's debt by supplying them 720 bags of cement. The court held that by virtue of the letter a new contract was created between the plaintiff and the defendant instead of the original contract between the plaintiff and Musoma FoodStuffs Trading Company. The Court went on to hold that, the doctrine of novation recognises that one party to a contract can release the other and substitute a third person who then undertakes to perform the released person's obligations.

6.2. Discharge by performance

When the parties to a contract fulfill their obligations arising out of the contract within the time and in the manner prescribed, the contract is said to be discharged by performance. Under normal circumstances when a party fully performs his part of bargain he becomes fully discharged from the obligations of the contract. At common law there exists a requirement of exact performance. If the terms of contract required payment of money or delivery of goods this must be done in the same agreed amount or quantity and at a place specified if any. Thus if the amount payable is Tshs. 5,000 by cash the contract will not be discharged if the debtor gives to the creditor a note of Tshs 10,000; the debtor will not be discharged because the creditor should not be forced to provide change unless there is no objection to that effect from the creditor. The same applies if payment is made by cheque; the debtor will not be discharged until the cheque is honoured by his bank.

In **Re Moore v Landauer** the agreement between the parties was to the effect that 3,000 tins of canned fruit packed in cases of 30 tins would be sold. The defendant discovered upon delivery that half the cases contained only 24 tins. Despite the fact that the total number of tins was still 3,000 and further fact that the market value was not affected, the Court of Appeal held that notwithstanding that there was no loss to the buyer, he was entitled to reject the whole consignment because of the breach of the requirement that goods must correspond with the description (see s.13 of the Sale of Goods Act).

6.2.1. The doctrine of substantial performance

If the plaintiff has substantially performed the contract he can institute an action for the contract price less a deduction for the deficiencies. However, this exception is only available in respect of quality of performance alone and not available in respect of failure to fully deliver goods as contracted for. For quantity related partial payment the general rule will apply.

In **Hoening v. Isaacks** the claimant agreed to decorate and furnish the defendant's flat for a certain amount of payment payable by two instalments and the balance on completion. The claimant completed the work but the defendant was unsatisfied with some of the furnishings and refused to pay the entire final instalment. The cost of the defects in the furniture he argued had also cost him. It was held that since the claimant had substantially performed the contract and was therefore entitled to the contractually agreed price minus the cost of the defects.

6.2.2. Partial performance

Where one party freely agrees to accept partial performance, then a sum is payable for the work completed. The main focus is on free acceptance. In **Sumpter v. Hedges** (1898) 1 QB 673 the plaintiff agreed to build a house at an agreed price and partially erected the building. As the work continued the plaintiff ran out of funds and hence stopped the construction. The defendant using the building materials that had been left on the site by the plaintiff completed the construction himself. When the plaintiff claimed his pay proportionate to the value of the work he had done plus the cost of his materials that had been used by the dependant to complete the work, he failed in his claim for the value of work done. In view of the court, the defendant though had accepted partial performance he had no option of rejecting that partial performance. This is because, construction of a building by its nature alters the status quo and therefore it was impossible for the plaintiff to reject the partial construction and retain the value of his property as it was before construction commenced. However, the plaintiff succeeded in respect of his materials used by the defendant to complete the building.

6.2.3. Divisible or severable contracts

This refers to contracts in which performance is to be measured by stages. A common example is a contract for building construction. Construction by its nature requires huge resources in terms of money, time and skills. Sometimes it is not possible to mobilise all the resources required at a go. There are two ways the example of construction of buildings may demonstrate this type of contracts. The first example refers to situations when one consulting company, let say an architectural firm is contracted to conduct a feasibility study for construction of a special economic zone in Tanzania.

This assignment commenced after a pre-feasibility study had been carried out by a different firm, and hence the client had made up his mind to embark on the actual project. The client however engaged the second consulting (architectural firm) in order to determine the scope of the project. Thus the client's contract with the architectural firm was both to conduct a feasibility study and design the special economic zone. This work is done in stages and the architectural firm was entitled to claim after completing the design for the feasibility study and later on claim payment after completion of the design for the special economic zone in Tanzania.

Assuming the architectural firm has commenced the designing of the special economic zone which is stage two as per the original contract, this second stage of the contract, may also be divisible or lump sum contract. In divisible or severed contract, the parties may agree that after the consulting firm has submitted the inception report it will be regarded as a specific stage entitling the consulting firm to claim payment for that stage. This is different from a lump sum contract where even though the consulting architectural firm may claim some amount proportionate to the work done it does not mean if it fails to complete the work and leave the client with just an inception report it will be automatically absolved from liabilities either for specific performance or payment of damages.

In Roberts v. Havelock the plaintiff entered into an agreement with the defendant to repair a ship. The contract did not specify at which stage payment could be claimed and paid. It was held that there was nowhere in the contract that could be construed to mean that the plaintiff could not claim payment of any amount until he completed the repair.

6.2.4. Party preventing performance

In cases where parties enter into a contract, the promisor commences performance but thereafter before full performance he is prevented by the promisee from continuing with such performance as per the terms of contract, such a prevented party may bring an action on the basis of quantum meruit. Quantum meruit refers to a reasonable sum of money to be paid for services rendered or work done when the amount due is not stipulated in a legally enforceable contract.

In **Planche v. Colburn** the plaintiff and defendant entered into a contract whereby the plaintiff was to write a Book on costume and amour. The Book was to appear in serial form in the defendant periodical. The agreement was to the effect that the plaintiff would be paid on completion. However, somewhere before completion but after the plaintiff had done some research, the defendant stopped publishing the periodical. It was held that the defendant having wrongly prevented the plaintiff from performing the contract, the plaintiff was entitled to quantum meruit.

6.2.5. Statutory requirement to perform

Section 37(1) of the Law of Contract Act provides that the parties to a contract must perform their respective promises, unless such performance is dispensed with or excused under the provisions of the same Law of Contract Act or any other law.

Thus, it appears the positions under common law and the Law of Contract Act are similar on the aspect of discharge of contract by performance.

6.2.6. Discharge by impossibility of performance or frustration

Frustration of a contract is a situation whereby it becomes impossible for reasons beyond the control of the parties to the contract to perform the contract. Such situation usually occurs after the parties have concluded a contract whereby some supervening event(s) makes the performance of a contract impossible. According to section 56 of the Law of Contract Act the doctrines of frustration involves: an agreement to do an act impossible in itself; a contract to do an act which, after the contract is made, becomes impossible or unlawful by reason of some event which the promisor could not prevent.

The supervening event making the performance of the contract impossible may be physical for example where the subject matter of performance burns down or is destroyed by any means. It can also be by operation of law such as where a thing contracted for becomes illegal to perform. Such law must have been passed after the contract had been entered into. Thus when such supervening event occurs without the fault of any parties to the contract it has the effect of discharging the parties.

The doctrine of frustration will apply in instances where the following conditions exist:

a) There is an unforeseeable event which has occurred and which was not or could not be contemplated by the parties at the formation of a contract
b) If by reason of a certain happening the contract if performed would be fundamentally different from the original contract;
c) When the impossibility of performance of a contract is a result of a thing for which neither of the parties was responsible;
d) An event will frustrate the contract if it can be proved that it results in a situation to which the parties did not wish originally to be bound.

6.2.6.1 Instances of frustration

The doctrine of frustration may apply in the following situations:

a) **Destruction of subject matter**

A defence of frustration will succeed where it can be shown that a thing essential or central to the performance of a contract was destroyed by reason not associated with a party to the contract thereby making performance of a contract impossible. In **Taylor v. Caldwell,** Caldwell had agreed to let a music hall to Taylor so that four concerts could be held there. Before the date of the first concert, the hall was destroyed by fire. Taylor claimed damages for Caldwell's failure to make the premises available. The court held that the claim for breach of contract must fail since it had become impossible to fulfil. The contractual obligation was dependent upon the continued existence of a particular object.

In **Howell v. Coupland** the parties entered into a contract of purchase and sale of a specified quantity of potatoes. Due to a disease, the defendant did not manage to get the quantity of potatoes from his farm and hence the delivery of potatoes to the plaintiff was affected. It was held that because the disease was a thing that could not be foreseen by the parties and that it was beyond the control of the defendant in the circumstances that existed, the contract was frustrated.

b) **Non-occurrence of contemplated event**

Where the contract is based on the occurrence of an event and the event does not occur the parties will be discharged from the obligation by operation of the doctrine of frustration. In **Krell v. Henry** the defendant Henry hired a room from Krell (the plaintiff in this case) for two days, to be used as a position from which to view the coronation procession of Edward VII. The contract deed did not make any mention of the purpose for which a room was hired and the contract itself made no reference to that intended use. The procession was cancelled (postponed) as a result of the King's illness. Henry has paid only one-third of rent to the plaintiff and the plaintiff sued in claim of the remaining one two third of rent. It was held that Henry was excused from paying the rent for the room. The holding of the procession on the dates planned was regarded by both parties as basic to enforcement of the contract. Thus it was held that since the procession considered in relation to the position of the room were fundamental to the contract the cancelation of the procession on the specified date frustrated the contract by and discharged parties from the contractual obligations.

However, **Krell v. Henry** is distinguishable where the event alleged to be the purpose for the parties to conclude an agreement is not considered to be central to the contract. In **Herne Bay Steamboat Co v Hutton**, Herne Bay agreed to hire a steamboat to Hutton for a period of two days for the purpose of taking passengers to Spithead to cruise round the fleet and see the naval review on the occasion of Edward VII's coronation. The review was cancelled due to the illness of the king, but the boat could have been used to cruise round the assembled fleet. It was held that the contract was not frustrated. The holding of the naval review was not the only event upon which the intended use of the boat was dependent. The other object of the contract was to cruise round the fleet, and this remained capable of fulfilment.

On the basis of the above two decisions for the defence of frustration to succeed in favour of a person who fails to perform his part of bargain as resulting from non- occurrence of a certain event, he must show that the occurrence of such event constitutes the whole mark of the contract for him to succeed. The occurrence of the contemplated event may seem to be having been taken into account by the contracting parties when making agreement but if it is not the sole purpose or major purpose for the contract it will not be taken to have frustrated the contract; that is discharging the parties from the obligations under the contract.

c) **Death or incapacity of party for personal service**

Frustration on ground of death or incapacity of a party to the contract occurs when if the person was so central to the performance of the contract especially if the performance of such a contract depends on the specific skills of a person. In **Robinson v. Davison**, the illness of a person who was central to the performance of a contract was considered. This case considered the issue of frustration of a contract and whether or not a concert organiser could recover damages from a woman who was contracted to perform at the concert but failed to do so due to illness. In this case there was no contract between the plaintiff and the defendant's wife.

The wife of the defendant was a renowned pianist and the defendant entered into a contract with the plaintiff that the wife would play a piano at a concert to be held by the plaintiff on a specified day. The plaintiff incurred loss as a result of postponement of the concert. The postponement was caused by serious illness of the pianist leading to her failure to attend the concert. Rejecting the plaintiff's claim for damages the court held that not only was she barred from playing the piano for reason of illness as she was unfit to do so, but also that she was excused from obligation to play the piano on that particular day. On ground of incapacitation of a central person to the performance of a contract for provision of personal services the contract was declared frustrated.

d) **Government or legislative intervention**

This occurs where a law, regulation, order, declaration or rules issued by appropriate state authorities issues directives which render performance of the whole or part of the terms of contract illegal. In such an occurrence a contract becomes frustrated. The case of **Asha Soud Salim v. Tanzania Housing Bank [1983] TLR 270** demonstrates the application of the doctrine of frustration in this context. In this case the borrower (the deceased mother of the applicant, Asha Soud Salim) borrowed money from the Permanent Building Society (the Society), the latter, whose activities, assets and liabilities were later on taken over by the then Tanzania Housing Bank (THB).

The purpose of the loan was to construct a house. According to the loan contract, the borrower was to pay the principal sum and interest. The loan was advanced in 1959 payable in 20 years and the borrower was paying Tshs. 398/= as principal sum plus interest as required until December 1963. The borrower however passed away in January 1967. Meanwhile, in 1964 the Revolutionary Council issued a proclamation prohibiting charging of interests on moneys borrowed. It was ordered by this proclamation in respect of all loans that only the principal amount could be repaid, without interest.

In 1967, the applicant was appointed administrator of the estate of her deceased mother. The applicant lodged an application in the High Court to redeem the mortgaged house on the ground that she was ready to pay the whole of the principal sum plus interest which accrued to the lender up to 1964 when the proclamation prohibiting the payment of interests came into force.

The Respondent claimed to be repaid the principal sum and interest as contracted for, for the entire period including the period after which the proclamation had prohibited the charging and paying of interests on loans. However, since 1964 the borrower could not receive any rents on the house because the house was taken over by the Revolutionary Government in 1972. As a result, the applicant could not earn income from the house and hence could not pay the instalments to the lender.

It was held that the contract was frustrated by two things, both imposed on the parties generally by the state. The first frustrating directive was the occupation of the house by the state which denied the borrower any earnings from the house, which could assist her in paying the instalments. The second frustrating regulation was the government proclamation prohibiting payment of interests on money lent which could not be paid by the applicant without committing an offence because such payment of interests was prohibited and hence illegal.

6.2.6.2 Effects of frustration

Section 56(2) provides that a contract to do an act which, after the contract is made, becomes impossible (that is frustrated by virtue of impossibility; or, by reason of some event which the promisor could not prevent, or is unlawful) **becomes void** when the act becomes impossible or unlawful.

Section 65 of the Law of Contract Act, Cap 345 (R.E) 2002 provides in respect of void contract and the effect of frustration. Specifically, it provides that

> "When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person agreement from whom he received it".

The principal is that no one should benefit out of frustration unfairly. However, the proviso to section 65 provides that where a contract becomes void by the reason of frustration, and a party thereto incurred expenses before the time when that occurs in, or for the purpose of, the performance of the contract, the court may, if it considers it just to do so in all the circumstances of the case, allow such party to retain the whole or any part of any such advantage as aforesaid received by him, or discharge him wholly or in part from making compensation therefore, or make an order that such party recover the whole or any part of any payments or other advantage which would have been due to him under the contract had it not become void, being, in any such case, an advantage or part thereof, discharge or payment, not greater in value than the expenses so incurred.

Test Yourself 6

Explain the concept of novation.

Answers to Test Yourself

Answer to TY 1

The contract, prima facie, appears to be a valid contract. However, the contract can be held void if Sunny proves that:

(a) At the time of making the contract, his mind was so affected that he was incapable of understanding the nature of his actions.

(b) The other party i.e. Bobby either knew or ought to have known of his disability.

In any case, however, Sunny must pay a reasonable price for the work done by Bobby.

Answer to TY 2

Perhaps not, because this is a transaction in the ordinary course of business, because:

(a) The relationship between Brown and the banker is not of such a nature that the banker can dominate the will of Brown.

(b) The banker has not used any influence.

(c) Signing loan documents on agreed terms is a usual business practice.

Answer to TY 3

This depends on whether the two parties in question had the intention to enter into a legal relationship when they made their promises. If the promises were made casually on a social occasion, the law would presume that the parties had no such intention. If this presumption can be rebutted and the intention to enter into a legal relationship can be proved, then the agreement would be legally enforceable.

Answer to TY 4

Yes, as the relationship between the attendant and patient is such that the patient may be affected by undue influence. This is because a patient is physically and psychologically dependent on his attendant to look after him and finds himself handicapped without him. He fears that if the amount demanded by him is not paid, the attendant may not work for him or will become less concerned.

Answer to TY 5

The remedy of specific performance is an equitable remedy. It means the party in breach is ordered by court to perform his obligations under the contract. A breach of contract does not automatically discharge a contract and relieve parties from obligations. The innocent party may, instead of accepting breach and become relieved of the obligations of the contract may decide to apply to court to obtain an order forcing the defaulting party to perform his part of the bargain.

The remedy of specific performance is not readily available.

Answer to TY 6

Novation occurs when a party to a contract agrees to release the other party to the contract by substituting that party with a third party. All of the three parties must agree to such arrangement.

For example, suppose Alpha owes Beta Tshs 1,000 and Beta owes Delta Tshs 1,000. Alpha agrees to pay Delta, Beta will be released from the obligation to pay. However all of the three parties must agree to that arrangement. Section 63 of the Law of Contract Act provides that if the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed.

In M**/s Musilanga Engineering v. Rf. Nyakutonga** Nyamgesera and Another Musoma Foodstuff Trading Company owned by the sons of the first defendant, were indebted to the plaintiffs for timber supplied to the company. The defendants by a letter undertook to pay the plaintiff the company's debt by supplying them 720 bags of cement. The court held that by virtue of the letter a new contract was created between the plaintiff and the defendant instead of the original contract between the plaintiff and Musoma FoodStuffs Trading Company. The Court went on to hold that, the doctrine of novation recognises that one party to a contract can release the other and substitute a third person who then undertakes to perform the released person's obligations.

SECTION D

CIVIL LAW FOR BUSINESSES AND PROFESSIONAL ACCOUNTANTS

D2

STUDY GUIDE D2: THE LAW OF AGENCY

Get Through Intro

One of the most common legal relationships in business is agency. With the growth of industry, the intervention of a third party in the process of marketing, selling and licensing a company's products is a common feature. The channel of distribution involves distributors, retailers, company and independent sales representatives. The contractual arrangement between these various entities is critical.

The agreement between the parties must be very clear, detailed and unambiguous. This Study Guide deals with an agency relationship, how an agency relationship is created, and the legal authority an agency has under the provisions of law.

Learning Outcomes

a) Explain the concept of agency.
b) State and explain the nature of an agency relationship.
c) Identify situations where agency exists.
d) Identify and explain the nature and authority of agents.
e) Identify and explain the duties and rights of agents.
f) Identify and explain negligent actions or omissions and their consequences.

Explain the concept of agency.

[Learning Outcome a]

According to Fisher, agency refers to “the fiduciary relationship that arises when one person (a “principal”) manifests assent to another person (an “agent”) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.”

Thus, the relationship of principal and agent entails a representative character, which must be capable of being gathered from the facts of the relationship of the parties. Thus, in agency one person (agent) acts on behalf of the other (principal) and is so authorised to act.

Therefore, in effect, an agent is the connecting link between the principal and the third person - a sort of conduit pipe or an intermediary. This intermediary has the power to create a legal relationship between the principal and the third party. He has the competency to make the principal responsible to the third party.

Example

Julie wishes to sell her car. She appoints Jack as her agent to sell the car. Jack meets John and tries to sell him Julie’s car. Here,

Jack is the agent.
Julie is the principal.
John is the third party.

It is very important to understand here that the contract entered into is between the principal and the third party. The agent has no personal rights or liabilities in relation to the contract and cannot be bound by the contract.

1. **Definition of an agent**

Definition

Section 134 of the Law of Contract Act defines an agent as a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such an act is done, or who is so represented, is called the “principal”.

Thus, the basic duties of an agent are to do acts for the principal including concluding contracts which are binding between the principal and the third party. Even though the agent facilitates the conclusion of a contract he does not become a party to the contract himself. An agent can be employed by any person who is of sound mind and of age of majority according to the law to which he is subject.

The agreements entered by the agent with the third parties are binding on the principal as if they were entered into by the principal. Section 178 of the Law of Contract Act provides that contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner, and will have the same legal consequences as if contracts had been entered into and the acts done by the principal in person.

Thus, persons entering into contracts through agents are protected and the principal cannot avoid liability on mere reason that he was not personally a party to the contract or transactions. However, if a person (third person) entering into contract induces the agent to act upon the belief that the principal only will be liable, or induces the principal to act upon the belief that the agent only will be held that liable, such a third person cannot afterwards hold liable the agent or principal respectively. Thus the contract entered through agency creates liability on both the principal and agent.

However section 182 of the Law of Contract Act exempts certain types or categories of contracts where the agent is not bound by them nor is he capable of enforcing them. Such contracts are those in which (a) a contract is made by an agent for the sale or purchase of goods for a merchant resident abroad; (b) where the agent does not disclose the name of his principal; and where the principal, though disclosed, cannot be sued.

Thus, section 182 provides that for such categories of contracts an agent cannot personally enforce contracts entered into by him on behalf of his principal and that the agent is not bound by such contracts. This position can be altered however, by a contract contrary to this position of the law between the parties.

Test Yourself 1

Who is an agent?

State and explain the nature of an agency relationship.

[Learning Outcome b]

2. Who May be an Agent?

Section 136 of the Law of Contract Act differentiates the requirements as to who may be an agent in respect of Principal and third persons and the agency as between the Principal and the agent. In the former case, any persons may become an agent of the principal. It means, if the principal allows a person to act as his agent such as a salesman in a shop he will not be able to avoid claims flowing from contracts made between himself and third parties through his agent.

However, in the latter case, a person who is not of the age of majority and of sound mind, will not be bound by provisions of the Law of Contract is as far as the would-be principal, had the alleged agent possessing capacity to contract, is concerned. Thus where an agent does not possess full capacity to contract but his principal does, contracts concluded with third parties will be binding. Such contracts will not be rendered void for lack of capacity (i.e. under age) because the contract will be between third parties and the principal who must possess full contractual capacity.

3. Types of Agency

There are three main types of agency

1. Special agency- in such type of agency, the principal appoints an agent to perform a specific act such as purchase of or clearing of the car from the port.

2. A general agency- this occurs where by the nature of the relationship existing between the parties, the agent has powers to perform all actions which ordinarily fall within the power of the agent by virtue of the nature of business entrusted to such agent, examples could be a lawyer or employee or a partner. Section 140(2) of the Law of Contract Act provides that an agent having authority to carry on a business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such business.

3. A universal agency- in this case, an agent is appointed by a deed known as “power of attorney”. Such an agent has unlimited authority to perform any acts that his principal is capable of performing including execution of a deed on his behalf. Section 140(1) of the Law of Contract Act provides that an agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act.

Moreover, section 141 provides for the authority of an agent in an emergency. It provides that an agent has authority, in an emergency; to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

4. Appointment of the Agent and Creation of Agency

Section 135 of the Law of Contract Act provides that any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent. The Principal may give authority to the agent thereby appointing him as his agent either expressly or impliedly.

In **Garnac Grain Co Inc v. HMF Faure & Fairclough Ltd** the court emphasised that the relationship “can only be established by the consent of the principal and the agent”. However in **Branwhite v Worcester Works Finance** it was stated that consent so given need not necessarily be to a relationship itself. It is sufficient if “they have agreed to what amounts in law to such a relationship.”

However, no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal. For example under section 145 where an agent appoints a sub-agent without authority and the such an agent is not of sound mind or of the age of majority according to the law to which he is subject, the principal will not be able to hold such an agent responsible.

It is also important to note in respect of creation of agency that no consideration is necessary for creating an agency. This is an exception to the general rule. Even though agency is created by a contract through the agent and principal there is no requirement of consideration which is always required under an ordinary contract.

Ordinarily, it is expected that there is an express agreement whereby the principal appoints the agent to act on his behalf to the extent that the actions of the agent with third parties will affect the principal and the agent consents so to act. This is mostly done through a written agreement. An authority is said to be express when it is given by words spoken or written and to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted depending on circumstances of the case.

Thus, by virtue of section 138 of the Law of Contract Act which recognises that the appointment or authority of the agent may be express or implied, there are circumstances when the principal and agent may not be aware that there exits the relationship of principal and agent between them. Hence it is important to explain situations where the relationship of principal and agent may arise.

Test Yourself 2

Identify and explain the types of agency you know

Identify situations where agency exists.

[Learning Outcome c]

5. Establishing the relationship of principal and agent

Contract of principal and agent may arise where a contract can be implied from the conduct and relationship of the parties. Under this method the principal may appoint the agent to carry out a particular task or to perform a specific function.

Example

An agency may be created when a principal gives power of attorney to a person who will then become the agent.

In order to determine whether or not the relationship of principal and agent exist the court will apply the objective test (that is whether an ordinary reasonable man would have thought so) and if yes the relationship will be implied even if principal and agent did not recognise the relationship themselves.

The relationship of principal and agent is automatically implied in respect of partnership whereas a partner is deemed to be acting as agent for his co-partners if the contract concluded between such a partner and a third party is within the usual scope of the partnership businesses.

Section 201 of the Law of Contract Act provides that every partner is an agent of the firm and his other partners for the purpose of the business of the partnership; and that the acts of every partner who does any act for carrying on in the usual way of business of the kind carried on by the firm bind the firm and his partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter, and the person with whom he is dealing either knows that he has no authority or does not know or believe him to be a partner. Thus it appears that for a third party entering into contract with a partner in a disputed agreement, for him to be protected against the firm or other partners he must be aware and believe that the person he concluded an agreement with was a partner.

Example

Employer and employee, company and company director are implied agency relationship. Although an express agreement is not created, a director, by his position, has the implied authority to act on behalf of his company.

There are exceptions also listed under the same section 201 which limit the agency authority of a partner for his fellow partners or firm in respect of certain activities unless there is such usage or custom of trade or express authority so act. The exempted activities include the following:

a) Submission of a dispute relating to the business of a firm to arbitration;
b) Opening a bank account on behalf of the firm in the individual partner’s name;
c) Compromising or relinquishing any claim or portion of the claim by the firm;
d) Withdrawing a suit or proceeding filed on behalf of the firm;
e) Admitting any liability in suit or proceeding against the firm;
f) Acquiring immovable property on behalf of the firm;
g) Transferring property belonging to the firm; or
h) Entering into partnership on behalf of the firm.

An implied agency may arise by estoppel where a person by his own words or conduct represents another as having authority to make contracts on his behalf. The person so represented shall be bound by such contracts as if he had expressly authorised them. Such a person will be stopped by his conduct not to deny the existence of an agency.

Estoppel means that a person is not permitted to deny an inference which a reasonable man would draw from his words or conduct. An agency is created by estoppel or holding out when the principal makes other parties believe that he has authorised a person to represent him. In such a case, the person is not an agent of the principal but the third parties are under the impression that there is an agency relationship between the other person and the principal. If the third party acts on this belief, the principal will be held liable for the acts of that other person.

Example

Francis, a dealer in food items, directed his brother James not to give any guarantee of the freshness of packed food items while selling them. Despite this, James gave a guarantee to Annette that the juices he sold to her were fresh and that he would replace the entire carton if the juices were sour. The entire carton of the juice boxes had turned sour. Annette asked for the replacement.

Here, Francis is liable to replace the goods. His brother had the authority to sell the goods. On the basis of this, he also had ostensible authority to give the guarantee on the basis of which Annette purchased the juices. Francis could escape the liability only if Annette knew that Francis had instructed his brother not to give any guarantee. In the above case, Annette had no knowledge of Francis' instruction to James. Therefore, Annette was not bound by the instructions which Francis gave privately to his brother.

Test Yourself 3

Explain briefly how an agency relationship is established through estoppel

Identify and explain the nature and authority of agents.

[Learning Outcome d]

Section 138 of the Law of Contract Act provides that authority of an agent may be express or implied. Thus where an agent is given express authority to an act performed within the scope of the given authority, it will bind the principal and the third party. The most common form of agency is that of employee and employer. In such relationship the agent is employed to conduct a certain trade or business for the employer. Accordingly, agent has an implied authority to do whatever is incidental to such trade or business.

This will be so implied by the court regardless of the fact that the principal might have expressly told the agent not to do so. Such an act may be precluded from the scope of agency in respect of the third party, if the third party was aware of the lack of authority.

This is important for protection of third parties who honestly, given the custom of trade, believe that persons who have been authorised to do certain acts have authority to do certain specific act. For example, if a person was not authorised as an agent in a sales shop it would be difficult for third persons to know that such agents are not authorised to sell certain particular articles.

Case Study

Watteau v Fenwick (1893): creation of agency by way of implied authority

In Watteau v Fenwick the pub manager was restricted by the owner from buying tobacco on credit. That means even though agent (Humble) had general authority to deal with the business of managing the Pub the principal (owner of the hotel) had restricted the authority by not authorising him to buy tobacco on credit.

Watteau (the plaintiff) sold tobacco to the Pub Manager (the agent) under honest belief that the manager was the owner of the hotel. In actual fact, Humble, the manager and agent, was the exclusive face of the hotel business with his name appearing on the bar and licence of the pub. Despite the fact that Humble, knew that he was forbidden from buying any article outside of bottled ales and mineral waters, he still went ahead and purchased cigars under a binding contract and yet failed to pay.

The plaintiff later on discovered that the defendant was the owner of the hotel and brought an action for collection against the owner, as the principal of Humble. It was held that the plaintiff was entitled to rely on the usual authority of the agent to deal with the business of managing a pub house which was held in this case to include purchase of tobacco. Thus, the principal was found to be liable for damages resulting from contracts concluded by his agent who did so knowing that he was acting outside his authority provided the third party was not aware of such lack of authority to do such actions.

The above position is also supported by section 140(2) which provides that an agent having authority to carry on a business has authority to do every lawful thing necessary for purpose, or usually done in the course of conducting such business. Even though the principal may be entitled to some rights against the agent who knowingly acts outside his authority such as the right not to remunerate the agent and the right to compensation by the agent) but in as far as third party is concerned such an agent is presumed to have authority so to act.

6. Repudiation of Contract of Agency by Principal

Section 167 of the Law of Contract Act provides for the right of the principal to repudiate the transactions entered by the agent where the agent acts on his own account without obtaining the consent of the principal and the principal is of the view the that the dealings of the agent have been disadvantageous to him. This appears to be a general provision as opposed to the general powers conferred by section 140(2) discussed above whereby the agent acts in accordance to the custom of trade.

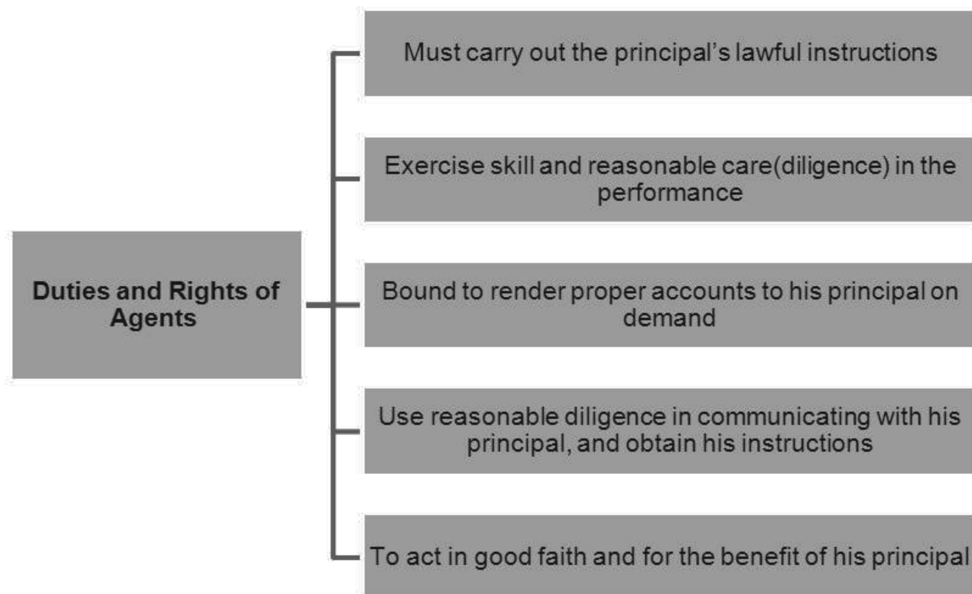
In the case of section 140(2) the court will use an objective test to determine what a reasonable man would have done or expected to have done in the business of that nature and it is construed to protect third parties who deal with the agent knowing he has the authority. Section 167 however seems to refer to the more general way in which the agent deals with the agency and how he carries on the business.

In the most common form of agency relating to an employee and his employer, identify the agent and their implied authority.

Identify and explain the duties and rights of agents.

[Learning Outcome e]

The agent has various duties in relation to the principal and third parties as explained below.
Diagram 1: Duties and Rights of Agents



Test Yourself 4

7. Duties of an agent

7.1. The agent must carry out the principal's lawful instructions

In **Turpin v Bilton** (1843) an insurance broker upon receipt of a fee, agreed to effect insurance on the ships of his principal, the plaintiff. The ship was lost at the sea without insurance as the result of the broker's failure to carry out the principal's lawful instructions and the defendant was held liable. It was held that an agent is bound to conduct the business of his principal according to the directions given by the principal, or in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

7.2. Duty to exercise skill and reasonable care (diligence) in the performance of his duties

The duty of the agent to act diligently by exercising his skills and care is absolute but the extent of exercise may differ depending on the circumstances of each case. For example a higher degree of care may be expected in respect of a professional as compared to a layman in a particular type of business. It may also be considered whether the agent was paid or not for carrying out particular business.

If it can be proved that the agent did not exercise due diligence and skill, the agent may be held liable for the tort of negligence. In **Hedrey Byrne v Heller,** the House of Lords recognised a tort of negligence on the basis of pure economic loss, resulting from a negligent misstatement. In this case the House of Lord overruled previous decisions, in which the notion that a party may owe another a duty of care for statements made in reliance had been rejected, with the only remedy for such losses being in contract law. Thus, the liability for pure economic loss not arising from a contractual relationship was recognised, introducing the idea of "assumption of responsibility".

Section 164 of the Law of Contract Act Cap 345 provides for the agent's duty of carrying out the business of the principal with skill and diligence. It provides that the agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business.

The duty may be lifted if the principal has notice of the agent's want of skill. The agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensations to his principal in respect of the direct consequences of his own neglect, want of skill or misconduct, but not in respect of loss or damage which are indirectly or remotely caused by such neglect, want of skill or misconduct.

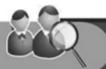
7.3. Duty to act in good faith and for the benefit of his principal

This is a common law duty of an agent. The duty to act in good faith and for the benefit of the principal can be demonstrated in the following ways which are within the same duty:

a) The agent must not let his interest conflict with his duty to his principal.

This duty exists even where there is no intent to defraud. For instance, if X is appointed an agent for effecting the purchase of a house for his principal, then the agent sells his own house to his principal he will have breached the duty even if he assesses his property which he sells to his principal at a proper market value he will be liable for breach of duty. This is because in so doing the agent will have placed himself in a precarious position where he is likely to be tempted not to act in the best interest of his principal which is the overriding object of the rule.

Where the agent so breaches the rule, the principal is entitled to rescind the contract.



Example

Jack employs Jane, a stockbroker, to buy some shares for him. Jane sells his own shares to Jack. In this situation Jack can rescind the contract. This is because the interest for Jane as an agent is to sell his own shares at the highest possible price, whereas his duty to his principal is to diligently look for shares sold at a lowest possible price for the benefit of his principal. In such a scenario there is a clear conflict of interest.

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a) The agent must not make a secret profit by the use of his position as agent.

This duty is also recognised by the Law of Contract Act under section 163. The provision first and foremost requires the agent to conduct the business of his principal according to the directions given by the principal or the custom of trade. However, if he breaches this primary duty and in the course of so doing the business *ultra vires* makes some profit the agent has a duty to account for such profit to his principal. This means even if the principal could not have earned the profit himself and the agent makes such a profit by virtue of his position as agent he must pay that profit to the principal.

Section 168 of the Law of Contract Act provides further that if an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction.

In the case of **Lucifero v Castel** an agent was appointed to purchase a yacht for his principal. It transpired that the agent bought the yacht for himself and then sold it to his principal at a profit. The principal was unaware that he was buying the agent's own property. It was held that an agent had a duty to pay his profit back to the principal and it is a must even if the principal could not have earned such a profit himself.

b) Duty to protect and preserve the interests of the principal entrusted in the agent upon principal's death or insanity.

Section 161 of the Law of Contract Act provides that when an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him.

8. Rights of the agent

The agent has the following rights:

a) Right to compensation by the principal where the agency is revoked or renunciated by the principal before the agreed period of agency expires and without sufficient cause. The agreed period of agency may be express or implied.

b) Agent's right of retainer out of sums received on principal's account.

Section 169 of the LCA provides that an agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business, and also such remuneration as may be payable to him for acting as agent.

c) Agent's right of lien on principal's property

According to section 173 of the Law of Contract Act, the agent has a right of lien on the property of the principal such as papers and other property whether movable or immovable unless there is a contract to the contrary between the principal and agent. In the absence of any such contract the agent is entitled to retain the property of the principal as described above in this paragraph until the amount due to him for commission, disbursements and services in respect of the same has been paid or accounted for him.

d) Agent's right of indemnification

An agent has a right of indemnification in two situations. The first situation is where the agent exercises the authority conferred to him by the principal but in the course of such exercise he incurs some liabilities. Section 174 of the Law of Contract Act provides that the employer of an agent is bound to indemnify himself against all consequences of all lawful acts done by such agent in exercise of the authority conferred upon him.

The second situation is where the acts of the agent may cause some injury to a third person and hence attract some liability against the agent. It appears the agent in such cases may not have express authority or have express authority but the scope of authority is questionable. However if it can be proved that the agent exercised the general authority in good faith and yet caused injury to the third party he is entitled to be indemnified by the principal. Section 175 of the Law of Contract Act provides that where one person employs another to do an act and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it causes an injury to the rights of third persons. Thus to qualify for indemnification it must be seen that the agent was employed to do such act, the act which caused injury to the third person.

9. Discharge of agency

Section 153 of the Law of Contract Act provides that an agency is terminated by the principal revoking his authority, or by the agent renouncing the business of the agency; or by the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind; or by the principal being adjudicated bankrupt under the provisions of any law for the time being in force relating to bankruptcy.

A contract of agency is a species of the general contract. As such, an agency may terminate in the same way as a contract is discharged except where the agency is irrevocable. The relation of principal and agent can only be terminated by the act or agreement of the parties to the agency or by operation of law. An agency may be terminated in the following ways:

9.1. An agency created for a specific purpose as well as an agency created by a power of attorney is terminated once the particular purpose for which it was created was accomplished. After the termination of the agency, the agent is free of any fiduciary duty to the principal arising from the agency relationship.
9.2. The parties can terminate the agency by mutual agreement. An agency relationship requires the mutual assent of the parties and both the parties have power to withdraw their assent. An agency may not be terminated by the act of one of the parties and should be done mutually. The mutual abandonment of an agency is a question of fact, since it is a matter of intention of both the parties. The court will ascertain such intent from the surrounding facts and circumstances of the transaction as well as implied from the conduct of the parties.
9.3. An agency contract may be cancelled on the basis of an express stipulation in the contract. In such a case, the parties will have a right of cancellation at the will of either party or upon the happening of a contingency or the nonperformance of some expressed condition. The principal cannot cancel such an agreement at will so long as the agent fulfills his/her part of the agreement. However, the principal can cancel the agency contract for any justifiable cause.
9.4. An agency may be revoked at the will of the principal when an agency is not coupled with an interest, and no third party's rights are involved. The party terminating the agency must show good cause.
9.5. A principal may unilaterally cancel an agency without incurring liability for breach of contract under the following instances: misconduct or habitual intoxication of the agent which interferes with his/her employment, the refusal of the agent to obey reasonable instructions or to permit the principal to make a proper audit of his/her accounts, serious neglect or breach of duty by the agent, dishonesty or untrustworthiness of the agent, the agent's failure to pay an indebtedness owing to the principal, disloyalty of the agent like using the agency to make secret profits.
9.6. Ordinarily, an agent may renounce the agency relationship by expressly notifying the principal, either orally or in writing. An agent's cessation of all relations with the principal, and abandonment by the agent may be treated as a renunciation..

Test Yourself 5

Explain any five duties of an agent.

Answers to Test Yourself

Answer to TY 1

An agent is a person who acts or has an authority to act and enter into contracts and dealings on behalf of another.

Section 134 of the Law of Contract Act defines an agent as a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such an act is done, or who is so represented, is called the "principal".

Thus, the basic duties of an agent are to do acts for the principal including concluding contracts which are binding between the principal and the third party. Even though the agent facilitates the conclusion of a contract he does not become a party to the contract himself. An agent can be employed by any person who is of sound mind and of age of majority according to the law to which he is subject.

Answer to TY 2

Following are the types of agencies:

1. Special agency- in such type of agency, the principal appoints an agent to perform a specific act such as purchase of or clearing of the car from the port.

2. A general agency- this occurs where by the nature of the relationship existing between the parties the agent has powers to perform all actions which ordinarily fall within the power of the agent by virtue of the nature of business entrusted to such agent, examples could be a lawyer or employee or a partner. Section 140(2) of the Law of Contract Act provides that an agent having authority to carry on a business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such business.

3. A universal agency- in this case, an agent is appointed by a deed known as "power of attorney". Such an agent has unlimited authority to perform any acts that his principal is capable of performing including execution of a deed on his behalf. Section 140(1) of the Law of Contract Act provides that an agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act.

4. Moreover, section 141 provides for the authority of an agent in an emergency. It provides that an agent has authority, in an emergency; to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

Answer to TY 3

An implied agency may arise by estoppel whereby a person by his own words or conduct represents another as having authority to make contracts on his behalf, he will be bound by such contracts as if he had expressly authorised them. Such a person will be stopped by his conduct not to deny the existence of an agency.

Estoppel means that a person is not permitted to resist an inference which a reasonable man would draw from his words or conduct. An agency is created by estoppel or holding out when the principal makes other parties believe that he has authorised a person to represent him. In such a case, the person is not an agent of the principal but the third parties are under the impression that there is an agency relationship between the other person and the principal. If the third party acts on this belief, the principal will be held liable for the acts of the agent i.e. the other person.

Answer to TY 4

Where the agency is for the employee, in this case an agent is employed to conduct a certain trade or business such agent has an implied authority to do whatever is incidental to such trade or business.

Answer to TY 5

Following are some of the duties of an agent:

1. The agent must carry out the principal's lawful instructions

An agent is bound to conduct the business of his principal according to the directions given by the principal, or in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

2. Duty to exercise skill and reasonable care (diligence) in the performance of his duties

The duty of the agent is to act diligently by exercising his skills and care is absolute but the extent of exercise may differ depending on the circumstances of each case. For example, a higher degree of care may be expected in respect of a professional as compared to a layman in a particular type of business. It may also be considered whether the agent was paid or not for carrying out particular business.

If it can be proved that the agent did not exercise due diligence agent and skill the agent may be held liable for the tort of negligence.

3. An agent is bound to render proper accounts to his principal on demand

4. It is the duty of an agent in case of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions

5. Duty to act in good faith and for the benefit of his principal

This is a common law duty of an agent. The duty to act in good faith and for the benefit of the principal can be demonstrated in the following ways which are within the same duty:

The agent must not let his interest conflict with his duty to his principal.
Agent's right of lien on principal's property
Duty to protect and preserve the interests of the principal entrusted in the agent upon principal's death or insanity.

STUDY GUIDE D3: LAW OF NEGOTIABLE INSTRUMENTS

Get Through Intro

The simple meaning of the word 'negotiable' is transferable from one person to another and the word 'instrument' means a written document by which right is created in favour of some person.

Exchange of goods and services is the foundation of every business activity. Goods are bought or sold either for cash or on credit. All these transactions require flow of cash either immediately or after some time. As the businesses grow, the scale of transactions and the amount of money involved in business transactions also grow. Gradually, the businesses find it difficult to make or receive huge payments in cash. It is also sometimes risky if actual cash transactions of huge amounts are involved.

In order to avoid these problems, modern businesses often make use of certain documents as means of receiving and making payments. Some of these documents are termed as negotiable instruments.

In this Study Guide, we will discuss the meaning of negotiable instruments, various types of negotiable instruments, their characteristics, the basic laws relating to negotiable instruments and the effects of forgery on negotiable instruments.

Learning Outcomes

a) Identify and state the basic laws relating to negotiable instruments.
b) Identify and state the types of bills of exchange, state the types of negotiation.
c) Explain the meaning and characteristics of negotiable instruments.
d) Explain the meaning of endorsement, bearer bills, inchoate instrument and holder in due course.
e) State the effects of forgery on a bill of exchange.

Explain the meaning and characteristics of negotiable instruments.
[Learning Outcome c]

1. Meaning of negotiable instruments

As the name suggests, negotiable instrument means a written document which creates a right to receive money in favour of some person and which is freely transferable. In other words, it is a method of transferring money owing from one person to another person. Negotiable instruments are the instruments which can be negotiated. The word instrument in this sense means a document which can produce money and the word "negotiate" means transfer of title or ownership over the document from one person to another. Negotiable instruments are therefore the documents which entitle the owner or the holder thereof to the payment of money. The full and legal title to the instrument is transferable by mere delivery or endorsement and delivery. As such, an instrument is negotiated when it is transferred from one person to another either by mere delivery or by endorsement and delivery so as to constitute delivery to the person to whom it is transferred.

Definition

Justice Willis defines a negotiable instrument as 'a negotiable instrument is one, the property in which is acquired by anyone who takes it bona fide and for value notwithstanding any defect of title in person from who he took it'.

2. Characteristics of negotiable instruments

Negotiable instruments have the following characteristics;

a) **Freely transferable**

Negotiable instruments are easily transferable from one person to another person. Right of ownership to property in the instrument is transferred by mere delivery (in case of bearer instruments). In such cases, the possessor of the negotiable instrument is presumed to be the owner of the property contained therein.

b) **Defect free title**

A person accepting an instrument bonafide and for value (known as a holder in due course) gets the instrument free from all defects in the title of the transferor. This means, the holder in due course is not affected by any defect, for example fraud, which might be available against the previous holder of the instrument.

c) **Right to sue**

The transferee of the negotiable instrument can sue in his own name, in case of dishonour. A negotiable instrument can be transferred any number of times till it is at maturity. The holder of the instrument need not give notice of transfer to the party liable on the instrument to pay.

d) **Presumptions**

Certain presumptions apply to all negotiable instruments. Some of the presumptions are:

i. Every negotiable instrument was made, drawn and accepted for consideration.
ii. Every negotiable instrument bearing a date was made or drawn on that date.
iii. Every holder of negotiable instrument is presumed to be holder in due course. That means it is assumed that the holder of the negotiable instrument has obtained the right to hold the instrument lawfully without any fraud or malpractice.
iv. Unless the contrary is proved it is presumed that every transfer of a negotiable instrument was made before its maturity.
v. Every bill of exchange is presumed to have been accepted within a reasonable time after its issue and before its maturity
vi. It is presumed that a lost promissory note, bill of exchange or cheque was duly stamped.

Test Yourself 1

State whether the following statement is true or false:

Generally, every holder of negotiable instrument is presumed to be holder in due course.

3. Basic laws relating to negotiable instruments

The basic law relating to negotiable instruments in Tanzania is the Bills of Exchange Act cap 215 RE 2002. The Act regulates bills of exchange, cheques and promissory notes.

Identify and state the types of bills of exchange, salient features and classification [Learning Outcome b]

A bill of exchange refers according to section 3(1) of the Bills of Exchange Act to an unconditional order in writing addressed by one person to another, signed by the maker, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person or to the bearer. A bill of exchange must be an order not a request and the original parties are the drawer, drawee and payee. The drawer must order the drawee to pay.

4. Types of Bills of Exchange

There are three types of bills of exchange. These are bills of exchange, cheques, and promissory notes.

4.1. Bill of exchange

Definition

As provided under section 3 of the Bills of Exchange Act, a bill of exchange as an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time, a sum certain in money to or the order of a specified person or to bearer.

A bill of exchange, therefore, is a written acknowledgement of the debt, written by the creditor and accepted by the debtor. Essential characteristics of a bill of exchange are that it must be in writing; it must be signed by the drawer; there must be three parties as drawer, drawee and payee and all the parties must be certain; the sum payable must be certain; it should be properly stamped; and it must contain an unconditional order to pay money.

An instrument which does not comply with the conditions stated above, or which orders any act to be done in addition to the payment of money is not a bill of exchange. A bill of exchange does not become invalid by reason of lacking a date on it; if it does not specify the value given or where any value has been given therefore or for not specifying the place where it is drawn or where it is payable.

4.1.1. Parties to a bill of exchange

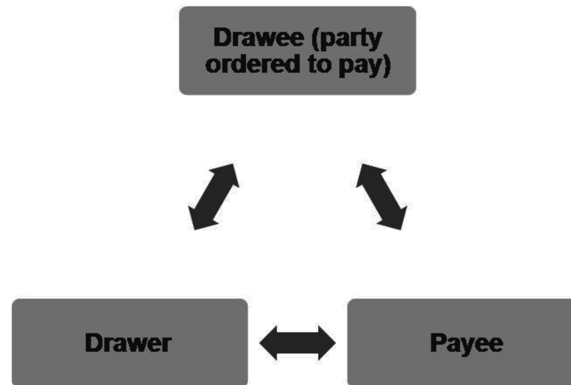
A bill of exchange contains three parties known as the drawer (the one giving the bill), the drawee (a person to whom the order is made) and the payee (a person to benefit from the order by being paid). The parties to a bill can be illustrated as follows:

a) **Drawer:** The maker of a bill of exchange is called the 'drawer'.
b) **Drawee**: The person who is directed to pay the money by the drawer is called the 'drawee'
c) **Payee:** The person named in the instrument, to whom or to whose order the money is directed to be paid by the instrument is called the 'payee'.

In addition to the above three main parties, there can be some other parties involved in a bill of exchange as follows:

a) **Indorser:** When the holder transfers the instrument to anyone else, the holder becomes the 'indorser'.
b) I**ndorsee**: The person to whom the bill is indorsed is called an 'indorsee'.
c) **Holder:** A person who is legally entitled to the possession of the negotiable instrument in his own name and to receive the amount thereof, is called a 'holder'. He is either the original payee, or the indorsee. In case the bill is payable to the bearer, the person in possession of the negotiable instrument is called the 'holder'.
d) **Drawee in case of need:** When in the bill or in any endorsement, the name of any person is given, in addition to the drawee, to be resorted to in case of need, such a person is called 'drawee in case of need'.

Diagram 1: The parties to a bill



Situations contemplated by section 3(4)(b) and (c) on criteria which need not invalidate the bill are covered and elaborated further under sections 30 and 45(d) of the Bills of Exchange Act respectively. Section 30 provides that every party whose signature appears on a bill is prima facie deemed to have become a party for value (to have given value for the bill).

Section 30(2) provides further that every holder of a bill is prima facie deemed to be holder in due course unless fraud, duress, force, illegality and fear in which case the burden of proof shifts to the holder and again unless and until the holder proves that subsequent to such alleged fraud, duress, fear or illegality value has been given for the bill.

Section 45(d) read together with section 40(1) requires that the bill must be properly presented for payment and that if not properly presented the drawer and endorsers (if any) shall be discharged. Section 40(2) covers the proper place of presentation in paragraph (b) as follows:

a) Where a place of payment is specified in the bill and the bill is presented;
b) Where no place of payment is specified but the address of the drawee or acceptor is given in the bill, and the bill is presented;
c) Where no place of payment is specified and no address is given, and the bill is presented at the drawee's or acceptor's place of business if known, and if not, at his ordinary residence if known;
d) In any other case if presented to the drawee or acceptor wherever he can be found, or if it can be presented at his last known place of business or residence.

A bill indicates the person to whom the money is to be paid although that need not be necessarily a name of a particular person. A bill may indicate that money should be paid either to a person who is named in the bill or to the endorsee of a person named in a bill, or to a bearer or just to a person who is named in the bill. For instance the payee may be indicated in the following ways:

- Pay Grace or Order (even where the words "or order" are omitted they are nevertheless deemed to be applicabl. Such words "or order" will be inapplicable; the drawer expressly prohibits the transferability of a bill.
- Pay Grace or bearer.
- Pay bearer.

Thus, anyone in possession of a bearer bill (a bill payable to bearer) is entitled to payment whereas a bill is an order bill is payable to a person named in the bill or order. An order bill can be negotiated (transferred) by way of a named person in the bill endorsing it at the back (writing the words "pay the person who is named in the bill or order" and signing it). Once that is done the title to the bill will pass to the endorsee or order (a person to whom a person who is named in the bill will endorse it). Section 31(1) of the Bills of Exchange Act provides that a Bill payable to the bearer is negotiated by delivery and a bill payable to order is negotiated by endorsement.

4.2. Cheque

Definition

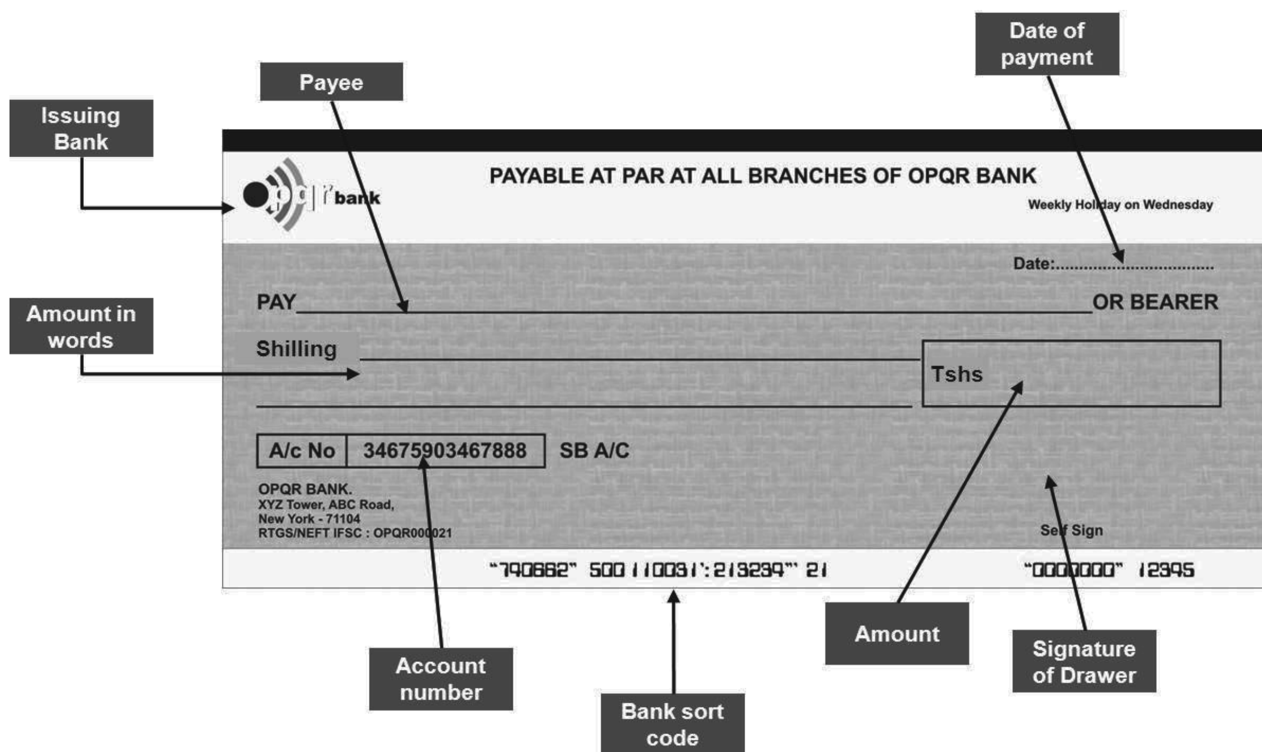
Section 73 of the Bills of Exchange Act defines a cheque as a bill of exchange drawn on a banker and payable on demand. Since a cheque by its definition is a bill of exchange, the provisions relating to the bills of exchange payable on demand apply also to a particular type of bill of exchange known as cheque unless misapplied by a particular provision of the Bills of Exchange Act, Cap 215.

Thus, a cheque is bill of exchange with two more qualifications: it is always drawn on a specified banker, and it is always payable on demand.

As a consequence, all cheques are bills of exchange, but not all bills of exchange are cheques. A cheque must satisfy all the requirements of a bill of exchange; that is, it must be signed by the drawer, and must contain an unconditional order on a specified banker to pay a certain sum of money to or to the order of a certain person or to the bearer of the cheque. However, it does not require acceptance.

The essential characteristics of a cheque are: it must be in writing; there must be an express order to pay; the order must be to pay a certain sum; the order must be to pay money only; the order to pay must be unconditional; it must be signed by the drawer; the three parties i.e. drawer, drawee and payee must be certain; the cheque must be drawn on a specified bank; and it must always be payable on demand.

Diagram 2: Specimen of a cheque



Test Yourself 2

Which of the following statements is correct?

1. All cheques are bills of exchange but not all bills of exchange are cheques.
2. All bills of exchange are cheques but all cheques are bills of exchange.

Parties to a Cheque

The parties to a cheque include:

a) **Drawer:** He is the person who draws the cheque, i.e., the depositor of money in the bank.
b) **Drawee:** It is the drawer's banker on whom the cheque has been drawn.
c) **Payee**: He is the person who is entitled to receive the payment of the cheque.

4.3. Promissory note

Definition

A promissory note is defined by section 89 of the Bills of Exchange Act as an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed determinable future time, certain sum in money, to or to the order of, a specified person or to bearer.

The essential characteristic of a promissory note is that it must be in writing. A mere verbal promise to pay is not a promissory note.

Example

Peter promises to pay Julie a sum of Tshs100,000/- over the telephone. This promise is not a promissory note because it is not in writing.

A promissory note must contain an express promise to pay. There must be an express undertaking to pay. A mere acknowledgment is not enough.

Test Yourself 3

State which of the following instruments is promissory notes.

1. Peter, I owe you Tshs100,000/-
2. I promise to pay Peter a sum of Tshs100,000/-

The promise to pay must be unconditional and must not depend upon the happening of some contingent event. It must be signed by the maker as otherwise it is incomplete and of no effect. It must clearly show with certainty the parties involved i.e. the maker of the note and the payee of the note. The sum payable must also be certain.

A promissory note differs from a bill of exchange the following ways namely:

- it can include a pledge of collateral security with authority to sell or dispose thereof whereas for a bill of exchange if an instrument purporting to be a bill of exchange orders anything to be done in addition to money it cannot be a bill of exchange
- a promissory note is an unconditional promise to pay whereas a bill of exchange is an unconditional order

The original parties to a promissory note are the promisor and the promisee.

5. Types of Negotiation

As discussed earlier, negotiation means the transfer of title or ownership over the document from one person to another. The types of negotiation of a bill of exchange are covered by section 31 of cap 215 and include;

- Mere delivery, and
- Endorsement and delivery.

One person who is entitled to be paid through a negotiable instrument can negotiate (transfer) his title to another person to whom he owes so that the instrument can be payable to his creditor. This can be done either by a mere signature without specifying the endorsee (person to be paid/payee) or by his signature together with words “pay a person who is named in the bill”.

Section 34 provides that an endorsement in blank specifies no endorsee and that a bill that is endorsed without specifying the payee becomes payable to bearer, that is anyone in possession of that bill. Section 34 further provides that a special endorsement specifies the person to whom, or, to whose order the bill is to be payable. Thus “a person who is named in the bill” who may be mentioned in the bill as payee may also negotiate it and so on.

Explain the meaning of endorsement, bearer bills, inchoate instrument and holder in due course.

[Learning Outcome d]

6. Endorsement

Section 2 of Cap 215 defines the term “endorsement” to mean an endorsement completed by delivery. And delivery is defined as transfer of possession, actual or constructive, from one person to another. Therefore, endorsement means writing of someone’s name on the back of the instrument with the intention of transferring the rights in the instrument. In other words, endorsement is signing a negotiable instrument on the back of it for the purpose of negotiation. The person who endorses the instrument is called an ‘endorser’, and the person to whom negotiable instrument is transferred by endorsement is called the ‘endorsee’.

6.1. Who can endorse?

The payee of an instrument is the rightful person to make the first endorsement. Thereafter the instrument may be endorsed by any person who has become the holder of the instrument. Section 2 of Cap 215 defines the term holder to mean the payee or endorsee or the bearer thereof.

7. Bearer bills

These are bills which are payable to the bearer and this is a bill which does not specify the endorsee. Section 34 of the Bills of Exchange Act provides in subsection (1) that an endorsement in blank specifies no endorsee and a bill so endorsed becomes payable to bearer. A bearer bill can be converted by any of its holder into a special endorsement bill by converting a blank endorsement into a special endorsement. This can be done by writing above the endorser's signature a direction to pay the bill to or to the order of himself or some other person.

8. Inchoate instrument

Inchoate instruments are instruments which are incomplete by lacking some important information such as the name of the payee or the amount payable. These are not bills but by virtue of signature of the drawer and delivery to the holder they may be converted into bills by the person possessing them. There is an assumption (prima facie) that a person who in possession of a blank stamped paper with a signature of the drawer has authority to complete it by filling in any particular material as he thinks fit for its completion thereby making it a complete bill.

Section 20(1) of the Bills of Exchange Act provides that where a simple signature on a blank stamped paper is delivered by a signatory in order that it may be converted into a bill, it operates as a prima facie (rebuttable presumption) authority to fill it up as a complete bill for any amount the stamp will cover, using the signature for that of the drawer, or the acceptor, or an endorser, and, in a like manner, when a bill is wanting in any material in particular, the person in possession of it has prima facie authority to fill up the omission in any way he thinks fit.

A person who becomes a party to an inchoate bill can enforce it against any person who became a party to it before it was completed (i.e. filled up in its lacking components). However, in order for such a party to successfully do so such a person must fill it up within a reasonable time and strictly in accordance with the authority given. Reasonable time for this purpose is a question of time. However, if an instrument after it has been filled up (after its completion) it is negotiated to a holder in due course it shall be valid and effectual for all purposes in his hands and he may enforce it as if it had been filled up within reasonable time, and strictly in accordance with the authority given. If such a bill lacks specification as to time of payment it shall be payable on demand.

Also according to section 12 of the Bills of Exchange Act, an undated bill or acceptance of a bill payable at a fixed date after it is undated, any holder may insert therein the true date of issue or acceptance, and the bill shall be payable accordingly. This is because every party whose signature appears on a bill is prima facie deemed to have become a party for value. However, it must be presented for payment at proper place in accordance with section 45(2) (d) of the Bills of Exchange Act explained earlier above.

9. Holder in due course

The term "holder in due course" is described rather than defined by section 29(1) of the Bills of Exchange Act. The provision provides that the holder in due course is a holder who has taken a bill complete and regular, on the face of it under the following conditions:

(a) that he became the holder before it was overdue, and without notice that it had been previously dishonoured if such was the fact;
(b) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defects in the title of the person who negotiated it.

In other words, a holder in due course is a person who pays or furnishes consideration in exchange for a bill with honest belief that the bill is a proper bill capable of being enforced and once properly presented secure the required payment. However, such a holder of a bill will not be protected or will not be deemed to be a holder in due course if he becomes aware before the bill is negotiated to him that the title of a person who negotiates the bill to him obtained such title through fraud, duress, or force and fear or other unlawful means or for illegal consideration, if negotiated in breach of faith or any such circumstances that amounts to fraud.

Moreover, if a holder in due course negotiates the bill to another person, such other person whether he is a holder for value or not shall have all the rights that were vested in the holder in due course as regards the acceptor and all parties to the bill prior to that holder provided he is himself not a party to any fraud, duress or any kind of use of illegal means affecting the bill.

State the effects of forgery on a bill of exchange.
[Learning Outcome e]

Forgery is the act of making a false document in order that it may be used as a genuine one. A document is false if any part of it purports to be made by a person who actually did not make it or authorized to make it. When a person signs a document in the name of another without authority in order that the instrument may be issued or negotiated, the signature is forgery. The most common species of forgery is fraudulently writing the name of the existing person. It is also forgery to sign the name of a fictitious person or a non-existing person. Even a man's signature of his own name may amount to forgery if it is put with the intention that the signature should pass for the signature of another person of the same name.

10. The Effect of Forgery on a bill of exchange

10.1. Forgery of drawer's signature

The general rule is that the only means by which a party can demonstrate his intention to be a party to the bill as drawer, endorser or acceptor is by affixing his signature to the bill as such and as the case may be. Section 23 of the Bills of Exchange Act provides that no person is liable as drawer, endorser or acceptor of a bill who has not signed it as such. Thus on the basis of this general rule it can be said since a forged signature is not a signature of the one pretended to be, it can create no liability against the person impersonated.

Section 24 of the Bills of Exchange Act provides that where a signature on a bill is forged or placed thereon without the authority of the person whose signature it purports to be, the forged or un authorised signature is wholly inoperative and no right to retain the bill or give a discharge or to enforce payment against any party thereto can be acquired through or under that signature, unless the party against whom it is sought to retain or enforce payment of a bill is precluded from setting up the forgery or want of authority. Thus it is important to examine what happens to the drawee when he is presented with a bill which bears a forged signature.

10.2. Acceptors liability

Section 17 of the Bills of Exchange defines an acceptance of a bill to mean the signification by the drawee of his assent to the order of the drawer. For such an acceptance to be valid it must comply with the following conditions:

a) It must be written on the bill and be signed the drawee. A mere signature of the drawee without additional words is sufficient;
b) It must not express that the drawee will perform his promise by any other means than the payment of money.

An acceptor of a bill, by accepting it engages that he will pay it according to the tenor of his acceptance. He is therefore precluded from denying to the holder in due course: the existence of the drawer, the genuineness of his existence and his capacity and authority to draw the bill; in the case of a bill payable to the drawer's order, the then capacity of the drawer to endorse, but not the genuineness or validity of his endorsement; or in the case of the bill payable to the order of the third person, the existence of the payee and his then capacity to endorse but not the genuineness or validity of his endorsement.

10.3. Liability of endorser(s)

In order to understand the effect of a forged cheque to the endorsers and the liability of endorsers generally it is first to take note of some legal positions or facts. The rule is that a bill payable to order is negotiated by endorsement of the holder completed by delivery. For an endorsement to be valid and binding or operative it must be done in accordance with the legal requirements so as to be able to effect negotiation. Section 32 of the Bills of Exchange Act stipulates these requirements are as follows:

(i) It must be written on the bill itself and must be signed by the endorser and the simple signature of the endorser on the bill of the signature, without additional words is sufficient;

(ii) It must be the endorsement of the entire bill and a partial endorsement, that is to say, an endorsement which purports to transfer to the endorsee a part only of the amount payable, or which purports to transfer the bill to two or more endorsees who are not partners, all must endorse unless the one endorsing has authority to endorse for the others;

(iii) Where the bill is payable to the order of two or more payees or endorsees who are not partners; all must endorse unless the one endorsing has authority to endorse for the others;

(iv) Where, in a bill payable to order, the payee or endorsee is wrongly designated or his name is misspelt, he may endorse the bill as described in the bill adding if he thinks fit, his proper signature

(v) Where there are two or more endorsements on a bill each endorsement is deemed to have been made in the order in which it appears on the bill, until the contrary is proved;

(vi) An endorsement however may be made in blank or special. It may also contain terms making it restrictive.

After all the legal requirements for proper endorsement of a bill are complied with thereby making the bill negotiable, section 55(2) provides for the liability of the endorser. The endorser of a bill by endorsing it creates certain liability or obligations. In the first place, he engages the liability that on due presentment as discussed above it shall be accepted and paid according to its tenor, and that if it is dishonoured he will compensate the holder or a subsequent endorser who is compelled to pay it, provided that the requisite proceedings on dishonour be duly taken.

Also the endorser of a bill, by endorsing it, is precluded from denying to a holder in due course the genuineness and regularity in all respects of the drawer's signature and all previous endorsements. Moreover, the endorser of a bill by endorsing it precluded from denying to his immediate or subsequent endorsee that the bill was at the time of his endorsement a valid and subsisting bill, and that he had then a good title.

Thus it suffices to say it is paramount that drawers, endorsers and acceptors should carefully guard against forgery of signatures. This is because of the likely negative consequences if they do not ascertain the genuineness of bills, endorsements or signature effected on the bill. The negative consequences as we have noted above are borne by the drawer, endorser or acceptor as the case may be whereas the beneficiary of the bill such as payee, endorsee, holder or holder in due course remain protected.

Test Yourself 4

Your friend has notified you that her bearer's cheque has been stolen and when she notified the drawer, it was discovered that the drawer's account was debited with the same amount of money which was specified on the cheque.

She is asking for your advice as to whether she is entitled to be issued with another cheque or be paid by any means.

Test Yourself 5

As you arrive in your office you discover that the cheque book that you are entrusted with is not where it is usually kept. Despite efforts to look for it, it appears the cheque book has disappeared completely and on the following day you realise that someone presented some cheques to the company's banker with forged signatures of your company's signatories, authorising the payments, and your banker honoured the cheques.

Who do you think has lost the money paid to whoever stole the cheque?

Answers to Test Yourself

Answer to TY 1

The statement is true.

Every holder of negotiable instrument is presumed to be holder in due course. That means it is assumed that the holder of the negotiable instrument has obtained the right to hold the instrument lawfully without any fraud or malpractice.

Answer to TY 2

The correct statement is ‘all cheques are bills of exchange but all bills are not cheque’.

This is because a cheque possesses all the characteristics of a bill of exchange but every bill of exchange does not possess the following key characteristics of a cheque:

- A cheque is always drawn on a specified banker, and
- A cheque is always payable on demand

Answer to TY 3

The first instrument containing a statement ‘Peter, I owe you Tshs100,000’ is not a promissory note as there is no express promise to pay. This is merely acknowledgement of indebtedness.

The second instrument containing a statement ‘I promise to pay Peter a sum of Tshs100,000’ is a promissory note as there is an express promise to pay.

Answer to TY 4

A bearer bill is as good as a universal bill. Any holder thereof is entitled to draw on the bill. Since a bearer bill does not specify the payee, any holder thereof is entitled to be paid with the amount specified. In this case a person who lost this cheque has no remedy against the drawer.

Answer to TY 5

A forged signature is as good as no signature at all; it creates no liability against the drawer. Thus in this case, it is the drawee whose money has been lost to culprits.

CIVIL LAW FOR BUSINESSES AND PROFESSIONAL ACCOUNTANTS

D4

STUDY GUIDE D4: LAW OF TORTS

Get Through Intro

The word tort simply means **"wrong."** A tort occurs when someone deliberately or carelessly causes harm or loss to another person or their property. There are many situations where people are harmed by someone else's action, but no crime has taken place. For example, violation of a duty not to injure the reputation of other person results in a tort of defamation. Violation of a duty not to interfere with the possession of land by another person results in tort of trespass to land.

The purpose of the law of torts is not to punish offenders but to provide remedy to victims as compensation for their losses. For example monetary settlements are used to restore, as far as possible, the lives of accident victims to their condition before the accident.

The law of torts is an important branch of civil law to those aspiring to work in the accounting field as well as in other fields. This is because commission of torts arises in most cases as a result of breach of duty imposed by law or contract but unfortunately in this case, for the latter, a contract is not fixed by the parties directly.

Thus, a party finds himself bound by a rule which he can hardly trace in any statute, but the breach of which, imposes an obligation to pay damages either by the person who committed a legal wrong himself or his employer.

In this Study Guide we will study the basics of torts and the other relates legal concepts like professional negligence, vicarious liability and tortuous liability.

Learning Outcomes

a) Explain the legal principles governing torts relating to the accounting profession
b) Define torts and describe their characteristics
c) Identify types of torts and their classification
d) State defences for tortious liability.

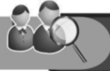
Define torts and describe their characteristics
Identify types of torts and their classification

[Learning Outcomes b, c]

1. Meaning of tort

In a person's day-to-day relations, he must be careful that his behaviour or actions do not cause injury to other people or their property. Law of torts imposes on each member of society the duty to take reasonable care to avoid causing harm to others. It provides legal recourse to those who suffer harm as a result of the breach of this duty. A person who has suffered such harm may have the right to obtain compensation for the injury in a civil action.

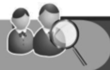
The word 'tort' is derived from a Latin term 'tortum' which means 'to twist'. It refers to conduct which is not straight or lawful but is twisted or unlawful. It is equivalent to the English term 'wrong'. This branch of law consists of various 'torts' or wrongful acts whereby the wrongdoer violates some legal right vested in another person.



Example

Bob digs a ditch on a public road. Jack, a passer-by, falls into the ditch and gets injured. Bob is liable to compensate Jack under the law of torts.

Tort is a private or civil wrong or injury for which a court of law may provide a remedy through a lawsuit for damages in the form of compensation. It gives rise to a non-contractual civil claim. When a person violates his duty to others created under general (or statutory) law, a tort has been committed.



Example

A person's actions may cause injury to others through negligence, nuisance, or damaging another's reputation by libel or slander.

Tort is an area of law concerned with injuries to people or property that come about due to a breach of duty imposed by the law rather than by some contractual arrangement between people. Individual torts include trespass, defamation, nuisance, negligence and passing-off.

Test Yourself 1

Briefly explain the meaning of torts.

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2. Classification of torts

Torts may be classified into three groups: intentional torts, negligence and strict liability.

2.1. Intentional torts

Are those wrongs committed where an individual or entity purposely engages in conduct that causes injury or damage to another. For example, intentionally hitting a person would amount to a tort of battery. Examples of intentional torts are assault, battery, false imprisonment, conversion, intentional infliction of emotional distress, fraud/deceit, trespass (to land and property) and defamation

2.2. Negligence

There is a specific code of conduct which every person is expected to follow and a legal duty of the public to act a certain way in order to reduce the risk of harm to others. Failure to adhere to these standards is known as negligence. Negligence is the most common type of tort. Unlike intentional torts, negligence cases do not involve deliberate actions, but instead are when an individual or entity is careless and fails to provide a duty owed to another person. Types of negligence include professional malpractice, slip and fall accidents and road accidents.

Case Study

Paris v Stepney Borough Council (1951)

The claimant in this case was blind in one eye and the defendant was aware of this fact. There was some risk of eye injury where the claimant was working. However, this risk was not enough for the claimant to ask the employer to provide goggles to all the other workers with two good eyes. A chip of metal got into the claimant's healthy eye resulting in injury.

Court's decision: it was held that it was the employer's duty to provide goggles to all employees. The employers did not provide goggles and they were therefore negligent in performing their duties.

2.3. Strict liability torts

Strict liability torts do not depend on the degree of carefulness by the defendant, but are established when a particular action causes damage. In order to collect damages, an injured party is required to prove only that he was harmed in a specified way, even if the person found strictly liable was not at fault or negligent. Prime examples of strict liability torts are the case of defective products (known as product liability) and abnormally dangerous activities.

A manufacturer of goods is liable for making and selling defective products. If any consumer suffers any injury because he used those goods, the manufacturer is responsible for damage suffered by the consumer. The injured claimant has to prove that the product caused harm but does not have to prove exactly how the manufacturer was careless.

Ryland v Fletcher (1968): strict liability

In this case, Ryland employed independent contractors to construct a mill on his land. During the excavation of the construction site, the contractors discovered some disused mine shafts. They failed to investigate where the shafts led, and admitted negligence on this front. The shafts led to Fletcher's land and water from the mill's reservoir, without negligence, flooded into the shafts and into Fletcher's land. Fletcher sued Ryland.

The court had to decide whether inherently dangerous activities could be subject to the doctrine of strict liability. Fletcher argued that Ryland should be liable for the damages caused by the storage of water on his land, an inherently dangerous activity. In other words, Fletcher argued that a strict doctrine of negligence should be applied. Ryland, on the other hand, argued that the flooding was a straightforward accident for which he could not be held responsible.

Court's decision

The court ruled in favour of Fletcher and ordered Ryland to pay for all the property damage to the mine. The court agreed that Ryland, as owner of the reservoir, was responsible for all damage caused by it, explaining that anyone who keeps "anything likely to do mischief" on his land, must take responsibility for any damage which is "a natural consequence of its escape". According to the court, the only case in which the defendant would be exempt from liability would be if the damage was caused by force majeure or an Act of God.

Ryland appealed to the House of Lords. The Lords gave the same verdict, except that the liability was restricted to there being a non-natural use of the land (i.e. the water in Ryland's reservoir had collected there as a result of man's intervention and not as a result of a natural process).

The above decision resulted into what is known as the rule in Ryland v Fletcher. Essentially, this rule states that a person who allows a dangerous element on their land which, if it escapes and damages a neighbour, is liable on a strict liability basis. It is not necessary to prove negligence on the part of the landowner from which has escaped the dangerous substance. However, there are exceptions to this rule:

i. Claimant's own default

If the damage is caused by the escape due to the claimant's own default it will be considered as a defence to the rule in Ryland v Fletcher.

ii. Act of God

If the escape was unforeseen and because of forces outside human control and the damage due to the escape could not have been avoided by taking reasonable care, the "Act of God" plea can be put forward. For example, if the embankments of ornamental lakes give way due to extraordinary rainfall, the owners of these lakes would not be liable under the rule.

iii. Consent of the claimant

If the claimant had consented to the accumulation of the dangerous thing on the defendant's land, the liability under the rule does not arise. Such consent is implied where the source of danger is for the common benefit of both the claimant and the defendant.

iv. **Act of third party**

If the harm had been caused due to the act of a stranger, who is neither the defendant's servant nor agent and the defendant has no control over him, the defendant will not be liable under the rule.

v. **Statutory Authority**

An act done under the authority of a statute is also a defence when an action under the rule in Ryland v Fletcher is brought.

3. Types of Torts

The types of torts are as follows:

3.1. Trespass

Trespass means interruption or interference with the possession of land. Violation of a duty not to interfere with the possession of land by another person results in the tort of trespass.

Example

Jack is the owner of one hectare of land. Ted has interfered with the possession of the land for six months. So this is a case of trespass.

3.2. Defamation

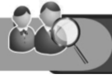
Defamation is making a statement which harms the status /reputation of the claimant. Violation of a duty not to injure the reputation of some other person, results in the tort of defamation.

Example

Without giving any specific reasons, the Association of Doctors has removed the right of a doctor to practice medicine. This act by the Association of Doctors may lead to defamation.

3.3. Nuisance

Nuisance involves unreasonable interference with or disrupts the use and enjoyment of another person's property.



Example

Ginny's neighbour often burns garbage. The smell and smoke drifts over to her property making it very unpleasant for her to sit outside.

3.4. Negligence

Negligence means failure to act reasonably. Business activities that involve negligence, such as selling defective goods, commit a tort.

Example

A railway passenger, who got injured due to the negligence of the driver, has a right to sue the railway company.

However, every negligent act does not make a person liable. To sustain an action of negligence, it must be shown that: the party in default owed a duty of care towards the injured party; that there was breach of that duty; and the breach resulted into injury.

3.5. Passing-off

An individual or company may claim to produce goods or offer services posing as some other person/company with the express permission of the other person/company in a manner that deceives the consumers into believing that they are purchasing the goods or services of the individual/company that they trust and recognise. This is a tort of passing off. The tort of passing off allows persons or companies to protect their goodwill. It was designed to stop a person from using a name that diverts business towards the other party by suggesting that the business belongs to the other party or is connected in any way with that other business.

In **Ewing v Buttercup Margarrine Co** (1917), the claimant successfully prevented the defendants from using a name that suggested a link to the claimant's diary company. However, this tort cannot be used to prevent a party from using a name, if: there is no likelihood of the public being confused between the businesses (Dunlop Pneumatic Tyre Co Ltd v Dunlop motors Co Ltd (1907) or the name consists of a word in general use (Aerators v Tollitt (1902)).

Explain the legal principles governing torts relating to the accounting profession
[Learning Outcome a]

In a number of cases, audit firms have been held responsible for negligence. In several cases, the liability was also higher than the auditor's direct responsibility for financial failure and the amount of audit fees. It is therefore important to understand the nature of tortious liability that may be imposed on professional accountants and auditors.

4. Professional Negligence

Definition

The professional negligence, in relation to accountants and auditors, would constitute failure to perform duties according to "accepted professional standards" resulting in some loss or damage to a party to whom the duty is owed.

Professionals such as lawyers, accountants and auditors or doctors in the course of their professions make statements and advices which may injure either clients or third parties to the contracts as the case may be. As we know the primary duty for an accountant is to the public. Even though the public may not have engaged an accountant to prepare financial statements for example, the accountant owes a duty of care to the public to prepare true financial statements out of which individual members may rely on for their various decisions.

In the accounting profession, as was the case in other professions, by the late 19th century restrictive liability rules made it virtually impossible for a third party to recover for harm caused by a negligent professional service provider such as an auditor. However, as the law of negligence came into play, liability for professional negligence has become very common in all professions.

Accountants and auditors may be for professional negligence arising from an act or default by them (or by their employees or associates) which results in a financial loss to a client or a third party to whom a duty of care is owed. Liability for professional accountants and auditors may arise in the following ways:

a) The use of engagement letters

There is, in almost all cases, a contractual relationship between an accountant and his or her client. In a contract for the supply of a service where the accountant is acting in the course of a business, there is an implied term that the supplier will carry out the service with reasonable care and skill. The degree of skill and care required will depend principally on the nature of the work undertaken. An accountant who undertakes work of an unusually specialized nature, or work of a kind whose negligent performance is particularly liable to cause substantial loss, will usually be taken to have assumed a duty to exercise a higher degree of skill and care than would be appropriate to less demanding work. Section 214 of the Companies Act makes void any provision in a company's articles or any contractual arrangement purporting to exempt the auditor from, or to indemnify him or her against, any liability for negligence, default, breach of duty or breach of trust.

b) Liability to third parties

An accountant may be liable for negligence, not only in contract but in tort, if a person to whom he or she owed a duty of care has suffered loss as a result of the accountant's negligence. Various court decisions have elaborated the classes of case in which a person professing some special skill (as an accountant does) could be liable for negligence to someone other than his or her own client: see in particular *Hedley Byrne and Co Ltd* v *Heller and Partners* (1964) AC 465, *Smith* v *Eric S Bush* (1990) 1 AC 831.

Such liability may arise whenever a professional person does work for his or her client in circumstances where that professional person knows or ought to know:

- that the work is liable to be relied upon by a third party; and
- that the third party may suffer financial loss if the work in question is done negligently

Liability will arise when the work in question is of a kind which it was reasonable for the third party to rely on for that person's particular purpose. If these conditions are satisfied, the third party is a person whom in the eyes of the law

the professional person ought to have in mind in applying his or her skills to the work in question.

The decision of the House of Lords in the case of *Caparo Industries PLC* v *Dickman and others* (1990) 2 AC 605 clarified the extent of auditors' liability by defining three criteria for the imposition of a duty of care as follows:

- It must be reasonably foreseeable by the defendant that the statements will be relied on by the plaintiff.
- There has to be a 'relevant degree of proximity' between the parties.
- It must be just and reasonable to impose a duty of care on the part of the defendant to the plaintiff.

c) Specialist advice

In expressing an opinion or giving advice on difficult and complicated matters (for example in the field of taxation), professionals have to bear in mind the magnitude of the financial consequences for their client should the advice tendered be incorrect or misconceived. Accountants and auditors may be held liable in tort for advice given which results into loss on the part of the client.

In *Sayers* v *Clarke Walker* (2002) EWCA 910, a practitioner had failed to advise a client on how to maximize his tax advantages when purchasing shares in a company. The practitioner had suggested to the client that specialist tax advice be sought, but that was not enough to absolve him from his obligation to give the client competent advice. Advice on how to maximize the client's tax advantages should have been within the practitioner's general competence as an accountant, and the practitioner's failure to give such advice amounted to a breach of trust and/or negligence.

4.1. Accountant's duty of care

This can be summarised as follows:

1. An accountant must possess the skills that an ordinarily prudent accountant would have and exercise the degree of care that an ordinarily prudent accountant would exercise.

2. By his contract with his client, an auditor owes a duty to perform the audit, report or investigation for which he was engaged while exercising reasonable care.

3. The duty of care would require that:

    a) The audit is properly pre-planned given the inherent risks of the client company.
    b) The audit is carried out by qualified personnel who in turn are supervised by experienced audit leaders.
    c) The audit is reviewed by an audit partner.

Any anomalous situations should be the subject of further investigation to eliminate the possibility of mistake or fraud. It is now well-established that the audit team may not blindly rely on statements made by management.

Test Yourself 5

Explain briefly the meaning of duty of care and the accountant's liability to third parties.

State defences available for tortious liability.

[Learning Outcome d]

5. Defences to tortious liability

There are various defences available for a person liable in tort. These defences are as follows:

5.1. *Volenti non fit injuria* (consent)

The defence of *volenti non fit injuria* (consent) means that a person who has freely volunteered to participate in an activity which causes him harm or either where he knows that actually the harm would occur or knowing that by the nature of an activity, the likelihood of harm is obvious cannot succeed in an action against the damage caused.

For this defence to succeed it must be shown that not only did the plaintiff know the danger but also that he appreciated the nature of the danger and yet voluntarily consented to take the risk of injury. In **Smith v. Baker**, Mr Smith sued his employers for injuries sustained while in the course of working in their employment. He was employed to hold a drill in position whilst two other workers took it in turns to hit the drill with a hammer. Next to where he was working, another set of workers were engaged in taking out stones and putting them into a steam crane which swung over the place where the claimant was working.

Mr Smith was injured when a stone fell out of the crane and struck him on the head. The defendant (employers) raised the defence of *volenti non fit injuria* in that the claimant knew it was a dangerous practice and had complained that it was dangerous but nevertheless continued. At trial the jury found that the employer (defendant) was liable to compensate the claimant employee.

The Defendant appealed and the Court of Appeal allowed the appeal holding that the Claimant was precluded from recovering damages as he had willingly accepted the risk. The Claimant appealed to the House of Lords and the appeal was allowed. It was held that the Claimant may have been aware of the danger of the job, but had not consented to the lack of care. He was therefore entitled to recover damages.

Thus, mere knowledge of the risk on part of the claimant is not sufficient for the defence to succeed but it must be proved that the claimant appreciated the nature of risk of injury and yet consented to run the risk.

5.2. Inevitable accident

This is a defence which is available to the defendant where he alleges that the harm occurred without the fault of the defendant. However this defence is not available in cases of strict liability.

5.3. Act of God/force majeure

This defence is applicable where the damage occurs but for something that was completely beyond the control of the defendant, and seemingly a natural act without the defendant's intervention. In Nichols v Marsland the defendant diverted a natural stream on his land to create ornamental lakes. Exceptionally heavy rain caused the artificial lakes and waterway to be flooded and damage adjoining land. The court held that the defendant was not liable under Ryland v Fletcher as the cause of the flood was an act of God.

5.4. Mistake of fact but not mistake of law

This applies in for example tort of false imprisonment. If a police officer is accused of falsely detaining a person who never committed a crime, the police officer may plead a defence of mistake of fact that he reasonably and honestly believed the plaintiff was the one who had been reported to have committed a crime. Similarly in malicious prosecution cases the accused person may plead that he was under mistaken belief that the plaintiff was guilty of the offence.

5.5. Necessity

The defence of necessity may be used where the defendant inflicts loss on an innocent plaintiff in the course of preventing greater loss to himself. This is for example when a driver is facing death and in the course of rescuing himself from falling into a pit which is likely to cause him death he knocks another person causing grievous bodily harm or trespass to person. If harm is done to a wrong doer like shooting an armed robber who has attempted to kill you is called self-defence whereas the harm is caused to an innocent person like trespassing to another's land in order to rescue your house from burning it is called defence of necessity.

5.6. Statutory authority

This defence is available to the defendant when an action complained of was authorised by a statute. The defence will be complete if the action complained of is a natural or obvious consequence of the authorisation. However, no defence in cases of conditional authority such as where the injury is not the necessary consequence of what is authorised.

Case Study

Davies v. Swan motor co (Swan Sea) ltd

Davies had been standing on steps at the side of a dust lorry. He was standing in a dangerous place. The lorry was travelling along a narrow road when a bus tried to pass the lorry. Davies was unfortunately killed. The court held that Davies was himself one-fifth responsible for the damage because of his negligence in standing upon, or being upon, the side of the dust lorry. Therefore, there are two aspects to apportioning responsibility between a plaintiff and defendant in an action for negligence, the respective causative potency of what they have done, and their respective blameworthiness.

Test Yourself 7

Explain briefly the defence of necessity in tort

Answers to Test Yourself

Answer to TY 1

The word 'tort' is derived from a Latin term 'tortum' which means 'to twist'. It refers to conduct which is not straight or lawful but is twisted or unlawful**. It is equivalent to the English term 'wrong'. This branch of law consists of various 'torts' or wrongful acts whereby the wrongdoer violates some legal right vested in another person.** The law imposes a duty to respect the legal rights vested in members of the society and the person who breaches these rights is said to have committed a wrongful act.

Tort law sets standards for behaviour and provides remedies if these standards are not met. It imposes on each member of society the duty to take reasonable care to avoid causing harm to others. It provides legal recourse to those who suffer harm as a result of the breach of this duty. A person who has suffered such harm may have the right to obtain compensation for the injury in a civil action.

Answer to TY 2

Tort and breach of contract distinguished

(a) A breach of contract results from the breach of a duty undertaken by the parties themselves. The agreement, the violation of which is known as a breach of contract is made by the parties with their free consent. For example, John undertakes to supply Ron a music system and then fails to perform the obligation. This is a breach of contract as John has voluntarily undertaken the obligation.

A tort, on the other hand, results from the breach of such duties which are not undertaken by the parties themselves but which are imposed by the law. For example, every person has a duty not to commit a nuisance not because he has voluntarily undertaken this duty but because the law imposes this duty on every person.

(b) In a contract, the duty is based on the privity of contract and each party owes a duty only to the other contracting party.

The law of torts does not impose duty towards any specific individual or individuals. These duties are towards the world at large.

In contract as well as tort, the person suffering the damage is able to sue.

(c) Both, breach of contract and law of tort offer damages as the main remedy. In a breach of contract, the damages may be 'liquidated'. However, the damages are always 'unliquidated' in an action for tort.

There may be certain cases when the same fact results in a breach of contract as well as a tort. For e.g., if due to the negligence of the driver, a railway passenger is injured, the railway authorities are liable for the breach of contract of safe carriage, there is also a tort of negligence which results in damages to the passenger. In such cases, both suits (for tort and breach of contract) can be filed parallel to each other.

Answer to TY 3

The Basic Rule contained in section 2 of The EU Consumer Protection Act, 1987, to succeed in a product claim against a manufacturer the plaintiff must show four things:

That the product contained a defect;
That the plaintiff suffered damage;
That the damage was caused by the product and,
That the defendant was a producer, 'own brander' or importer of the product

Answer to TY 4

Negligence may be defined as an act or omission which constitutes a breach of a duty of care owed by another person by the person who acts or fails to act and which causes that other person to suffer harm**.**

The professional negligence, in relation to accountants and auditors, would constitute failure to perform duties according to "accepted professional standards" resulting in some loss or damage to a party to whom the duty is owed.

There are three elements which the client (plaintiff) must establish if he wants to succeed in a case of professional negligence:

Firstly, he must establish that there was a duty of care owed by an Advocate.

Secondly, the client must establish that there was a breach of that duty by an Advocate (the defendant).

Thirdly, the client must establish that the breach of the Advocate's duty caused loss or damage to the client.

Answer to TY 5

As with other professions, auditors and accountants owe a duty of care to their clients. This duty arises from the law of negligence, contract, fiduciaries, or, in the case of auditors of corporate clients, from business corporations' legislation. However, auditors and accountants have often also been held liable to third parties who have relied on their professional advice to a client.

The duty of care has been defined as doing the things that a prudent man would do in the circumstances and refraining from those things he would not do. In the case of an auditor engaged to audit a company's accounts, this presumably means that the audit will be conducted in accordance with the accepted accounting standards and standards of audit practice.

The accountant's liability to third parties

1. An accountant only owes a duty of care to those persons for whose primary benefit the accountant's statements were intended, namely:
   - persons in privity with the accountant.
   - third parties whose relationship with the accountant was "so close as to approach that of privity".

2. Accountants are also liable to third parties

   - for whose benefit and guidance the accountant intends to supply the information or knows that the recipient intends to supply it.
   - whom the accountant intends the information to influence or whom the accountant knows that the recipient intends the information to influence.

Answer to TY 6

The fundamental principles concerning the doctrine of vicarious liability in Tanzania are as follows:

By vicarious liability the master is liable for tortuous acts or omissions of the servant and the two are joint tort feasors; either or both of them can be sued;

Vicarious liability does not transfer the principal liability of the servant to the master;

By vicarious liability an employer is vicariously liable for torts committed by his servant; but that does not absolve the liability of the servant for the tort he has committed;

Suing the government under vicarious liability does not confer immunity on the servant of the government who actually committed the tort; the right to sue the servant is not affected by the right to sue the master;

There is no law conferring immunity upon ministers or public officials from being sued personally for torts they commit in the course of their official duties; when they are so sued in their personal capacity, it is not a suit against the government;

The vicarious liability of the master and the initial liability of the servant are two different branches of liability.

Answer to TY 7

The defence of necessity may be used where the defendant inflicts loss on an innocent plaintiff in the course of preventing greater loss to himself. This is for example when a driver is facing death and in the course of rescuing himself from falling into a pit which is likely to cause him death he knocks another person causing grievous bodily harm or trespass to person. If harm is done to a wrong doer like shooting an armed robber who has attempted to kill you is called self defence whereas the harm is caused to an innocent person like trespassing to another's land in order to rescue your house from burning it is called defence of necessity.

SECTION E

EMPLOYMENT LAW

E1

STUDY GUIDE E1: EMPLOYMENT LAW

Get Through Intro

In everyday life adult persons look for jobs. Some look for low skill jobs, others look for 'white collar jobs' and yet for blue collar jobs. It appears the major motivation behind working is remuneration expected to be earned out of work. In some instances, especially involving people with certain skills, some people look for jobs just for gaining certain professional experience.

On the part of employers, many look for a worker who will produce the best for their business venture. Unfortunately, for some economic reasons or just 'an attitude' some look for workers whom they can pay less.

What is clear is that the employer has a wider power of choice of the type of workers while for the worker a job is a matter of survival. Thus this Study Guide deals at great and elaborate lengths with the establishment of employment contract, distinction between employment and independent contracting, rights and duties of employer and employee, dispute resolution procedures and institutions and other matters.

Learning Outcomes

a) State the core labour standards in Tanzania and the objectives of Employment Law
b) Identify sources of employment law in Tanzania
c) Identify and state the distinction between contract for service and the contract of service
d) Identify and explain the rights and duties of employees and employers in Tanzania
e) Identify salient features of a contract of employment
f) Identify situations in which the contract of employment may be terminated in Tanzania and the consequences of unfair dismissal and other reliefs.

State the core labour standards in Tanzania and the objectives of Employment Law.
Identify sources of employment law in Tanzania
Identify salient features of contract of employment [Learning Outcome a, b & e]

Employment law is a broad area encompassing all areas of the employer/employee relationship. Employment law consists of various statutes, administrative regulations, and judicial decisions which sets rights, duties and mechanisms for establishing, maintaining and terminating employment relations.

1. Core labour standards in Tanzania

Section 13(1) of the Employment and Labour Relations Act No. 6 of 2004 (ELRA) defines an employment standard to mean a provision of the Act on wage determination which stipulates the minimum term and conditions of employment. Some of the core labour standards are in regards to:

1.1. Working hours

Subject to other provisions of the Act, section 19(2) provides that the maximum number of ordinary days or hours that an employee may be required to work is six days in a week, forty five hours in a week, and nine hours in a day. In addition, section 21(1) of the Act requires an employer to give an employee who works continuously for more than five hours a break of at least one hour in between the working hours. Further, Regulation 6 of the Employment and Labour Relations (General) Regulations, 2017 provides that no child shall be permitted to work overtime or between 8 p.m. and 6 a.m.

1.2. Wages

Employment laws in Tanzania contain detailed guidelines for the calculation of wages of an employee who is entitled to hourly, daily, weekly or monthly wage rates. The payment of remuneration to an employee must be in the form of money; not in kind. Minimum wages are proposed by the Wage Boards established under section 39 of the Labour Institutions Act No. 7 of 2004. The proposals from the Wage Boards are submitted to the Minister who is by virtue of section 98 of the ELRA responsible to issue regulations on wages. Currently, wages are determined in accordance with Labour Institutions Wage Order, GN. 196 of 2013.

1.3. Annual leave

An employee is entitled to annual leave of not less than 28 consecutive days during one leave cycle. One leave cycle is constituted by a period of 12 months' consecutive employment. The 28 days' leave is inclusive of any public holiday which may fall within the period of the leave. During the annual leave, the employee is entitled to payment of his full remuneration in spite of his absence from work.

1.4. Maternity and paternity leave

A female employee is entitled to a paid maternity leave of not less than 84 days during one leave cycle. The maternity leave period would be 100 days if the employee gave birth to more than one child. Similarly, the employee is entitled to an additional 84 days' paid maternity leave within the same leave cycle if the child dies within a year of birth. Likewise, a male employee is entitled to 3 days of paid paternity leave. The only conditions stipulated are that the employee must be the father of the newly born child and that the leave must be taken within the first seven days of the birth of the child.

2. Objectives and functions of employment law

The objectives and functions of employment law can be stated in the following terms:

2.1. protection of the rights of employees

This objective is achieved through the following ways:

a) By restricting the powers of the employer to dismiss employees or to terminate employment. See s. 37 of the ELRA 2004 which deals with unfair termination.
b) By regulating the wage to be paid to workers and hence maintaining the financial capacity of the employee. See sections 26-28 of the ELRA 2004 and PART V of the Labour Institutions Act 2004.
c) By regulating conditions of work or employment for example it provides for rest hours, rest days etc. See part III sub part B of the ELRA.
d) By providing for care and welfare of the employee such as repatriation of the employee, subsistence allowance.
e) By providing the pension and other terminal benefits after retirement.

2.2. Balancing interests between employers and employees

Labour law helps to balance conflicts of interests as between employer and the employee. In any employment relationship, employees are there to earn something for themselves and their families while employers' interest is to make profit Labour law helps to maintain industrial peace by maintaining good relationship between employers and employees. By so doing labour law helps to increase production of goods and provision of services.

2.3. Dispute settlement

Labour law function to resolve disputes arising from employment relations. For instance, the Labour Institutions Act provides for the machinery for which labour disputes may be settled in Tanzania.

3. Sources of Employment Law in Tanzania

Employment law in Tanzania can be traced from the following sources:

1) **Constitution:** This is the basic law of the land, article 22 (1) states that every person has a right to work and as far as remuneration is concerned article 23 (10& (2) is very clear to that effect

2) Statutes: the most part of labour law in this country is codified in the statutes; these statutes are divided in Principal legislation and subsidiary legislation. Some of principle legislations are:

    a) the Employment and Labour Relations Act, No. 6 of 2004
    b) the Labour Institutions Act, No. 7 of 2004
    c) the Occupational Health and safety Act
    d) the Workers' Compensation Act (Cap 263 R.E 2002)
    e) the Public service Act, No. 8 of 2002

    Some of the subsidiary legislations are:

    a) the Employment and Labour Relations (Code of Good Practice) Rules, 2007 [Government Notice No 42 of 16th February 2007]
    b) the Labour Institutions (Mediation and Arbitration) Rules, 2007 [government Notice No. 64 of 23rd March 2007]
    c) the employment and Labour Relations (Forms) Rules, 2007 [Government Notice 65 of 23rd March 2007]
    d) the Labour Institutions and Code of Conduct for Mediators and Arbitrators Rules 2007, [Government Notice No. 66 of 23rd March 2007]
    e) The Labour Institutions (Mediation and Arbitration Guidelines) Rules, 2007 [Government Notice No 67 of 23rd March, 2007)
    f) The Public Service Regulations, 2003 (Government Notice No 168 of 20th June 2003)
    g) The Public Service Scheme, Government Notice No 169 of 20th June 2003
    h) Labour Institutions Wage Order, Government Notice No 196 of 2013.
    i) The Employment and Labour Relations (General) Regulations, Government Notice No 47 of 2017.

3) Case Law from precedents made previous decisions of higher courts i.e. Court of Appeal and High Court. For instance in the case of **JUWATA V KIUTA**, the case was to the effect that, disputes of management employees are supposed to go directly to the Industrial Court of Tanzania without passing through the Conciliation Board; also in the case of **KITUNDU SISAL ESTATE V SHINGO MSHUTI AND OTHERS** (1970) HCD 243 the case defined summary dismissal to mean termination of contract of service without notice.; the same definition was later reiterated by the case of **WALTER JAGER V CORDURA LTD t/a TANGANYIKA TORIST HOTELS AND OYSTER BAY HOTEL** (1972) HCD 133 that to terminate the contract of service before it being out of its course is as much as summary dismissal.

4. Formation of the Contract of Employment in Tanzania

This part will discuss the essential elements of a valid contract of employment and the types and forms of contracts of employment recognised by employment law in Tanzania.

4.1. Essential elements of a valid contract of employment

A contract of employment is a contract between the employer and the employee where the employer promises to pay remuneration and the employee to render services. Thus a contract of employment must contain the essential elements of a contract discussed earlier in this study book. However, this being not just a general contract but a contract of a specific branch of law. It must comply with other specific requirements for a specialised kind of contract, that is, contract of employment.

According to **Ready Mixed Concrete v Ministry of Pensions and National Insurance (1968),** three conditions support the existence of a contract of employment:

a) the employee agrees with the employer to provide his own work and skill in return for wages paid by the employer.
b) the employee either expressly or impliedly agrees with the employer that he will be subject to a degree of control exercisable by the employer.
c) the other provisions of the contract are consistent with the contract being a contract of employment.

The essential elements of a contract as discussed earlier provide the basis for formation of contracts of employment. For a contract of employment to be valid it must have the following elements:

4.2. Offer and acceptance

There must be offer and acceptance. The offer must contain the terms of the contract or indicate where they may be found. For example if a potential employee (X) applies for a particular job, he may be first shortlisted for a post, be invited for a series of interviews and finally be issued with a letter that notifies him or her about selection for a post applied. Until then, X is not an employee of the company to which he or she applied. A letter which notifies him of being selected is what constitutes an offer for employment.

This letter will inform him or her about various terms such as type of work, place of work, working hours and days, salary and other benefits among others. The same letter may also state that other terms will in accordance of the company's policies or government's scheme of service, depending on the type and nature of employer.

After X carefully considers the terms both evidence in the letter and others that may be available in other official documents relevant to the employer, may decide to accept the offer and sign a contract of employment or reject it. It is only after signing the contract that the relationship between X and the company becomes that of employer and employee.

The law in Tanzania requires no specific form of contract of employment. The contract may be oral or in writing. The only exception to this rule is if the contract is to be performed outside the United Republic of Tanzania, it has to be in writing (Section 14 (2) of the ELRA).

4.3. Consideration

The consideration is the employer's promise to pay the agreed wages in return for the employee's promise to perform a particular task. Even though generally speaking in contract law consideration need not be adequate but sufficient, in employment contracts the wages must comply with the minimum wages policies set by the law for each sector or category of employees for example for government employees in terms of scheme of services.

4.4. Capacity

Mainly employment law deals with the capacity of who can be employed rather than who can employ. Generally, the contractual rules on the age of majority, sanity of mind and not being declared bankrupt will apply just as they apply under the general law of contract as discussed earlier. However, under employment law there are additional considerations. For instance, section 5 of the ELRA, 2004 prohibits the employment of a child.

Section 4 of the same Act defines a "child" to mean a person under the age of 14 years; provided that for the employment in hazardous sectors, child means a person under the age of 18 years. Based on this distinction of nature of work in relation to child labour one would argue that prohibition of the employment of a child in Tanzania is not absolute.

Section 5 of the ELRA, 2004 provides detailed and specific rules on when is the prohibition of child labour absolute, when is it allowed depending on the nature of work or employment sectors and which employers are absolutely prohibited from employing children.

4.5. Legality of contract

A contract of employment must be encored in the performance of lawful matter by legally permitted subjects. For instance, production of chemicals in a factory is lawful matter. But when that factory employs a child to work in the chemicals production section, the contract may be help illegal because a child is prohibited from being employed in hazardous works. In addition, a contract of employment would be illegal if it involves forced labour.

Test Yourself 1

Identify three conditions which support the existence of a contract of employment.

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5. Types of employment contracts recognised in Tanzania

Section 14(1) of the (ELRA) provides that employment contracts recognisable in are of three types: a contract for an unspecified period of time; a contract for a specified period of time for professionals and managerial cadre, and a contract for a specific task.

5.1. **A contract for an unspecified period of time**
This is a type of contract that continues until it is terminated through agreement, notice by one party to the other, through an occurrence of death, retirement or due to a lawful cause such as disciplinary measures taken as a result of misconduct at work place. This form of contract is often refers to as permanent and pensionable contract of employment.

5.2. **A contract for a specified period of time for professionals and managerial cadre**
This type of contract exists for a certain specific period which is specified in the contract. The contracts of this nature (practically in writing though no such legal requirement as a general rule) specifies the starting and ending dates of the contract

This type of contract is entered into by professionals hired on the basis on their professionalism and/or by people hired for managerial positions in an organisation. However, the law does not provide for any specific level of education or profession that may entitle an applicant to be considered a professional. It can be argued that since professionals are put in the same category as those in the managerial cadre, then, in the absence of any authoritative or legal interpretation of this provision, people of known professions and levels of education such as accountants, lawyers, architects, doctors among others are eligible for such contracts.

5.3. **A contract for a specific task**

With this type of a contract what is at stake is not working period, but the task to be accomplished. For example, it could be the construction of roads, building a house, painting of a house etc. The employer and employee will enter into a contract to perform a certain specific task and once the task is accomplished the contract also ends. This is commonly referred to as contract for service (see discussion on the next part).

6. Legal safeguards of parties to the contract of employment

Employment law establishes some safeguards to protect employees in the contract of employment. Some of those safeguards are discussed below:

6.1. **Written statement of particulars**

Section 15(1) requires an employer to provide an employee with a written statement of particulars or terms. The employer is required to supply an employee with the statement of particulars when the employee commences employment. Section 15(2) waives this requirement if the particulars are included in a written contract of employment which the employer has supplied to the employee. The statement of particulars should include the following:

(i) name, age, permanent address and sex of the employee;
(ii) place of recruitment;
(iii) job description;
(iv) date of commencement-
(v) form and duration of the contract;
(vi) place of work;
(vii) hours of work;
(viii) remuneration, the method of its calculation, and details of any benefits or payments in kind, and
(ix) any other prescribed matter.

The particulars may either make reference to law, regulations, rules, orders or other documents relevant to the agreement. Also reference may be made to staff regulations of the employer or to a disciplinary code under a relevant law. The importance of particulars of employment was considered in the case of **DPP V. Eliatosha Mosha and Anothe**r [1984] TLR 28 where it was held that they assist the court in arriving at a conclusion whether a person is an employee or an independent contractor.

It should be noted that a written statement of particulars is not the same as or synonymous to a contract of employment though their contents may serve the same purpose to a large extent. This means a written statement of particulars is more important and mandatory in respect of oral contracts of employment. This is for obvious reasons, that is, to mainly safeguard the interests of employees who are usually assumed to be weaker parties in employment contractual relationships.

Without such particulars it would be difficult to prove or disprove a term of a contract in case of dispute. At the same time the possible rationale for the law to allow oral contract is to facilitate business through easy entry into contracts of employment taking into account the level of development in Tanzania, yet without putting the interests of parties at jeopardy.

In a similar vein, section 15(3) provides that if an employee does not understand the written particulars, the employer has a duty to ensure that they are explained to the employee in a manner that the employee understands. Also, where any matter or particular changes, the employer is under obligation, in consultation with the employee, to revise the written particulars to reflect the change and notify the employee of the change in writing.

The employer is also under duty to keep the written particulars (and obviously the written employment contracts if any), for a period of five years after the termination of employment. If in any legal proceedings, an employer fails to produce a written contract or the written particulars as required by the law, the burden of proving or disproving an alleged term of employment shall be on the employer.

6.2. **Duty to display the rights of employees in a conspicuous place**

Section 16 of ELRA provides that the employer shall be under obligation to display a statement of the employee's rights provided for under the ELRA in the prescribed form in a conspicuous place. The prescribed form can be found in the Second Schedule to GN No. 47 of 2017.

Test Yourself 2

State the legal safeguards established to protect employees in oral contracts.

Identify and state the distinction between contract for service and the contract of service. [Learning Outcome c]

7. Distinction between contract for service and contract of service

The Black's Law Dictionary defines an employee as "a person in the service of another under any contract of hire, express or implied, oral or written, where the employer has the power or right to control and direct the employee in the material details of how the work is to be performed." This definition from Black's Law Dictionary is based on the control test on the nature of employment relationship. This was the first test developed to determine the existence of the relationship of employer and employee. Indeed, embedded in the contract of service is an element of control of the employee by the employer, leading to an inherent character of subordination of the employee to the employer or servant to the master. This relationship is characterised further by the fact that the employer bears power while the employee does not bear power.

On the other hand, a contract for service is a contract between two parties with relatively equal powers. One party will be the employer but the other is an independent contractor usually offering specialised services. The independent contractor is expected to possess sufficient skills and technical knowhow required for the service to be offered. That is why he or she need not work under control or direction of the employer/other party.

Also the independent contractor is expected to possess capital required for accomplishing the assignment and hence need not be supplied with working equipment. What is important in a contract for service is to agree on the scope of work, time within which the work should be accomplished and may be the quality of the final product.

It is upon the independent contractor to utilise the resources he possesses to deliver quality product or work to the other party. For practical and monitoring purposes, the agreement between the employer and independent contractor may stipulate that the employer will be entitled to periodic inspection of the work whereas the independent contractor is entitled to partial payment of the total fees upon completing certain stages of the work. Thus, the independent contractor works under a contract for service as opposed to the employee who works under a contract of service.

The distinction between contract of service and contract for service or independent contractor is important. This is because the nature of the relationship gives rise to different nature of obligations and rights between the parties.

In distinguishing between the contract of service and the contract for services three tests have been developed over time. They include:

a) Control test
b) Organisational test
c) Multiple test

In the case of **STEVENSON JORDANS AND HARRISON LTD V MACDONALD AND EVANS** [1952] 1 TLR 101 Lord Justice Denning noted that the distinction between a contract of service and a contract for service is a troublesome question.

7.1. Control test

This is the first test that evolved to decide whether a person was an employee or an independent contractor. The test dates back to the 19th Century. Under this test, in order to recognize that there exists a contract of service or a contract for service the question asked is whether the employer controls not only what a person does but also the manner of doing it. If the answer is yes, then there is an existence of a contract of service. If it is no, the contract is taken to be a contract for service. Thus, under this test the greater the extent the person directs and controls another person, the more likely such a person is to be the employer and the directed or controlled to be an employee.

In **Gould v Minister of National Insurance and Another** it was held that it is easy to say that this is a contract of service and this is a contract for service but there are cases in between the two extremes where it is not easy to draw a line. The court went on to say:

> "It is clear that the real question is one of degree of control exercised by the person employing and this means not only the amount of control but the nature of that control and the direction in which it is exercised".

In this case Lord Thakerton quoted with approval the indicators of a contract of service as enumerated by Lord Justice Clerk. These indicators are:
a) the master's power of selecting his employees,
b) the payment of wages or other remunerations,
c) the master's right to control the method of doing the work and
d) the master's right of suspension or dismissal.

However, this test is suitable to only certain categories of employees such as agricultural workers, clerks etc. These are employees whose employments do not require highly specialized skills. In these circumstances, the employer provides the tools of work.

For works requiring more specialized skills, the control test is insufficient. After the industrial revolution, the control test failed to operate since most of the services were more technical. Therefore the employer could not dictate the manner of performing that service. For instance, a surgeon, pilot or architect are not controlled by the employer in the performance of their work but rather guided by their skills. In fact the control test became irrelevant to all professionals. As such, a new test was developed, known as the organisational test.

7.2. Organisation or integration test

Under this test the question for determining whether there is an existence of a contract of service or a contract for service is whether the person is an integral part of a given organisation in which he works. If the answer is yes, then the law presumes existence of a contract of service. If the answer is negative then there is a contract for service.

This is a test which has brought many professionals to serve under a contract of service. In the case of **Cassidy v Ministry of Health**, Lord Justice Somervell pointed out that there are many contracts of service where the master cannot control the manner in which the work is to be done as in the case of captain of ship. He further stated that under the contract of service a man is employed as part of the business whereas under the contract for services his work although done for the business is not integrated to it but only accessory to it.

In the case of **Rosen V. Queen** the organisation test was used to determine whether a University Professor who used to lecture in three universities was serving under a contract for service or a contract of service. This was important for income tax purposes. It was argued by the professor that he was an independent contractor. This submission was dismissed by the court on the ground that he was doing what any university professor would do and so he was serving under a contract of service because what he did formed an integral part of the business of the university.

Despite the two tests being developed, judges still found themselves in situations where they could not determine whether a person was an employee or an independent contract. Consequently, a third test was developed – the multiple test.

7.3. **Multiple or economic reality test**

This test is a response to the inadequacies of the control and organisational tests. This test takes into account control and organisation test as well as many other relevant factors in determining the nature of the employment relationship. It is called pragmatic because it is not based on rigid doctrines and also it is practical because it calls the court to consider all circumstances in totality and infer whether there is a contract of service. It is multiple because it draws its conclusion from multiplicity of factors. Section 61 of the Labour Institution Act provides the criteria for determining the type of employment relationship. The criteria provided under that section point to the gist of the multiple/economic reality test.

According to the test, in order to draw a conclusion on whether there is a contract of service or a contract for service, the following questions should be answered:

- Whether the work is done on employer's premise or from home.
- Whether the worker is under the control of or bound by the employer's disciplinary code?
- Whether there are any deductions made on remuneration such as taxes.
- Whether the worker runs personal business risk.
- Whether the employer supplies the worker with uniform and/or equipment.
- Does the worker receive payment when absent for illness?
- Does the worker receives or is entitled to holiday pay?
- Whether the worker has membership of company (employer) pension scheme?

Test Yourself 3

State the importance determining whether or not a contract of employment (of service) exists.

Identify and explain the rights and duties of employees and employers in Tanzania.
[Learning Outcome d]

8. Rights and duties of employees and employers in Tanzania

As pointed out above the relationship between employer and employee gives rise to certain rights and duties. These rights and duties may be expressed in the contract between the parties. They may also be fixed in the statutory law applicable or implied either by conduct of the parties or by common law.

8.1. **Duties of the Employer**

a) **Duty to pay wages or remuneration**

Section 27(1) of the ELRA provides for the duty of employer to pay any monetary remuneration to his or her employee to which the employee is entitled. Section 27(2) provides further that each payment shall be supported by a written statement of particulars in the prescribed form which (a) shall accompany the payment if the payment is in cash or by cheque; or (b) shall be given to the employee in a sealed envelope if the payment is by direct deposit. If an employer contravenes the provisions section 27 of the ELRA, he shall be liable to a fine not exceeding one million upon conviction and sentence.

With this duty, the employer has to observe the following matters:

i. **Amount of pay**

The employer is obliged to pay the agreed remuneration. The mode of calculating remuneration is regulated by section 26(1) of the ELRA and the third schedule thereof. Section 26 applies when it is necessary to determine the applicable hourly, daily, weekly or monthly rate of pay. The employer is required to observe government regulations and orders in respect of wages when calculating the amount of pay.

ii. **Minimum wage**

The government (through the Minister for Labour) usually issues the Wage Order which stipulates the minimum wage for various sectors. This is in accordance to the Labour Institutions Act, No. 7 of 2004. The Current Wage Order came into force on 1 July 2013 and was published as Government Notice 196 of 2013. The Wage Order prescribes the minimum wages and in some cases standards. The prescribed minimum wages and standards can still be improved through the collective bargaining agreements or as agreed otherwise.

iii. **Availability of work**

The employer has a duty to pay the employee even if the employee has not worked provided that, it is not the fault of the employee not to work but that of the employer did to provide the work. Time workers should be paid for readiness to work, willingness and being able to work for the agreed hours. With exception to the work which is necessary for the future reputation of the employee, the duty of the employer is to pay remuneration and not to provide work.

However, if no work is available due to circumstances outside the control of the employer, then there is no obligation on the part of the employer to pay the employees. In this case, the employer may be forced to terminate the contracts of employment.

iv. **Overtime payment**

As a general rule, overtime is payable when it is expressly agreed in the contract, or when it is so provided by the custom of trade. In cases where overtime is expressly provided, as obligatory the employer is then under obligation to pay it and the employee in turn must serve it. According to section 18(b) of the ELRA, "overtime" means work over and above ordinary hours of work. Section 19(5) of the ELRA provides that an employer shall pay an employee not less than one and one half times the employee's basic wage for any overtime worked.

v. **Payment during illness**

Section 32 of the ELRA provides that an employee is entitled to sick leave for at least 126 days in a given leave cycle. The employer is obliged to grant the employee a paid sick leave within those days. However, the employer shall not be obliged to pay the employee during sick leave if the employee fails to produce a medical certificate or if the employee is entitled to a paid sick leave under any other law, fund or collective agreement.

vi. **Payment during maternity and paternity leaves**

Section 33(6) provides that an employee shall be entitled, within any leave cycle, to at least 84 days' paid maternity leave (for a single child); or 100 days paid maternity leave if the employee gives birth to more than one child at the same time. An employee is entitled to an additional 84 days paid maternity leave within the leave cycle if the child dies within a year of birth.

Also an employer has a duty to grant 3 days paid paternity leave. The leave must be taken within 7 days of the birth of the child and the employee should be the father of the child. The employer also has a duty to grant at least 4 days paid leave in case of the sickness or death of the employee's child and the death of the employee's spouse, parent, grandparent, grandchild or sibling.

b) **Duty to provide work**

As discussed earlier the employer is generally under no obligation to provide work for his employees except in the following circumstances:

i. If the employment and the particular work is essential to provide a reputation for future employment. In **Clayton & Waller v Oliver** (1930) an actor was engaged and according to the job description he was supposed to have a leading role in a show. The management later on changed mind and engage someone else without jeopardising the actor's lost wages due to non-assignment of work. The actor however, sued for loss of reputation and the court held that he was entitled to damages. In subsequent cases the principle in Clayton's case was extended to journalists and other skilled workers.

ii. If remuneration is subject to amount of work done. If for instance the employee depends of sales commissions as his or her remuneration, the employer will have a duty to provide work in order to enable the employee to earn the commission. In the case of Turner v Goldsmith it was held that the employer was under obligation to provide work for pieceworkers as their pay depended upon performance.

c) **Indemnity**

An employer has a duty to indemnify his employee in circumstances where the employee incurs a liability whilst acting in the course of his employment. However, the employer will not be liable in an indemnity action, if the employee knew that he was doing an unlawful act or where the employee knew that the employer had no right to give the order in question.

d) **Duty to ensure safe working conditions**

At common law there is a duty that the employer must take reasonable care to ensure that the environment or premises in which the employee works is safe. This should include avoiding or removing structural defects, bad ventilation, ensuring the insulations were applicable are safe, no slippery floors or staircases.

e) **Duty not to discriminate against employee/job applicant**

Section 7(4) of ELRA imposes a duty on the employer to treat all employees equally without any kind of discrimination. When an employee or applicant makes an allegation of discrimination at the work place, it is the duty of the employer to prove that discrimination did not take place as alleged

8.2. **Duties of the employee**

The employee's duties are connected to the duties of the employer. The duties of the employer give rise to the rights of employees and hence the rights on part of the employer create corresponding obligations on part of the employees. Thus the employees have the following duties towards their employers:

a) **Duty to render service**

The contract of employment is a business contract with the interest of financial gain at its centre. When the employer promises to pay remuneration he or she does so in expectation of certain services from the employee. The services must actually be rendered by the employee in order to make the business a going concern. Thus if an employee does not tender services may not be entitled to wages with the exception of certain cases such as in case of all types of leaves.

b) **Duty to remain reasonably efficient while in the employer's service**

The employee when applying and signing a contract of service presents himself or herself as possessing certain qualifications, knowledge, skills and experience. It is upon such presentation with a reasonable level of investigation such as studying certificates, applicant's profile and contacting referees that the decision to employ one and not the other is based. After commencing employment the employee is expected to demonstrate the qualifications, skills and experience that he or she alleged to possess.

In addition to the general professional qualification, the employee has a duty to behave responsibly and efficiently in his or her duty including: obeying lawful or reasonable orders within the terms of the contract of employment; serving faithfully; cooperating with the employer in all lawful matters; performing duties with proper care and diligence and without misusing the confidential information acquired while in service.

Depending on the type of contract, the level of expected efficiency may differ. For example for low skilled employees the duty of the employee to remain reasonably efficient may correspond to the employer's duty to specifically train the employee on the required standard of efficiency while in service whereas for professionals and workers in the managerial cadre.

This duty on the part of the employer may not be very strict to allow the employer to hold the employee accountable for failure to remain reasonably efficient. Also this duty corresponds to the employer's duty to prescribe a clear job description against which the efficiency of employee may be measured. This aspect will be discussed further under the part dealing with termination of employment on the ground of incapacity.

c) **Duty to promote and protect the employer's business interests**

The employee has a duty to promote and protect the employer's business interests by devoting his knowledge, skills and full time as per his contract of service to the employer. In order to create conducive environment for the flourishing of the business of the employer an employee must be respectful and obedient to the employer. Failure to abide by these duties by the employee may be deemed to be making the employment relationship intolerable.

Moreover, legally speaking, all employees are agents of their employers whereas the employer is the principal. In accordance to the law of agency, principal has certain legitimate expectations concerning the behaviour of the agent. It follows therefore that the employee as an agent of the principal (employer) must abide to the basic duties embedded in the principal-agent relationship such as the obligation to be royal, obedient, exercise due care and skill, communication and respect for employer's property among others.

In addition to the above, furthering the employer's business interests may also include avoiding avoidable accidents, complying with relevant laws and work schedules and deadlines, undertaking your duties as required so as avoiding any possible liabilities on the part of the employer such as vicarious liability and unsafe conditions in the work premises.

d) **Duty to respect other employees**

An employee has a duty to relate reasonably well with other employees so as not to be an obstacle for others to perform their duties. This should include not using abusive language or perpetrating sexual harassment to other employees.

e) **Duty to refrain from misconduct**

Employees must refrain themselves from misconduct generally. Misconduct by an employee may affect the employer, other employees and clients of the employer or others who may come in contact with the employer for some reasons.

Behaviours that may be regarded as misconduct may include using abusive language to all or any of the groups mentioned above, being under the influence of intoxication in the work premises, absconding from employment among others. Depending on the degree of the misconduct and whether or not the employer has warned the employee against the misconduct depending on the circumstances of each particular case, misconduct may form the basis for termination of employment.

Test Yourself 4

Briefly explain the provisions of ELRA relating to discrimination against employees

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Identify situations in which the contract of employment may be terminated in Tanzania and the consequences of unfair termination and other reliefs.

[Learning Outcome f]

9. Termination of employment contract

The term termination of employment contract has a meaning close to discharge of a contract which is commonly used in general contract law. It means circumstances by which a contract of employment comes to an end either lawfully or unlawfully.

For example in general contract law a contract can be discharged through a breach of contract and also through performance of contractual obligation or by agreement. The same applies with termination of a contract of employment. Termination of a contract of employment can arise in a variety number of ways.

These include, by agreement between employer and employee, by an act of either party with a reasonable cause to terminate the contract without notice, by operation of law and by an act of either party terminating the contract with notice. Termination of contract by operation of law for example may occur in instances of death, dissolution of a partnership or death of a partner (in the absence of term in a partnership deed providing for continuity of partnership in case of death), appointment of a receiver, compulsory winding up of a company and frustration.

Taking the example of termination of a contract of employment as a result of frustration, this is one scenario where a contract will have to be terminated without a fault of either party to the contract. This occurs where each party to the contract becomes incapable of performing his or her part of the contract due to circumstances beyond his or her control. Frustrating events to the contract of employment may include illness of the parties especially of the employee where it is such that it renders the performance of the contract impossible.

Illness may also frustrate an employment contract even if it does not totally render performance totally impossible but at least changes the nature of performance from that originally envisaged when the parties entered into a contract. For where an employee renders personal services such as drumming and due to illness his or her drumming schedules are restricted to two or three per week from three agreed in the contract, such a contract may be held to be frustrated.

This will be easily so held if the sickness is of a permanent nature of likely to persist for a reasonable long period of time depending also on the nature of employment and type of work to be done. Another instance capable of frustrating the employment is imprisonment of an employee.

According to section 36 of the ELRA the incidences of termination of employment contract includes a lawful termination of employment under the common law; a termination by an employee as a result of the employer making continued employment intolerable for the employee; a failure to renew a fixed term contract on the same or similar terms if there was a reasonable expectation of renewal; a failure to allow an employee to resume work after taking maternity leave granted under the ELRA or any agreed maternity leave; and a failure to re-employ an employee if the employer has terminated the employment of a number of employees for the same or similar reasons and has offered to re-employ one or more of them. The next part will discuss each manner of terminating a contract under the Tanzanian labour law.

9.1. **Termination by agreement**

This is anchored on a trite principal of law of contract that parties to a contractual relationship must do so voluntarily and with the meeting of their minds (consensus *ad idem*). It is expected under the general rules of contract that parties will not be forced to be bound by the contract if they can both come to agreement to be relieved from the contractual obligations.

Rule 4 of the Employment and Relations (Code of Good Practice) Rules, 2007 (hereinafter, the Code) creates room for employer and employee to agree to terminate a contract by their agreement. According to rule 4(2) a fixed term contract for example terminates automatically upon the expiry of the term to which the parties agreed that it should terminate.

This means, for instance, if the contract of the parties contained a term that a fixed-term contract shall come to an end at the expiry of two years, the contract shall so end as per the agreement of the parties unless the contract specifies otherwise. Likewise, a contract for specific task shall end upon the completion of task contracted for. In addition, if the employer offers voluntary retrenchment and an employee agrees to it subject to an agreed package the contract of employment terminates from a specified date.

In respect of a fixed term contract it may happen that some fixed term contracts provide that parties shall issues notice to each party may be three months before the expiry of contract if they intend to renew a contract. However, in practice it may happen that although none of the parties, issues such a notice the employee continues to render services and the employer continues to pay salary. Rule 4(3) covers such an eventuality.

The sub-rule provides that there shall be a presumption or renewal by default if after an expiry term of a fixed term contract an employee continues to work and circumstances allow. It is more so when not only does the employee continue to work but also the employer continues to pay.

9.2. **Automatic termination**

This may occur in the event of death of either the employee or the employer depending on the nature of employment or business as per rule 5 of the Code of Good Practice Rules. It may also occur as a result of the business of the employer being would up or where by employer loses the relevant expertise of the business.

Rule 5(2) implies that where the contract of employment is terminated as a result of the employer's business being transferred to another business entity or wound up, the new employer who takes over the activities or responsibilities of the former employer in accordance with the circumstances described above (i.e. due to the death of the employer of employer losing relevant expertise or being wound up) shall first consider to employ the employees whose employment so terminated before considering new/fresh employees.

Also by virtue of Rule5 (3), a contract of employment may terminate automatically where an employee attains the retirement age either as set by the law or by agreement between the parties. In the event that there is no prior agreement concerning retirement age the practice of the employer or work environment shall be taken into account. However, in the event, an employee continues to work after attaining retirement age, the contract of employment shall be renewed and be subject to all rules regulating termination of employment unless the parties agree otherwise (Rule5(5)).

9.3. **Termination of employment by the employer**

Rule 8 of the Code of Good Practice Rules covers termination of contract of employment by the employer generally. According to Rule 8(1)(a)-(c), the employer may legally terminate the employment contract of an employee if he complies with the contractual requirements for termination of contract of employment; complies with the requirements of sections 41-44 of the ELRA concerning the rule on issuance of termination notice, payment of severance pay, provision of transport and payment to the place of recruitment, complies with legal requirements before termination of contract; and has a valid reason for terminating the contract of employment in accordance with section 37(2) of the ELRA.

Rule 8(2) stipulates further that the employer may only legally terminate a fixed term contract of employment before the expiry of contractual period if an employee commits a fundamental breach of the contract of employment. Short of that, the employer may also terminate the fixed-term contract of employment before its expiry by letting the employee agree to such termination.

9.4. **Termination of employment by employee**

Termination of employment contract by employee before the expiry of a period stipulated in the employment contract is also known as resignation. This is covered and elaborated under Rule 6 of the Code of Good Practice Rules. The employee under a fixed term contract has two avenues for terminating such a contract before the expiry of the contract period.

The first avenue available to the employee is if the employer commits material or fundamental breach of the terms of contract. In the absence of the material breach by the employer, the second avenue is by the employee letting the employer agree to an early termination of a contract of employment.

However, in respect of a contract for unspecified period of contract, the situation is a bit different. In such contracts an employee is at liberty to terminate a contract of employment without much condition such as those required for a fixed-term contract. An employee under an unspecified period of time contract can decide unilaterally to terminate a contract of employment by issuance of a notice of termination as per Rule 6(2)(a).

Rule 6(3) of the Code of Good Practice sheds light on what may constitute material breach of the contract of employment by the employer. It refers to a major wrongdoing of a nature of a breach of contract which goes to the root of the contract of employment itself. Such breaches of a fundamental nature likely to warranty termination of employment by the employee without notice are provided for under Rule 6(4) (a)-(d). They include refusal to pay salary or wages, verbal or physical abuse or sexual harassment, unfair discrimination or any other form of breach of contract (rule 5), termination by employee (rule 6), termination by employer (rule 8), and forced resignation/constructive termination (rule 7).

9.5. Forced resignation/constructive termination

Section 36(a)(ii) of the ELRA envisages a situation where an employee terminates employment as a result of the employer making continued employment intolerable for the employee. The Code of Good Practice Rules also covers this type of termination under Rule 7 stating that if such circumstances occur where the employer makes continued employment intolerable to the employer it will be deemed as forced resignation or termination of employment.

Rule 7(2) enumerates situations in which an employee can be deemed constructively dismissed or forced to terminate the contract of employment. These include sexual harassment or failure on the part of the employer to protect the employee against such sexual harassment.

Another scenario that may warrant constructive dismissal is where the employee has been unfairly treated provided such an employee has taken steps to exhaust the administrative procures available to remedy her grievances unless there are fundamental reasons on the part of the employee justifying his or her failure to exhaust such procedural procedures. Thus where it will be determined by a competent authority that the employee terminated employment because the employment was intolerable to the employee, that employment contract will be deemed to have been terminated by the employer.

The High Court of Tanzania (Labour Division) had had an opportunity to deal with the aspect of constructive dismissal in the case of **March L. Lumanija & Another v Tanganyika Bus Service Co. Ltd**. The respondent in this case, had unilaterally changed the terms of the contract of employment from monthly pay to daily pay and forced the applicants (drivers) to sign a new contract of employment on new terms being paid daily instead of monthly rates without prior consultation. In protest to the change, each driver packed the vehicle he was otherwise supposed to drive followed by reporting the dispute to the Commission for Mediation and Arbitration (CMA). In the CMA, the arbitrator found that the termination was fair and that the applicants were not entitled to terminal benefits, on ground of misconduct. Aggrieved by the arbitrator's decision the employees applied for revision of the arbitrator's award to the High Court.

The High Court held that respondent's (employer's) action amounted to constructive termination of the applicants' employment as provided under section 36(a) (ii) (iii) and section 37 of ELRA read together with rule 7 of the Code. The unilateral change of applicants' terms and nature of employment contract from monthly to daily pay amounted to fundamental change to terms and conditions of employment. This was found to amounting to constructive termination of employment and the same was unfair because the employer failed to prove that the said termination was fair in terms of section 37 of the Act. They were therefore awarded terminal benefits.

9.6. Failure to Renew a Fixed Term Contract on the same or Similar Terms if there was a reasonable expectation of renewal

This is provided for under section 36 read together with rule 4(4) of the Code of Good Practice Rules. It provides that if there is failure to renew a fixed term contract where there was reasonable expectation of renew that would amount to termination. It will be unfair termination of employment where in the circumstances of each case an employee had reasonable expectation of renew of employment after the expiry of the preceding fixed term contract.

Depending on the circumstances, the provisions of section 61 of the Labour Institutions Act may be used to presume existence of employment contract when even though there is no formal renewal of a fixed term contract, the employer continues to render equipment to the employee or tools of trade, the employee continues to work for that same employer only during the disputed period and hence becomes economically dependent upon that employer.

In respect to reasonable expectation of renewal by employee rule 4(4) provides a guiding criteria. For instance a record of previous renewals or employer's undertaking to renew the contract may form a reasonable ground of expectation on part of the employee for another renewal.

9.7. A failure to allow an employee to resume work after taking maternity leave

Section 36(a)(iv) of the ELRA provides that it is termination of employment to fail to allow an employee to resume work after taking maternity leave granted under the Act or any agreed maternity leave.

10. Concept of unfair termination of employment

Section 37 of the ELRA addresses the question of unfair termination of employment. It is important to note that this section do not apply to an employee with less than 6 months' employment with the same employer, whether under one or more contracts.

Section 37 provides that it shall be unlawful for an employer to terminate the employment of an employee unfairly. By use of the phrase 'unfair termination' the ELRA does away with the concept of dismissal or summary dismissal. The section goes on to state that a termination of employment by an employer is unfair if employer fails to prove either that the reason for the termination is valid, that the reason is a fair reason or that the employment was terminated in accordance with a fair procedure.

10.1. What constitutes unfair termination of employment?

Section 37(2) of the ELRA clearly provides for what constitutes unfair termination of employment by an employer in Tanzania. It provides that termination of employment by an employer is unfair if the employer fails to prove either that that the reason for the termination is valid or that the reason is a fair reason. Fairness of termination is divided into two: substantive fairness and procedural fairness.

Substantive fairness refers to the valid legal reasons by which contract of employment may be terminated. According to section 37(1)(b) (i) and (ii) a fair reason for termination of employment is that which is related to the employee's conduct, capacity or compatibility. It can also be based on the operational requirements of the employer. In addition to the substantive fairness or validity of the reason for termination, the law also takes into account the procedure for terminating the employment. That means, even where the employer proves that the termination of employment of employee was due to a valid or fair reason, another requirement is that the employer must show that the required procedure for termination was followed. That is a procedure for termination must be fair as prescribed under the law. This is known as procedural fairness.

For avoidance of doubt, section 37(3) enumerates the reasons that cannot be taken as fair reasons for termination of a contract of employment. The reasons are categorised into two groups of (a) and (b). It provides that it shall not be a fair reason to terminate the employment of an employee:

> "for the reason that: discloses information that the employee is entitled or required to disclose to another person under this Act or any other law; fails or refuses to do anything that an employer may not lawfully permit or require the employee to do; exercises any right conferred by agreement, this Act or any other law; belongs, or belonged, to any trade union; or participates in the lawful activities of a trade union, including a lawful strike. In addition it shall not be fair reason to terminate the employment of an employee for reasons: related to pregnancy; related to disability, and that constitute discrimination under ELRA".

Section 37(4) of the ELRA requires an employer, arbitrator or labour court when deciding whether the termination of employment was fair or not to take into account any Code of Good Practice published under section 99 of the ELRA. Rule 9(1) of the Code of Good Practice Rules echoes the provisions of section 37 by reiterating that an employer shall follow a fair procedure before terminating the employment contract of an employee which may depend to some extent on the kind of reasons given for such termination.

Rule 9(2) stresses and clarifies that the procedure to be used in respect of incapacity or incapability shall be different. In any case the employer bears the burden of proving that the reason was fair or valid and the procedure was also fair but the nature of burden is that of balance of probabilities as per rule 9(3). Rule 9(4) lists reasons which may justify termination by the employer upon following a fair procedure to be conduct, capacity, compatibility or employer's operations requirements.

10.2. Termination of employment contract on ground of misconduct

Rule 11 of the Code of Good Practice Rules, 2007 provides for the duty on part of employer to manage misconduct in workplaces including a duty to implement disciplinary policies and make them available and known to the employees, and to adopt corrective disciplinary measures geared at correction of the behaviour of the employee including counselling and warning.

Rule 11 was applied in both the CMA and the Labour Court in the case of **Knight Support Ltd v Chrisprinus S Kaloli**. The facts of the case were that the respondent (employee) had been away from the job

for five consecutive days for what he averred to be due to illness, the fact that the applicant (employer) denied. In application for revision of the arbitrator's award in the labour Court the applicant argued that the respondent did not follow a proper procure in booking his sick sheet and abiding to the Organisational Rules in obtaining the claimed treatment from a hospital or clinic not recommended by the employer and that the respondent had continued to be away from employment without leave.

The employer argued that being away from employment for more than five days was sufficient ground of termination. Moreover, the employer sought to rely on the provisions of rule 9(1) which provides that an employer shall follow a fair procedure before terminating an employee's employment which may depend to some extent on the kind of reasons given for such termination.

Accordingly the employer sought the labour court to fault the decision of the arbitrator on the ground that the arbitrator based much on the disciplinary procedure whereas in the employer's view the employer has a right to depart from it depending on the circumstances of each case and nature of the offence.

The High Court Labour Division held that the there was sufficient proof that the respondent (employee) was sick and hence it could not be said that his absconding from work constituted misconduct. The Court also went on hold by way of obiter that even if there was any misconduct the employer was duty bound to comply with the provisions of Rule 11(4) of the Code of Good Practice Rules.

The provision of Rule 11 provides that efforts shall be made to correct employee's behaviour through a system of disciplinary measures such as counselling and warnings. Thus the employer ought to counsel and warn the employee first rather than terminating the employment outright.

Rule 12(2) provides further that the first offence of an employee shall not justify termination of employment unless the misconduct is proved to be so grave to make the continued employment relationship intolerable. Rule 12(3) lists the acts which may justify termination to include gross dishonesty, wilful damage to property, wilful endangering the safety of others, gross negligence, assault on a co-employer, supplier, customer or a member of the family of, and any other person associated with, the employer and gross insubordination. Even though these acts may exist against the employee they do not automatically entitle the employer to terminate the employment of the employee out rightly.

10.3. Termination of employment contract on ground of incapacity

Rules 15 and 16 of the Code of Good Practice Rules govern this aspect read together with section 37 of ELRA. Rule 15(1) elaborates on what may determine the employee's incapacity to include ill-health, injury or poor work performance. Rule 15(2) requires that each reason or aspect of incapacity should be dealt with on its merits and a fair procedure must be applied accordingly depending on the circumstances of each case. Also for the termination of employment to be valid on the basis of incapacity of employee on the ground of poor work performance the employer must show that there existed performance standards which were also known to the employees.

In respect to poor work performance as a component of employee's incapacity to perform the work, rule 17(1) requires any decision maker (employer, arbitrator or Labour Court) to make a determination as whether the termination of employment on ground of poor work performance is fair considering a number of factors. These factors include whether or not the employee failed to meet a performance standard; whether the employee was aware, or could reasonably be expected to have been aware, of the required performance standard; whether the performance standard are reasonable; the reasons why the employee failed to meet the standard; and whether the employee was afforded a fair opportunity to meet the performance standard.

Rules 17(2) establishes a principle that even though the employer has the managerial prerogative to set performance standards, such set standards shall (or should) not be unreasonable. It is acknowledged however by rule 17(3) that proof of poor work performance is a question of fact to be determined on a balance of probabilities.

Rule 18 is dedicated to the fairness of procedure in respect of termination of employment on ground of incapacity emanating from poor work performance. It requires the employer to first, before considering termination, carry out an investigation concerning the reasons for unsatisfactory work performance which is intended to reveal the extent of the problem. The outcome of the investigation may guide the employer to provide appropriate guidance, instructions or training, if necessary to an employee before terminating the employee for poor work performance.

The employee should be given reasonable time to improve depending on the nature of the job, the extent of the performance, status of the employee, length of service and the employee past performance record. Should no positive change occur the employer is required to warn the employee that employment may terminate if there is no improvement.

However, an opportunity to improve may be dispensed with if the employee is a manger or senior employee whose knowledge and experience qualify him to judge whether he is meeting the standards set by the

employer, which must be reasonable. The opportunity to improve may also be dispensed with if the degree of professional skill that is required is so high that the potential consequences of the smallest departure from that high standard are so serious that even an isolated instance of failure to meet the standard may justify termination.

Rule 18(6) enjoins an employer contemplating termination of the employee's employment on ground of poor work performance to hold a meeting with an employee, the latter who shall be entitled to the representation of fellow employee or trade union for assistance. Both sides (employer and employee) at the meeting shall make presentation on the reasons for the action to be taken on part of the employer and defence or explanation on part of the employee. The employer is enjoined to take into account the presentations and if not acceptable on his part explain why. The employer is further enjoined to communicate the outcome of the meeting to the employee in writing with brief reasons.

In the case of **TISCAN Limited v Levocatus Simba,** the Labour court had an opportunity to consider some of these provisions of the law. The issues in the CMA were whether there was a valid reason for terminating the services of the respondent (employee) and whether the employer followed a fair procedure in terminating the employment of the employee. In the CMA the arbitrator found that there was no valid reason for terminating the employment and the respondent (employee) was not given an opportunity/right to be heard the fair procedure for termination of employment was not adhered to.

Having determined that the main reason for termination of employment was non-performance, the High Court went on to reiterate the position of the law discussed above that the determination of whether there is poor work performance is a question of fact as per rules 17(1), (3) and rule 18 of G.N no. 42/2007. The court concluded that the employer is duty bound to inquire on the fairness of the reason and follow the stipulated procedure. Failure to follow the stipulated procedure denied the respondent the fundamental right to be heard on allegations charged in the termination letter. The transaction [in respect of] which the employee was required to give explanation, prior to suspension were quite different from those indicated in the termination letter. Hence the employee, in the circumstances of the case was entitled to be given an opportunity to account for the poor work performance.

The quoted part of the judgment underscores two important points. One is the importance of the requirement to carry out an investigation to ascertain whether or not a hearing is necessary before termination is considered. Embedded in a requirement for a hearing is the need to grant especially to the employee the right to be heard. The right to be heard includes allowing the employee to put forward explanation or defence in respect of the offence he is charged with and where the charge contains different offence whereas he is terminated on a different allegation for which he has not been specifically given an opportunity to put forward defence it cannot be said that the requirement for a fair procedure including availing an accused person a right to be heard has been complied with.

Another important principle underscored in the above ruling is to differentiate termination on ground of misconduct from termination resulting from incapacity including poor work performance. This is because the resultant procedures and duties on part of the employer before he can come to a decision to terminate are different.

The reasoning in the above cited case is also echoed in **Cocacola kwanza Ltd v. Emmanuel Mollel**. The respondent in this case referred the dispute to CMA which was about termination of services by the applicant. The respondent claimed that the termination was unfair and applied for reliefs, during the proceedings it was alleged that the applicant wrote a letter to the respondent calling the applicant for disciplinary hearing, which implied that he will be called for disciplinary proceedings due to gross negligence. Later on, he was terminated from employment on ground of incapacity. The arbitrator ruled in favour of respondent.

The applicant made an application for revision of an arbitrator's award on the ground that termination was fair and that the difference between gross negligence shown as a charge in the letter calling the disciplinary proceedings and the reason of incapacity as given in the letter of termination is not serious enough to warrant the orders made by the arbitrator. The court held that the termination was unfair termination because the reasons cited in the letter were different from those cited in the letter of disciplinary action. Also, termination was based on an audit report in which the employee was not involved as the audit was conducted after he was terminated.

10.4. Termination of employment on ground of ill health or injury

As stated above, ill-health or injury are taken to be components of incapacity hence likely to justify termination of employment by the employer. However, the substantive and procedural fairness in relation to termination of employment on ground of ill health are governed by rules 19, 20 (particularly on HIV/AIDS) and 21 of the Code of Good Practice Rules, 2007.

Rule 19(1) provides for the factors that an employer contemplating to terminate the employment of an employee on ground of ill health or injury should take into account. The factors include: the cause of the incapacity, the degree of the incapacity, the temporary or permanent nature of the incapacity, the ability to accommodate the incapacity and the existence of any compensation or pension.

Rule 19(2) enjoins the employer to go to greater lengths to accommodate the employee in terms of the ability to accommodate where an employee is injured at work or is incapacitated by a work-related illness. In determining the cause of the injury or incapacity, the degree thereof and whether it is of permanent or temporary nature the employer shall be guided by the opinion of a registered medical practitioner. If it is determined that the employee is temporarily unable to work the employer is required by rule 19(4) to investigate the extent of the incapacity or the injury.

Where it is discovered upon investigation that the employee is likely to be absent for a time that is unreasonably long in the circumstances of a particular case (for example taking into account the nature and duration of the employment contract and or inherent requirements of a job) the employer is enjoined to investigate possible ways to accommodate the employee or to consider all possible alternatives short of termination.

Rule 19(6) lists possible alternatives short of termination as including: temporary replacement, light duty, alternative work, early retirement, pension or any other acceptable alternative. The factors that may be relevant in the investigation include the nature of the job, the period of absence, the seriousness of the illness or injury, and the possibility of securing a temporary replacement or adapting the job.

Rule 19(8) goes to a greater length by accommodating employees who incapable to perform their work as a result of alcoholism or drug abuse. It provides that in such cases counselling and rehabilitation may be appropriate steps for an employer to consider.

In any cause of incapacity discussed above, where the employee is permanently incapacitated, the employer shall ascertain the possibility of securing alternative employment for the employee or adapting the duties or work circumstances of the employee to accommodate the employee's disability. If the employee is incapacitated to a limited degree the employer is under duty to consider removing the duties the employee cannot perform and if possible adding those which are less onerous tasks or adapting the work environment to accommodate the employee's disability.

The law provides guidelines in terms of rules in making such choices of alternatives and considerations. Rule 19(11) provides that the general test is whether in a particular case the employer can reasonably be expected to accommodate the employee's disability taking into account the cost, practicality and convenience of such steps, and the cause of the employee's incapacity. Determination of the cause of the incapacity is vital because there is more onerous duty on an employer where the incapacity arose out of a work-related injury or illness.

It appears the law discourages employers to consider termination on ground of ill health or injury as the obvious option by somehow providing for endless procedures and opening up possible options for accommodating the employee despite illness or injury.

Rule 19(12) goes on to provide that where it is established that the employee's work circumstances or duties cannot reasonably be adapted to accommodate the disability, the employer shall consider the availability of any suitable alternative work. Suitable alternative work will depend on the circumstances and may include such factors as whether the incapacity was due to a work-related illness or injury, the employee's experience and qualification and the employee's ability to adapt to a changed working environment. And if there is a vacancy which the employee could fill with training such vacancy shall be offered to the employee.

In the case of **Martin Oyier v. Geita Gold Mine Ltd** a dispute relating to termination on ground of ill health (incapacity) the application of rule 19 was considered. The applicant (an employee) of the respondent filed an application for revision of the decision based on an arbitrator’s finding that termination was fair, on grounds of ill health.

The application was based on grounds that arbitrator's decision was not based on the adduced evidence, that the arbitrator wrongly concluded that the doctor advised that he be terminated while the advice was that he be given light duty, that rule 19(13) of ELR (code of good practice) rules 2007 was not complied with, that the employer failed to consider that he had other qualifications and therefore could be given alternative employment. The issue for consideration by the High Court was whether on the basis of evidence on record, the arbitrator's decision that termination was fair was irrational or a misinterpretation of evidence.

The Court held that although the law does not mandate an employer to continue to employ an employee who cannot perform duties, the employer is required to make reasonable efforts to accommodate the employee's disability caused by ill health before taking a decision to terminate. The judge found that the termination was procedurally unfair because there was no evidence to show that the duration/permanency of the respondent’s ill health was investigated. The investigations carried on focused only on the respondent’s current position and not having a possibility to do alternative work and so many other procedural irregularities. Hence the termination was unfair.

10.5. Termination of employment on ground of incompatibility

In view of section 37(2)(b)(i) read together with rule 22, incompatibility constitutes a fair reason for termination of employment. According to rule 22(1) there are two types of incompatibility. The first type refers to unsuitability of the employees to his work due to his character or disposition. The second type refers to the incompatibility of the employee to his work environment in that he relates badly with fellow employees, clients or other persons who are important to the business.

The employer contemplating termination of the employment of employee on ground of incompatibility is required to treat the matter in a similar way as to incapacity for poor work performance. Thus the steps required to be complied with under rule 18 in respect of incapacity for poor work performance are also applicable in case of poor work performance.

However, specific circumstances of each case may require or justify strict adherence to the said rule within the limits of the law as provides for under rule 22(3). In particular, the employer is required to record the incidents of incompatibility that gave rise to concrete problems or disruption. The employer is also expected to warn and counsel the employee before termination. This should include advising the employee of unacceptable conduct, who has been adversely affected by the conduct, and what remedial action is proposed.

After taking into account all the surrounding circumstances the employer can terminate the employment of the employee. However, before taking such a decision to terminate the employment of the employee on the ground of incompatibility, the employer must give the employee a fair opportunity to consider and reply to the allegations of incompatibility, remove the cause for disharmony or propose an alternative to termination.

10.6. Termination of employment on the basis of operational requirement of the employer

Section 4 defines 'operational requirements' to mean requirements based on the economic, technological, structural or similar needs of the employer. Under the Code of Good Practice Rules, this aspect is covered under rule 23. Termination of employment on ground of operational requirement is also known as or referred to as retrenchment. Rule 23(2) elaborates the scope of the three components of operational requirements mentioned in section 4 concerning the definition of operational requirements, i.e. economic needs, technological needs and structural needs. The rule provides that as a general rule the circumstances that may legitimately form the basis of termination are:

a) economic needs that relate to the financial management of the enterprise,
b) technological needs that refer to the introduction of new technology which affects work relationships either by making existing jobs redundant or by requiring employees to adapt to the new technology or a consequential restructuring of the workplace,
c) structural needs that arise from restructuring of the business as a result of a number of business related causes such as the merger of business, a change in the nature of the business, or effective ways of working, a transfer of the business or part of the business.

Rule 23(3) imposes a duty and grants mandate on the court to scrutinise a termination based on operational requirements carefully in order to ensure that the employer considered all possible alternatives to termination before termination was effected in a particular case.

Section 38 of the ELRA provides for a procedure for carrying out retrenchments. It provides in subsection (1) of section 38 that in any termination for operational requirements (retrenchment), the employer must comply with the requisite principles which are stipulated under the same sub-section. The principles are to the effect that:

(a) The employer must give notice of any intention to retrench as soon as it is contemplated;
(b) The employer must disclose of all relevant information on the intended retrenchment for the purpose of proper consultation with the employees likely to be affected and consultation prior to retrenchment or redundancy. In this respect, the employer must:

  (i) give the reasons for the intended retrenchment,
  (ii) explain any measures to avoid or minimise the intended retrenchment,
  (iii) state the method of selection of the employees to be retrenched, the timing of the retrenchments, and
  (iv) ensure the payment of severance pay in respect of the retrenchments,

(c) Give the notice; make the disclosure and consult, in terms of subsection 1 to section 38.
(d) The employer is further obliged to consult in addition to the employees, with any trade union recognised in terms of section 67 of ELRA.

Therefore, in such cases, the primary duty in respect of consultation is to the trade union but if there are employees who are not represented through trade union, the employees themselves must be consulted in person.

According to section 37(2), where in the consultations held in terms of sub-section (l) no agreement is reached between the parties, the matter must be referred to mediation under Part VIII of the ELRA. The objective that must be taken into account throughout the consultation process is stated in rule 23(4) that the purpose of the consultation required by section 38 discussed above is to permit the parties (employer and employees whether in person or through the representation of trade unions) in the form of a joint problem solving exercise, to reach agreement on reasons for the intended retrenchment, any measures to avoid or minimise the intended retrenchment such as transfer to other jobs, early retirement, voluntary retrenchment packages, lay off among others.

Also the consultation process is expected to lead to an amicable solution concerning the criteria for selecting the employees for termination, such as last-in-first out (LIFO), subject to the need to retain key jobs, experience or special skills, affirmative action and qualifications. Another consideration to be taken into account and expected to be mutually resolved relates to the timing for the proposed retrenchment, severance pay and other conditions of which terminations take place as well as steps to avoid the adverse effects of the terminations such as time off to seek work.

Moreover, rule 23(6) provides that the consultation process referred to above must commence as soon as the employer contemplates a reduction of the workforce by way of retrenchment to enable exploration of possible alternatives and hence effectiveness of the consultation process. Thus the process should allow sufficient time to the union to meet and report to employees, meet with the employer and request, receive and consider all relevant information to enable the trade union to inform itself of the relevant facts for the purpose of reaching agreement with the employer on possible alternative solutions.

The circumstances of each case in view of the above paragraph must be taken into account. For example if the need of the business to respond to the factors giving rise to any contemplated termination of employment through retrenchment is so urgent, the consultation process may equally be so truncated. This is a consideration of rule 23(7).

The same rub-rule however, warns that urgency may not be induced by the failure to commence the process as soon as a reduction of workforce was likely. To meet the objectives of the consultation process outline above, the sub-rule also provides that the parties who are required to reach agreement shall meet, as soon as and as frequently as may be practicable during the process.

As stated earlier in view of section 38(2) of the ELRA and reiterated by rule 23(8) after the consultation process if no agreement is reached between the parties, the matter will have to be referred to commission for medication and arbitration (CMA). In any case, if there is an agreement reached between the employer and a trade union recognised as the exclusive bargaining agent, it will be binding on all employees within the bargaining unit in terms of section 71(3)(c) of the ELRA.

Where a matter is referred to the CMA, the employer may not implement the retrenchment plan within 30 days of the referral to the medication. This can only be possible if it is agreed between the parties. Once the period of 30 days has elapsed the employer may proceed with retrenchment unilaterally. However, the fairness of the employer's actions may be disputed and referred to arbitration, once the mediation fails.

Rule 24 deals with a situation where retrenchment is selective, that is where only one or two employees are to be selected for the termination from a number of employees. It requires that in such cases, the criteria for such selection must be agreed with the trade union. If criteria are not agreed, the criteria used by the employer must be fair and objective.

Correspondingly, rule 24(2) provides that the criteria that infringe a right protected by the ELRA cannot be deemed to be fair if applied. Such criteria include selection on the basis of union membership or activity, pregnancy or other discriminatory grounds. Rule 24(3) lists selection criteria that are generally accepted as fair and these include: length of service, the need to retain key jobs, experience or skills, affirmative action and qualifications.

Section 38(3) provides that where, in any retrenchment, the reason for the termination is the refusal of an employee to accept new terms and conditions of employment, the employer shall satisfy the Labour Court that the recourse to a lock out to effect the change to terms and conditions was not appropriate in the circumstances.

Finally rule 25(1) provides in effect that where it occurs that after retrenchment has taken place and the employer happens to re-hire employees with comparable qualifications such employer is under obligation to give preference to the retrenched employees. This is subject to the condition that the employee having expressed within a reasonable time from the date of termination a desire to be re-hired and a time limit on preferential re-hiring shall also ideally form the subject of agreement between the employer and the union.

Once the above conditions are met, the employer is supposed to take reasonable steps to inform the employee, including notification of the representative trade union, of the offer of re-employment.

10.7. Termination of employment on a ground related to pregnancy

Section 37(3) (b) provides that it shall not be a fair reason to terminate the employment of an employee on aground that relates to pregnancy. The ELR Code of Good Practice Rules G.N no. 42 of 2007 do not seem to contain elaborate provision on this criteria of unfair reason for termination of employment.

Even though it is generally said, based on published reports that women female employees are more than often harassed on basis of pregnancy including discrimination and termination employment it seems such cases do not come feature into the mostly reported cases in the dispute resolution institutions. However considering that the ELRA borrows heavily from the South Africa labour statutes, some decisions made in South Africa can clarify this.

The case of **Marie-louise de Beer v S.A. Export Connection** is a case in point. The applicant was employed by the respondent as a travel consultant. She fell pregnant and agreed with the respondent to return to work a month after she had given birth contrary to a four months maternity leave to which she was entitled to under the law. She gave birth to twins who suffered from colic. Two to three days before the applicant was required to return to work, she requested that she be given a further one month off to stay with her twins at home.

The respondent was prepared to grant her an extra two weeks only (instead of the requested one month) that the applicant refused to accept. Her services were terminated on 31 October 2005. She then referred a dispute to the CCMA and contended that her dismissal was automatically unfair in terms of section 187(1) (e) of the Labour Relations Act 66 of 1995 (the LRA).

Section 187 of the South Africa's labour Relations Act contain in part a provision similar to section 37(3)(b) of the Tanzania Employment and Labour Relations Act No. 6 of 2004 cited above. The section (Section 187(1)(e) of the LRA) provides that 'A dismissal is automatically unfair if the employer, in dismissing the employee, acts contrary to section 5 or, if the reason for the dismissal is the employee's pregnancy, intended pregnancy, or any reason related to her pregnancy'.

In the above cited case, the Court attempted to define the meaning of a phrase ' any reason related to her pregnancy' and held that:

The phrase "any reason related to her pregnancy" should in my view be carefully considered by the Courts. No rigid rules can be given by this Court and each matter should be considered on its own facts. Where an employee like the applicant in this present case is denied the right to go on maternity leave for four months, has a colic child or a child with a condition that needs the nurturing of a mother and is dismissed, it will be impossible for the employer to argue that the condition of the baby and in this case the colic babies are not linked to the pregnancy. After all, the natural consequence of being pregnant is giving birth...

The fact is that the applicant was entitled to four months maternity leave. The law allows her to structure how she intends to take the maternity leave. Whether she agreed to work a shorter period does not assist the respondent. The agreement was unlawful. The phrase "any reason" is not only related to pregnancy related health problems but should also include babies who are ill and need nurturing from their mothers.

Before arriving to the holding cited above the court reasoned taking into account the balancing exercise between the cost on part of the employer and the need to accord equal opportunities at work places and stated as follows:

> 'Section 187(1) (e) of the LRA must be seen as part of social legislation passed for the specific protection of women and to put them on an equal footing with men. I have no doubt that it is often a considerable burden to an employer to have to make the necessary arrangements to keep a woman's job open for her while she is absent from work to have a baby, but this is a price that has to be paid as part of the social and legal recognition of the equal status of women in the workplace. If an employer dismisses a woman because she is pregnant and is not prepared to make the arrangements to cover her temporary absence from work the dismissal would automatically be unfair'.

The above case is also an authority for the principle that the parties to the employment contract cannot validly/legally enter into a contract which provides for inferior terms than those provided for in the law.

10.8. Mass dismissal/termination

Termination of employment includes a failure to re-employ an employee if the employer has terminated the employment of a number of employees for the same or similar reasons and has offered to re-employ one or more of them.

This principle is provided for under section 36(a) (v) as constituting termination of employment. The Act provides that termination of employment includes a failure to re-employ an employee if the employer has terminated the employment of a number of employees for the same or similar reasons and has offered to re-employ one or more of them.

This principle prevents employers from utilising the mechanism of termination of employment as a weapon in favour of employer's unacceptable conducts or using termination of employment as a form of punishing those employees who behave in a manner not considered to be favourable to the employer even where such conducts are lawful and actually encouraged by the law. The law foresees a situation where the employer may decide to terminate the employment of, for instance, employees who participated in a strike and later decide to re employ them except the ring leaders.

10.9. Other aspects of procedural fairness in respect of termination of employment

As discussed earlier, validity of termination of employment requires both substantive (fairness of reason) and procedural (fairness of the procedure) for terminating a contract of employment. Thus apart from the procedure relating to validating the fairness of the reason such as incapacity or incompatibility discussed above, there are other procedural requirements. These relate to prescribed notice of termination, payment of severance amount, and transport to place of recruitment, other payments and issuance of certificate of employment. The following sub-part discusses these items one after another.

10.9.1 Issuance of notice

Section 41(1) provides that if a contract of employment can be terminated on notice. The period of notice shall not be less than seven days, if notice is given in the first month of employment. Where notice is not given in the first month of employment, the notice period is 4 days if the employee is employed on a daily or weekly basis and 28 days if the employee is employed on a monthly basis. In the case of **Omary Mkele &20 Others v. M/s Shipping Freight Consultant** discussed above the labour court pronounced on the requirement of notice in relation to a contract for a specific task under section14(1)(c) of the ELRA.

The applicants filed a claim for compensation against former employer (the respondent) for dismissal which the complainant's alleged was unfair. Evidence showed that the applicants were employed on daily basis that is they were employed for 8 hours basis and paid at the end of the day for performing specific assigned tasks as discussed earlier in this Study Guide. In this case the employer paid the employees 7days notice pay (which was above statutory requirement). The judge having found that the complainants were employed under oral contract for a specific task under section 14(1)(c) ELRA which ended at the end of each working day, proceeded to hold that the notice period of 7 days was sufficient and in fact beyond the legal requirement of 4 days and hence lawful.

In **Hamza Jembe v. Salmin Mbaraka** the applicant filed an application for revision of an arbitrator's award. The applicant was employed as a night watchman. He only worked for 3 days and terminated by employer because he left the guard point without notice. He challenged the termination to be unfair because the employer did not conduct disciplinary proceeding before terminating him and also he did not abide with section 41(1)(a) of ELRA which required the employer to give seven days' notice of dismissal from employment.

The Arbitrator found that the applicant was not entitled to salary in lieu of notice because he had left his guard point, an act which would have caused loss to the employer.

> The High Court on its part overruling the decision of the Arbitrator held that for such a finding to hold, the employer must be shown to have acted in accordance with the Code of Good Practice Rules, GN no 42 of 2007 which enjoin the employer to conduct disciplinary proceedings [to establish misconduct] before enforcing a disciplinary penalty. There were no such disciplinary proceedings held, so the arbitrator could not unilaterally find the applicant guilty of misconduct. The applicant is entitled to payment in lieu of notice. The facts show that the applicant was dismissed in the first month of service, so the period of notice is seven days. The court awarded the applicant among others 13,500/= as a penalty to employer for failure to abide with the procedural requirement of giving a 7-day notice.

The law describes the period or circumstances within which notice of termination cannot be validly/legally provides. These include during any period of leave taken under this the ELRA or to run concurrently with any such period of leave.

Also according to section 41(5) an employer may pay the employee the remuneration that the employee would have received if the employee had worked during the notice period instead of giving an employee notice of termination. This is the basis of the holding of Mandia J discussed above and common practice.

However, where an employer issues notice while an employee is expected to be working during the notice period but an employee refuses to work during the notice period, an employer may deduct, from any money due to that employee on termination, the amount that would have been due to the employee if that employee had worked during the notice period.

However nothing in section 41 may affect the right of an employee to dispute the lawfulness or fairness of a termination of employment under the ELRA or any other law or an employer or an employee to terminate employment without notice for any cause recognised by law.

10.9.2 Severance pay

The aspect of payment of severance pay is governed by section 42 of the ELRA, rule 26(1)-(3) of the Code of Good Practice G.N 42 of 2007 and a number of the High Court decisions. Section 42 of ELRA defines the term severance pay to mean an amount at least equal to 7 days' basic wage for each completed year of continuous service with that employer, up to a maximum of ten years.

Section 42 and rule 26 provide restrictions or conditions for payment of severance pay. These include completion of 12 months continuous service with an employer by an employee; and the fact that subject to the provisions of subsection 42(3), the employer terminates the employment.

However, according to section 42(3) the employee shall not be entitled to severance pay if the termination is fair on grounds of misconduct, incapacity, incompatibility or operational requirements of the employer but who unreasonably refuses to accept alternative employment with that employer or any other employer in respect of the last ground.

Rule 26 which otherwise contains similar provisions as section 42 provides for an additional pre-requisite for the entitlement to severance pay by an employee upon termination of employment. Rule 26(2) provides that the employer is not required to pay severance pay if the employment is terminated before the competition of the first year of employment.

What constitutes unreasonable refusal (to accept alternative employment with that employer or any other employer) in respect of section 42(3) (b) of ELRA or rule 26(2) (c) depends on the circumstances of each case. In any case, the payment of severance pay under the ELRA (section 42) shall not affect an employee's right to any other amount payable under the ELRA or any other written law.

It is possibly on the basis of rule 26(2)(a) the High Court has persistently held that employees under contract for a specific task whose employment ends at the completion of the task and payable daily are not entitled to severance pay.

For example in **Omary Mkele&20 Others v. M/s Shipping Freight Consultant** the judge found that the complainants were employed under oral contract for a specific task under section 14(1)(c) ELRA which ended at the end of each working day. Thus, they do not qualify for severance pay under section 42 ELRA 2004.

In another case of **Leonard Charles v. M.G.Teng**a the applicant filed in CMA a dispute about termination of services. The applicant claimed that he was unfairly terminated and was not paid terminal benefits. After a due hearing, the arbitrator found that the applicant was employed for specific task and paid at the end of every four hours of work as laid down in the Wage Order. The arbitrator dismissed the applicant's claim for notice pay and severance allowance because he was on daily pay basis. The applicant aggrieved with these findings referred a revision in the labour court.

The judge held that arbitrator was right in ruling that the applicant was not entitled to leave pay and was not eligible for the NSSF scheme. However it was held that the arbitrator was erroneous in ruling that the applicant was not entitled to notice pay as the applicant was entitled to the same under section 41(1)(b)(i) ELRA. Therefore applicant was awarded four days' notice pay.

10.9.3 Transport to place of recruitment

Section 43(1) of the Employment and Labour Relations Act, 2004 requires the employer who terminates the employee's contract of employment at a place other than where the employee was recruited, either transport the employee and his personal effects to the place of recruitment, pay for the transportation of the employee to the place of recruitment, or to pay the employee an allowance for transportation to the place of recruitment in accordance with subsection (2) and daily subsistence expenses during the period, if any, between the date of termination of the contract and the date of transporting the employee and his family to the place of recruitment.

Subsection (2) to section 43 provides that an allowance prescribed under this requirement shall be equal to at least a bus fare to the bus station nearest to the place of recruitment.

In this context Section 43(3) defines the term "recruit" to mean the solicitation of any employee for employment by the employer or the employer's agent.

11. Consequences of unfair termination of employment

This aspect is covered by section 40 of the ELRA. According to section 40(1) of ELRA, if an arbitrator or Labour Court finds a termination to unfair, the arbitrator or Court may order the employer to either reinstate the employee from the date the employee was terminated without loss of remuneration during the period that the employee was absent from work due to the unfair termination; or to re-engage the employee on any terms that the arbitrator or Court may decide.

The Arbitrator or court may also in alternative to the above mentioned remedies order the employer to pay compensation to the employee of not less than twelve months' remuneration. An order for compensation made under this section shall be in addition to, and not a substitute for, any other amount to which the employee may be entitled in terms of any law or agreement.

It should be borne in mind that the twelve month's remuneration as a basis of compensation for unfair termination of employment is just a minimum. This was emphasised by the court in the case of **International Medical and Technical University v. Eliwangu Ngowi**. In this revision the applicant employer argued that the relief granted to the respondent under section 40(1) (c) of the ELRA was excessive. The Court held that reliefs under section 40(1) are discretionary on the court/arbitrator, that section 40(1) (c) provides that “not less than 12 months remuneration” but does not limit the number upwards. However it was also held that the court/arbitrator should not grant anticipatory damages.

Section 40(3) provides that where an order of reinstatement or re-engagement is made by an arbitrator or court and the employer decides not to reinstate or reengage the employee, the employer shall pay compensation of twelve months wages in addition to wages due and other benefits from the date of unfair termination to the date of final payment.

Test Yourself 5

State the principles which must be complied by employers at the time of retrenchment.

Answers to Test Yourself

Answer to TY 1

According to **Ready Mixed Concrete v Ministry of Pensions and National Insurance (1968),** the following three conditions support the existence of a contract of employment:

1. the employee agrees with the employer to provide his own work and skill in return for wages paid by the employer.

2. the employee either expressly or impliedly agrees with the employer that he will be subject to a degree of control exercisable by the employer.

3. the other provisions of the contract are consistent with the contract being a contract of employment.

Answer to TY 2

This test is a response to the inadequacies of control and organisational tests. It is called pragmatic because it is not based on rigid doctrines and also it is practical because it calls the court to consider all circumstances in totality and infer whether there is a contract of service. It is multiple because it draws its conclusion from multiplicity of factors. Thus some scholars refer to this test as the multiple factor test.

In order to draw a conclusion whether there is a contract of service or a contract for service the answers to the following indicators are important:

Whether the person performing the services in a given concern is doing so in his own account

Whether there is power to hire and fire the employee

Whether there is a direct payment of some form of remuneration. This indicator is open to criticisms because no service is rendered freely so it seems to be inadequate.

Whether there are any deductions made on remuneration

Answer to TY 3

It is important to determine whether or not a contract of employment (of service) exists for the following reasons:

- An employer is vicariously liable for torts committed by his employees in the course of employment, but not for torts committed by the independent contractors.
- An employee has statutory protection not given to independent contractors such as entitlement for leaves with pay.
- Social security provisions for statutory sick and maternity pay
- For tax purposes- an employee is liable to pay income tax which is to be collected directly by the employer.
- For insolvency purposes- employees have preferential rights when the employer is bankrupt or insolvent.
- Implied common law duties of an employer and employee which apply only in respect of contract of service and not in respect to contract for service

Answer to TY 4

Section 7(4) of ELRA imposes a duty on the employer to treat all employees equally without any kind of discrimination based on the grounds enumerated under the same sub-section. This gives rise to a further related duty of the employer to prove that discrimination did not take place as alleged; or that the discriminatory act or omission is not based on any of those grounds whenever an employee makes a prima facie case of discrimination. In a case where an employee alleges harassment as provided under subsection 5 read together with sub-section 4 to section 7, the employer has a duty to prove a defence in terms of subsection (6).

Also in connection to the duty not to discriminate against employees, the employer has a duty to take positive steps to guarantee equal remuneration for men and women for work of equal value.

Answer to TY 5

Section 38 of the ELRA provides for a procedure for carrying out retrenchments. It provides in subsection (1) of section 38 that in any termination for operational requirements (retrenchment), the employer must comply with the requisite principles which are stipulated under the same sub-section. The principles are to the effect that:

(a) The employer must give notice of any intention to retrench as soon as it is contemplated;

(b) The employer must disclose of all relevant information on the intended retrenchment for the purpose of proper consultation with the employees likely to be affected and consultation prior to retrenchment or redundancy. In this respect, the employer must:

(i) give the reasons for the intended retrenchment,
(ii) explain any measures to avoid or minimise the intended retrenchment,
(iii) state the method of selection of the employees to be retrenched, the timing of the retrenchments, and
(iv) ensure the payment of severance pay in respect of the retrenchments,

(c) Give the notice; make the disclosure and consult, in terms of subsection 1 to section 38.

(d) The employer is further obliged to consult in addition to the employees, with any trade

STUDY GUIDE E2: RESOLUTION OF EMPLOYMENT DISPUTES

Get Through Intro

In everyday life not only adult persons but even minors look for jobs. Some look for low skill jobs, others look for 'white collar jobs' and yet for blue collar jobs. It appears the major motivation behind working is remuneration expected to be earned out of work. In some instances, especially involving people with certain skills, some people look for jobs just for gaining certain professional experience.

On the part of employers, many look for a worker who will produce the best for their business venture. Unfortunately, for some economic reasons or just 'an attitude' some look for workers whom they can pay less.

What is clear is that the employer has a wider power of choice of the type of workers while for the worker a job is a matter of survival. Thus this Study Guide deals at great and elaborate lengths with the establishment of employment contract, distinction between employment and independent contracting, rights and duties of employer and employee, dispute resolution procedures and institutions and other matters.

Learning Outcomes

a) Explain legal mechanisms for resolving employment disputes in Tanzania
b) Identify institutions responsible for resolving employment dispute in Tanzania.
c) State institutional procedures for dealing with strikes, protest actions and lock-outs
e) Describe institutional procedure for dealing with welfare of employees.

Explain the legal mechanisms for resolving employment disputes in Tanzania
[Learning Outcome a]

The ELRA recognises two types of labour disputes, namely disputes of interest and complaints. Section 4 of ELRA defines a 'dispute of interest' to mean any dispute except a complaint whereas a 'complaint' means any dispute arising from the application, interpretation or implementation of (a) an agreement or contract with an employee; (b) a collective agreement; (c) the ELRA or any other written law administered by the Minister and (d) part VII of the Merchant Shipping Act.

Thus a dispute of interest is any dispute which does not concern itself with the application, interpretation or implementation of any agreement or contract or any statute and regulation.

In other words, matters which are covered by a contract, agreement or written law do not give rise to a dispute of interest under the ELRA. Such are constitutes complaints. A dispute of interest arises from matters which are not expressly provided for in the individual contract of employment, collective agreement or written law but which concern general conditions of work which employees feel are entitled to. They are matters which employees consider as necessary for the improvement of working conditions and hence improved production.

1. **Dispute Resolution Mechanisms**

There are three main mechanisms of resolving employment disputes, namely mediation, arbitration and adjudication.

1.1. Mediation

Mediation is the process of negotiation among parties to a dispute with the assistance of a neutral third party. In mediation, the parties do not reach a resolution unless all sides agree. It appears a labour dispute can hardly be adjudicated upon by the labour Court if it has not first been referred for mediation through the Commission for Mediation and Arbitration (CMA).

This fact is borne by the provisions of section 94(2) of the ELRA which provides for the possibility of the Labour Court to refuse to hear a complaint if such a complaint has not been referred to mediation by the Commission under section 86; or the provisions of that section have not been complied with and the application is not urgent. The language used is 'may' rather than 'shall' when referring to the court's possible refusal to entertain a complaint which has not first been referred to mediation.

Section 86 of the ELRA provides for the manner in which mediation must be initiated, conducted, the rights of the parties, duration within which the CMA must conduct mediation, and other related matters. The section requires that the application must be in a prescribed form and that the party who refers the dispute to the CMA must also serve a copy of the referral to the other party (parties) to the dispute.

This has a rationale of serving the cardinal principle of law on the right to be heard which includes enabling the defendant to understand the allegations alleged against him, the nature of the allegation and being afford reasonably sufficient time to prepare a defence.

Rule 12(1) and (2) of the Labour Institutions (Mediation and Arbitration) reiterates the same position as described above and contained in section 86(1) and (2) of the ELRA. Rules 12(2) clarifies further that the referring party must sign the referral document in accordance with rule 5.

The referring party must also attach a proof that the referral was served to the other party in accordance with rule 6. Rule 10 stipulates generally time within which a dispute can be referred to the CMA. Rule 10(1) provides that the period for referring a dispute concerning unfair termination of employment is thirty days from the date that the employer made a final decision to terminate or uphold the decision to terminate. In respect of all other disputes the time limit for referring such disputes is sixty days from the date when the dispute arose.

However, in accordance to rule 11 a referring party who is out of the prescribed time (for filing a dispute) can apply for condonation in accordance with rule 10.

Upon receipt of the referral the Commission is obliged to appoint a mediator to mediate the dispute, decide the time, date and place of the mediation hearing and advise the parties to the dispute of the details concerning the mediator, time, date and place of mediation hearing.

Section 86(4) requires the mediator to resolve the dispute within thirty days unless the parties agree to a longer period. Where the parties agree to a different (longer) period, this must be in writing. Rule 13 requires the Commission to give to parties at least a 14 days' notice in writing of a mediation hearing unless the parties agree to a shorter period of notice.

The mediator shall decide the manner in which the mediation shall be conducted and if necessary may require further meetings within the period referred to above. If there is a need for further meetings the parties are

entitled to 7 days' notice in respect of such meetings unless they agree to a shorter period of notice. The notice inviting parties must state date, time and place of attendance.

However rule 14 specifically provides that the Commission may contact parties by telephone or other means, prior to the commencement of mediation in order to seek to resolve the dispute.

Section 86(6) provides that in any mediation, a party to a dispute may be represented by a member or an official of that party's trade union or employers' association, an advocate or a personal representative of the party's own choice. Once mediation is concluded the mediator is required by rule 16(1) to issue a certificate as soon as is practicable stating whether the dispute has been settled or not but in any case the issuance of such a certificate shall not exceed the period of 30 days as stated in section 86(4).

The certificate issued by the mediator which must identify the nature of the dispute for purposes of determining the rights the parties in respect of the ELRA shall be applicable and final in respect of the nature of the dispute irrespective of what was stated in the referral form by the parties. However, it appears the intention of rule 16(3) is not to bar even the labour court from reopening the enquiry on the nature of the dispute should such a dispute arise. In practice some applicants have attempted to raise such allegations.

The issuance of certificate by the mediator upon concluding mediation is also necessary and mandatory for the next procedure, for example where the dispute has not been resolved through mediation. In the case of **General Manager Mufindi Paper Mills Ltd v. Masoya Magoti & Cosmas Fimbo Msigwa (Arbitrator)** the Court held that failure of mediation is an essential ingredient in arbitration proceedings. The Court stated emphasised that the Mediator cannot rule on his own that there would be combined mediation/arbitration proceedings at the start because he will be taking over the role of one of the parties to the dispute. The role of mediator, the court stated, is spelled out in rule 16(1) of Labour Institutions (Mediation and Arbitration) Rules, 2007 and issuing a certificate to indicate that mediation has failed is one of them.

Mediation being anchored on the principles of mutual trust, amicable resolution of disputes and hence encouraging transparency for purposes of achieving truth and reconciliation, its proceedings are protected by the law. Rule 17(1) provides that 'no person may refer to anything said at mediation proceedings during any subsequent proceedings, unless the parties agree in writing'. With the same ambience rule 17(2) emphasises that no person, including the mediator, may be called as a witness during any subsequent proceedings, in the Commission or in any Court to give evidence about what transpired during mediation.

As discussed earlier, the next step to follow after mediation has failed (i.e. where a dispute was not resolved through mediation) or a mediator has failed to resolve a dispute within a prescribed time, will depend on the nature of the dispute. Section 86(7) provides that in such circumstances a party to the dispute may if the dispute is a dispute of interest, give notice of its intention to commence a strike or a lockout in accordance with sections 80 or 82.

This means, where the dispute is not about matters which are expressly provided for in the written law, individual contract agreement or collective agreement but are such matters which employees feel are necessary for improving working conditions the step to follow in such a case is to lodge an intention to commence a strike or lockout. Conversely, if the dispute is a complaint a party to a dispute may decide to refer the complaint to arbitration; or refer the complaint to the Labour Court.

Moreover, section 86(8) provides that the mediator shall remain seized with the dispute until the dispute is settled. Within that capacity the mediator may convene meetings between the parties to the dispute in order to settle the dispute at any time before or during any strike, lockout, arbitration or adjudication. That is so notwithstanding the failure, on part of the mediator to resolve a dispute within period stipulated in section 86 (4), the ELRA, i.e. 30 days' period.

This provision seems to be unnecessarily mandating the delay and somewhat of confusion of dispute resolution procedure. This is because it firstly appears to create unproductive avenue by endowing the same process (mediation) power to achieve something whereas the Commission has already certified to have failed to achieve. Secondly it creates a possibility of parallel processes going on at the same time.

Consequences of Failure to Attend Mediation by Employees, Trade Union, Employer or Employers' Association

Section 87 deals with a situation where the employees, trade union, employer or employers' association fails to attend mediation hearing in respect of a dispute of interest. It is not clear whether reference to 'an employer' in this context is intentionally omitted or it is inadvertent.

It provides in subsection (1) that in such an event the mediator may extend the period stipulated section 86(4) by a further thirty days if the employees or union fail to attend the hearing arranged by the Commission. The Commission may also shorten the period stipulated in section 86(4) if the employer or employers' association party to the dispute fail to attend the hearing.

Similarly where an employer or an employers' association refers a dispute of interest to the Commission under section 86, the mediator may extend the period stipulated under section 86(4) by a further thirty days if the employer or employer association fails to attend the hearing arranged by the Commission or shorten the period stipulated in section 86(4) if the employees or trade union party to the dispute fail to attend the hearing.

However, the position is different concerning the consequence of non- attendance of parties in respect of a complaint. Section 87(3) of the ELRA provides that the consequence in respect of a complaint referred under the ELRA, the mediator may dismiss the complaint if the party who referred the complaint fails to attend a mediation hearing. The mediator may also decide to decide the complaint if the other party to the complaint fails to attend a mediation hearing. According to section 87(4) the decision made under this section may be enforced in the Labour Court as a decree of a court of competent jurisdiction.

However, as is a tradition in expert judgements under ordinary court's practice, the Commission may reverse a decision made in the manner described above, if an application is made in the prescribed manner; and the Commission is satisfied that there are good grounds for failing to attend the hearing.

1.2. Arbitration

Arbitration is the process of solving an argument (dispute) between people by helping them to agree to an acceptable solution. Arbitration is similar to adjudication since it involves similar procedures such as calling witnesses and taking evidence. The difference between arbitration and adjudication is that arbitration is conducted outside the court and does not abide to strict rules of procedure as in ordinary litigation.

The process of arbitration is covered under sections 88 through to section 93 of the Employment and Labour Relations Act, 2004. The provisions refer to compulsory arbitration and voluntary arbitration.

1.2.1. Compulsory arbitration

Compulsory arbitration applies to limited types of 'disputes'. These include: dispute of interest where the parties to the dispute are engaged in an essential service; and complaints where the dispute is over

(i) the fairness or lawfulness of an employee's termination of employment, any other contravention of the ELRA or any other labour law or breach of contract or any employment or labour
(ii) the matter falling under common law, tortuous liability and vicarious liability in which the amount claimed is below the pecuniary jurisdictions of the High Court;
(iii) any dispute referred to arbitration by the Labour Court under section 94(3) (a) (ii).

Procedure in compulsory arbitration

Arbitration is a procedure that follows after the Commission has failed to resolve a dispute through mediation. Thus upon such unresolved dispute the Commission goes through a similar process as one obtaining under section 86 in respect of mediation. This includes appointing an arbitrator to decide the dispute, determining the time, date and place of the arbitration hearing and advise the parties to the dispute of the details stipulated in concerning the arbitrator, time, date and place of arbitration.

Moreover section 88(3) creates a possibility that the arbitrator may do all of the processes stated above before mediation has failed. Under rule 18(1) read together with section 19(7) of the Labour Institutions Act (LIA), No. 7 of 2004, this is referred to as combined mediation and arbitration proceedings. Section 19(7) of LIA mandates while taking into account the provisions of the ELRA the possibility of a person being appointed as both a mediator and an arbitrator and that such person so appointed may be assigned to perform in both capacities in respect of a dispute.

Where the CMA conducts combined mediation and arbitration it has to give parties a 14 days' notice specifically stating that the hearing is for a combined proceeding with an option for parties to agree to a shorter period of notice. Also before commencing the arbitration hearing the parties are entitled to a 14 days' notice of hearing unless the parties agree to a shorter period as per rule 19 of the Mediation and Arbitration Rules G. N No. 64 of 2007.

Section 88(4) gives wider discretionary powers to the arbitrator to conduct the arbitration in a manner that the arbitrator considers appropriate in order to determine the dispute fairly and quickly. In the exercise of this discretion, the arbitrator may allow or require the party to the proceedings to give evidence, calling of witnesses, questioning of witnesses, and presentation of arguments. The arbitrator is however obliged by the same subsection to deal with the substantial merits of the dispute with the minimum of legal formalities.

However, the parties to the dispute have also a respected or valued position on how the arbitration can be conducted. For example if such parties to the dispute consent, the arbitrator may suspend proceedings and resolve the dispute through mediation. Just as is the case for mediation, in any arbitration hearing, a party to a dispute may be represented by either member or official of that party's trade union or employers' association, an advocate, or a personal representative of the party's own choice.

Another important role played by the parties to the dispute in arbitration proceedings is the duty to prove that the CMA and particularly the arbitrator has jurisdiction which lies on the referring parties of the dispute. Thus where during the arbitration proceedings it appears that the issue or jurisdiction is not determined, the arbitrator shall revert to the parties to prove that the CMA has jurisdiction to arbitrate the dispute.

According to section 88(8) and (9) an arbitrator may make any appropriate award but may not make an order for costs unless a party or a person representing a party acted in a frivolous or vexatious manner. Also the law requires the arbitrator to issue an award with reasons signed by him (arbitrator) within thirty days of the conclusion of the arbitration proceedings.

1.2.2. Voluntary Arbitration

As discussed above, compulsory arbitration is only prescribed in respect of specified categories of disputes as discussed above. However section 93 creates a room and possibility for parties to an employment contract or dispute to choose to submit a dispute for arbitration even though they are not legally bound to do so. However if such parties so decide the provisions of the Arbitration Act, shall apply to any agreed submission of a dispute to arbitration.

1.2.3. The effect of arbitration Award

Section 89(1) provides that an arbitration award made under the ELRA as discussed above shall be binding on the parties to the dispute and may be served and executed in the Labour Court as if it were a decree of a court of law. However, according to section 90 of the ELRA an arbitrator who has made an award under section 88(8) may, on application or on his own motion, correct in the award any clerical mistake or error arising from any accidental slip or omission.

Any party to an arbitration award made under section 88(8) who alleges a defect in any arbitration proceedings under the auspices of the Commission may apply to the Labour Court for a decision to set aside the arbitration award. Such an application should be made within six weeks of the date that the award was served on the applicant unless the alleged defect involves improper procurement in which case the application should be made within six weeks of the date that the applicant discovers that fact.

Section 91(2) of the ELRA provides that the Labour Court may set aside an arbitration award made under the ELRA on grounds that there was misconduct on the part of the arbitrator and or that the award was improperly procured. Where such an allegation has been made to the court the Labour Court may stay the enforcement of the award pending its decision and upon proof of the allegation set aside the award. Where the award is so set aside by the labour court the court may decide to determine the dispute in a manner it considers appropriate or make any order it considers appropriate in respect of the proceedings to be followed in order to determine the dispute.

The above discussed provisions of the law have been tested by the High Court labour Court division on a number of occasions. This includes in the case of **The Coordinator of Tadepa v Donatiana Pancrase and Revina Kiguzi**. The revision concerned the failure to follow procedures prescribed by the law in arbitration. The applicant (employer) brought an application for revision of the CMA's arbitration award on ground that the award was improperly procured, that the arbitrator misconceived evidence and facts before him among others.

In this case, parties in the arbitration did not agree to the issues in dispute. The learned judge found that the arbitrator did not adhere to fundamental principles of a legal arbitration as prescribed under rules 18 to 22 of the Labour Institutions (Mediation and Arbitration) Rules, 2007. Thus the arbitration proceedings and subsequently the award were quashed and the learned judge ordered fresh arbitration to be conducted in accordance with the law.

Also the case of **China Railway Jiang Engineering Co. Ltd v. Abdalah Ibadi and Salumum Mtengevu** is another authority for the principle that failure to follow procedure provided by law in arbitration proceeding makes the whole proceeding defective and therefore null and void. This case referred to an application for revision of the CMA award.

The respondent (employee) referred as dispute against the applicant (originally, the employer) alleging unfair termination and seeking reliefs. The arbitrator gave an award in favour of the respondent. Thus the applicant sought revision. The court quashed the award and ordered CMA to conduct fresh arbitration in accordance with the law, because the arbitrator’s proceedings were defective. The record of proceedings were uncertified and unsigned by the arbitrator, also applicants evidence was not properly recorded as per rule 25 of the Mediation and Arbitration Rules G.N No. 64 of 2007.

It is also worth noting that section 92 of the ELRA expressly excludes the application of the Arbitration Act from applying to arbitration conducted by the Commission for Mediation and Arbitration.

1.3. Adjudication

Section 94(1) of the ELRA vests adjudicatory powers on labour disputes to the Labour Court. The Labour Court has, subject to the Constitution of the United Republic of Tanzania, exclusive jurisdiction over the application, interpretation and implementation of the provisions of the ELRA over any employment or labour matter falling under common law, tortuous liability, vicarious liability or breach of contract within the pecuniary jurisdiction of the High Court. The Labour Court also has jurisdiction to decide appeals from the decisions of the Registrar made under Part IV of the ELRA. Further, it has jurisdiction to review and revise arbitrator's awards, decisions of the Essential Services Committee made under Part VII. Further, it has jurisdiction to review decisions, codes, guidelines or regulations made by the Minister under the ELRA.

In addition, the Labour Court has jurisdiction over complaints, other than those that are to be decided by arbitration under the provisions of the ELRA, any dispute reserved for decision by the Labour Court under the ELRA and applications including a declaratory order in respect of any provision of the ELRA or an injunction.

However, despite the wide powers conferred to the labour court, the court in the exercise of its discretion does not have to necessarily apply all of the adjudicatory powers conferred to it in all occasions. For example section 94(2) discussed earlier provides that the Court may refuse to hear a complaint if the complaint has not been referred to mediation by the Commission under section 86; or the provisions of that section have not been complied with and the application is not urgent.

This means in the exercise of its discretion the Court may decide to entertain a case referred to it if it is satisfied that the case is urgent even if it is not first referred to the CMA and vice versa, i.e. if the case is not urgent in view of the Court such a case will be returned to the CMA.

Apart from the above avenue for the court to refuse to entertain a case brought to it, also under section 94(4) where a party refers a dispute to the Labour Court, the Court may, if it is a dispute that is required to be referred to the Labour Court in terms of the ELRA, decide the dispute, or, refer the dispute to the Commission to be decided by arbitration. If a case so referred to the High Court is a complaint that is required to be referred to arbitration the labour court may refer the complaint to the Commission for it to be dealt with under section 88. The Labour Court however also decides the complaint provided that it may make an appropriate order as to costs.

Test Yourself 1

Write a brief note on voluntary arbitration.

Identify institutions responsible for resolving employment disputes in Tanzania
[Learning Outcome b]

2. Institutions for resolving labour disputes

The Labour Institutions Act No. 7 of 2004 provide for the following institutions responsible for resolution of labour disputes in Tanzania.

2.1. Labour, Economic and Social Council

This is established under section 3(1) of the Labour Institutions Act, No 7 of 2004. The Council is to be headed by the chairperson who is appointed by the Minister responsible for labour matters. The chairperson may not be a member of official or office bearer of a trade union, employers association or federation; or an employee in the public service of the Government of the United Republic.

In addition to the chairman, the Council also consists of sixteen other members, comprising: the Permanent Secretary and three other members to represent the interests of the government; four members to represent the interests of employers; four members to represent the interests of employees; four members appointed because of their expertise in labour, economic, and social policy formulation. The sixteen other members are also appointed by the Minister responsible just as it is the case with the chairman.

The functions of the Council are provided for under section 5(1) of the Labour Institutions Act (LIA) and include advising the Government through the Ministry on: measures to promote economic growth and social equity; the promotion of a co-ordinated policy on labour, economic and social matters; an issue arising from the International Labour Organisation etc.

2.2. Commission for Mediation and Arbitration

This is probably the most active and popular institution for labour related disputes. This fact is inherent in its establishment because the law mandates that every labour dispute must commence in the Commission for Mediation and Arbitration (CMA). This was intended to centralize the machinery for resolving employment disputes as opposed to the old labour law regime where the jurisdiction of various institutions was not straight forward to determine.

The CMA is established under section 12 of the Labour Institution Act (LIA) as a department of the government. In addition to the provisions of LIA the provisions of any written law relating to public departments also apply to the Commission subject to the provisions of LIA and the office of the Commission and any office established under the Commission are established as a public office.

The functions of the CMA are provided for under section 14(1) and include: to mediate any dispute referred to it in terms of any labour law and to determine any dispute referred to it by arbitration subject to the conditions of the law as to submissions of complaints for arbitration.

2.3. Labour Court

The Labour Institutions Act provides for the establishment of a labour division of the High Court which shall consist of such number of Judges as the Chief Justice may consider necessary and two panels of assessors appointed in terms of one panel representing the interests of the employees and another panel representing the interests of the employers (ss. 50, 53).

The Labour Division of the High Court shall be duly constituted when a Judge sits with at least two assessors one from either panel of assessors. The Labour Court shall have exclusive jurisdiction over any matter reserved for its decision by the labour laws.

2.4. Essential services committee

This is an organ which is established within the Commission under s. 29 of the LIA. The organ comprises of 5 persons appointed by the minister in consultation with the Council. The qualifications for these members include knowledge and experience in labour law and labour relations. Among these members, the minister shall appoint a chairperson of the committee (s.31). The tenure of the committee is three years but a member may be reappointed at the end of his term of office.

The functions of the Essential Services Committee are: to designate essential services in terms of the provisions of the ELRA, 2004; and to determine disputes about whether or not an employee or employer is engaged in a designated essential service (s.30). However, in the performance of its activities, the Committee has the following powers:

(a) It may summon any person for questioning where it considers that the attendance of this person will assist in the performance of its functions;
(b) It may summon any person believed to have the possession or control of any book, document, or object relevant to the performance of its function to appear for questioning and production of such a document;
(c) It may administer an oath or accept an affirmation from any person called to give evidence; and
(d) It may question any person about any matter relevant to the performance of its functions (s.32)

It should be noted that a person shall not be required to answer any question or furnish any information, book, document or object if there is a lawful ground for not doing so. Also the Committee shall pay the prescribed witness fee to each person who appears before a mediator or arbitrator in response to a subpoena issued in this regard (ss. 32(2) and (3).

State institutional procedures for dealing with welfare of employees

[Learning Outcome d]

3. Organisational Rights

Welfare of employees at the work place is dealt with through what is known as organisational rights. Organisational rights are rights which can be enjoyed by organisations such as a trade union. A trade union is defined as an organized association of workers in a trade, group of trades, or profession, formed to protect and further their rights and interests. The ELRA provide for a number of organisational rights such as access to employers premises (s. 60), deduction of trade union dues (s. 61), trade union representation (s. 62), leave for trade union activities (s. 63) and constitution.

3.1. Disputes involving organizational rights

Section 64(3) sets up the procedure for resolution of dispute involving organizational rights. This procedure involves mediation and adjudication. The procedure may be resorted to where either (a) there is no collective agreement on grant of the rights or the manner in which any rights, if granted, may be exercised; or (b) the employer fails to meet with the trade union within the prescribed 30 days period.

3.2. Right to institute Proceedings

It appears that the right to put the dispute resolution procedure in motion is available to trade unions only. Even where mediation fails, only the trade union is given the right to petition to the Labour Court. Employers or employers' Associations do not, as the law presently stands, have the right to take action. The restriction of the right of action to trade unions is open to objection under the provision of section 64 (3) which assume that the trade union is the aggrieved party. There could however be scenarios where trade union is the culprit and the employer the aggrieved party.

The applicable provision in this reverse scenario is section 65 (1), which provides for a situation where "a trade union materially breaches the terms and conditions for the exercise of organizational rights". In this case, the employer is entitled to refer the issue to the Commission for mediation and if the mediation fails to resolve the issue, the employer may apply to the Labour Court for either of the following orders: an order to terminate any organizational rights granted to the trade union under a collective agreement or an order to withdraw an order made under section 64 of the ELRA.

Several points of concern may be noted from the several potential scenarios emerging from the dispute settlement scheme concerning organizational rights. The first scenario, which arises out of the provisions of section 64, is where no collective agreement is reached granting an organizational right and regulating the manner of exercise of that right. Here, the right to put the Commission or the Labour Court in motion vests in trade unions only. It appears that employers have no right to do so.

This is a matter for concern because, for myriad reasons, employers may be interested in petitioning the Commission or the Court for appropriate orders independently of the trade union's right and initiative. Employers should have access to the Commission and the Labour Court even where no agreement is reached, if they are aggrieved by the conduct of the trade union.

The second scenario, which arises out of section 65, is where a collective agreement is reached but the trade union materially breaches the terms of and conditions. In order to avail himself of a cause of action under this provision, an employer will need to show that the trade union is, to use the language of the statute, in "material breach of the terms and conditions for the exercise of organizational rights." The problem here is the meaning to be attached to the term "material breach", which has been left to conjecture.

In any case, the law has placed an onerous burden of proof on employers to show "material breach." The legislature should have laid down specific criteria for determining a "material breach of the terms and conditions for the exercise of organizational rights" to enable employers to make informed decisions on the availability of the right to petition the Commission and the Labour Court under section 65 because the non-existence of material breach is a ground for non-suiting an employer.

3.3. Collective Bargaining

An important feature of the labour relations regime is the Part VI of the ELRA, which is dedicated to the idea of collective bargaining. In a nutshell, this Part lays down rules concerning recognition for purposes of collective bargaining of trade unions and lays down substantive rules of play in collective bargaining binding on the employer and the trade union, as well as the resultant collective agreement. In addition, this Part lays down the procedure for resolution of disputes concerning the representatives of trade unions, disclosure of information material to collective bargaining as well as the application, interpretation or implementation of collective agreements that result from collective bargaining.

3.4. Recognized Bargaining Units and Agents

The ELRA lays down the pre-requisites that have to be met by a trade union before it can qualify as a bargaining agent i.e. before it gains the competence to bargain on behalf of its members with the employers. In this respect, the Act defines a bargaining unit in section 66(a)(i) and (ii) as "any unit of employees in respect of which a registered trade union is recognized, or is entitled to be recognized, as the exclusive bargaining agent" and that term includes "a unit of employees employed by more than one employer." It is evident from this definition that in order to be recognizable as an exclusive bargaining agent, the employees must be members of a trade union that is either registered or is entitled to be registered.

However, membership to a trade union alone is not enough to endow the employees with the legal competence to bargain. The registered trade union itself of which employees are members must still pass the additional test of "members' majority" in order to acquire the attribute of an exclusive bargaining agent. In this respect, the Act provides in section 67 (1) that "a registered trade union that represents the majority of the employees in an appropriate bargaining unit shall be entitled to be recognized as the exclusive bargaining agent of the employees in that unit." That is to say, a registered trade union is a competent bargaining agent only if it commands the majority of members in the relevant bargaining unit.

To reinforce the majority test, the provisions of section 67 (2) of the ELRA empowers an employer or employer's association to decline recognition of a trade union as an exclusive bargaining agent "unless the trade union is registered and represents the majority of the employees in the bargaining unit."

The mere fact that a trade union meets the qualifications of an exclusive bargaining agent does not, however, entitle it to immediate recognition of the employer or an employers association, without ado. There are procedural hurdles to be jumped by the trade union. In this respect, section 67 (3) of the Act requires the trade union to notify the employer or employer's association in prescribed form that "it shall seek recognition as the exclusive bargaining agent within an appropriate bargaining unit." And section 67 (4) of the Act state: "within thirty days of the notice an employer or employer's organization shall meet to conclude a collective agreement recognizing the trade union."

3.5. Substantive Rules of in Collective Bargaining

Besides rules pertaining to recognition of bargaining units and bargaining agents, the ELRA provides for substantive rules regulating the collective bargaining process. Notably, the Act enacts a mutual duty to bargain in good faith and a duty on the part of the employer to disclose to a recognized bargaining agent to disclose what is termed as "relevant information."

The precise scope of the duty to bargain in good faith is subjective as the law does not lay down criteria for determining when a party bargains mala fide. The duty to disclose relevant information is no doubt aimed at creating a level playing field for both parties to collective bargaining, considering that certain information within the power or possession of the employer may not be easily accessible to the bargaining agent.

However, the employer's duty to disclose information is not absolute. The employer is insulated against non-disclosure of specified information, notably privileged, confidential and personal information. The law provides the manner in which a trade union may handle confidential or personal information coming its way.

3.6. Specific Provisions on Collective Agreements

Collective bargaining refers to the negotiation of wages and other conditions of employment by an organized body of employees i.e. a trade union. The terms and conditions of employment reached collectively between the employer and the employees is called are called collective agreements. A collective agreement is a written contract between the employer and a union that outlines many of the terms and conditions of employment for employees in a bargaining unit

3.6.1. Form and Content

A collective agreement is by definition "a written agreement concluded by a registered trade union and an employer or registered employer's association on any labour matter." In order for an agreement to satisfy this definition, it has first and foremost to be reduced in writing. In terms of personal content (*ration personae)*, the agreement must be between a registered trade union, as opposed to an employee or employees, and either an employer or an employer's association. In terms of material content (*ration materiae)*, the subject of the agreement must be a "labour matter."

The last ingredient in this definition is registration. That is to say, the trade union must be one that is duly registered. Similarly, in the case of an agreement between a trade union and an employer's association, the latter must similarly be registered.

The form of collective agreements is governed by section 71 (1) of the Act, which states: "Collective agreements shall be in writing and signed by the parties." An agreement that is not in writing and signed by the parties may not be unlawful but it is certainly void *ab initio*. Equally important is the question when a collective agreement shall become binding. Under the provisions of section 71 (2), "[a] collective agreement shall be binding on the last signature unless the agreement states otherwise."

This is a marked departure from the previous legal position, under which collective agreements did not become binding merely upon signature. The Industrial Court of Tanzania Act, 1967 subjected collective agreements to a host of cumbersome, bureaucratic and time-consuming post-signature procedural requirements involving judicial fiat, non-compliance with which affected the validity of the agreements.

3.6.2. Procedure for Settlement of Collective Disputes

The provisions of section 74 (a) of the Act provides for a procedure and machinery of disputes arising out of collective agreements. This provision envisages three types of disputes amenable to settlement under this procedure; (a) disputes concerning application of the agreement; (b) disputes concerning interpretation of collective agreements; and (c) disputes concerning implementation of the agreement.

In terms of forum, the provision section 74 (a) provides that the dispute shall first be referred to the Commission for mediation; and, under the provisions of section 74 (b), "if the mediation fails, any party may refer the dispute to the Labour Court for decision." Uncharacteristically, this provision falls short of defining the jurisdiction of the Labour Court when seized with a dispute concerning the application, interpretation or application of a collective agreement.

Lastly, it is very important to note that the dispute settlement procedure envisaged under section 74 is not exclusive of any other mode of settling such disputes that shall have been elected by the employer and the trade union under the collective agreement. In this respect, section 74 states that the procedure it puts in place shall be resorted to "unless the parties to a collective agreement agree otherwise." In appears that contractually designated dispute settlement methods take precedence over the statutory procedure prescribed in section 74. Usually, these take the form of an arbitration clause, or a choice of forum clause, or a choice of law clause.

Test Yourself 3

Briefly discuss the procedures for settlement of collective disputes

State institutional procedures for dealing with strikes, protest action and lockouts **[Learning Outcome d]**

4. Strikes, Lockouts and Protest Action

The employees have some common interests which they demand from their employer. These common interests include but not limited to a better pay and better working conditions. In achieving their demands the workers may unite and demand collectively. Quoting the writings of Karl Marx, Shivji argues that working class have sometimes united to wage a general competition with the capitalist.

In waging this general competition with the capitalist class, Marx argues that, the most potent weapon of the working class is strike, that is, the withdrawal of labour power. A strike is a weapon of collective bargaining only and cannot be carried on by a single employee. This is because withdrawal by an individual worker is only a breach of contract which may put an end to his employment.

The manifest purpose of a strike action is not the permanent severance of industrial relationship between labour and management but the stepping up of bargaining pressure by its suspension. Thus it has been held that strikes are negotiations conducted by other means.

The ELRA provides for the right to every employee to strike in respect of a dispute of interest. In the same way the employers are accorded a right to lockout in respect of a dispute of interest (s.75). The law protects persons who engage in a lawful strike or lockout.

Section 83 provides that a lawful strike or lawful lockout shall not amount into a breach of contract or a tort or a criminal offence and an employer is prohibited from terminating employment on the ground that an employee has participated in a lawful strike or for not acceding to an employer's demand in a lockout. Thus, no civil or criminal proceedings shall lie against any person for participating in a lawful strike or lawful lockout.

4.1. Do employers have a duty to remunerate during strike and lockouts?

The law provides that an employer shall not be obliged to remunerate an employee for services that the employee does not render during a lawful strike or lawful lockout. But the employer is bound to continue doing the following during a lawful strike or lawful lockout:

he shall continue to make his contribution and employees contribution to any funds that the employee is required to belong to by the law or under the contract of employment

if the employer provides accommodation, the provision of food or other basic amenities of life, the employer shall continue to provide that accommodation, food or amenities of life

After the end of the strike or lockout, the employer may deduct any of the employee's contribution made to the fund during a strike or lockout from the remuneration of the employee. The employer may also deduct the agreed value of the accommodation, food or amenities from the employee's remuneration with the consent of the employee.

According to section 84 where a strike or lockout is not in compliance with the provisions of the ELRA, or a trade union or employer or employer's association engages in a prohibited conduct, the Labour Court shall have exclusive jurisdiction to issue an injunction to restrain a person from engaging in an unlawful strike or lockout or to engage in any prohibited conduct. The Labour Court shall also have an exclusive jurisdiction to order the payment of just and equitable compensation for any loss attributable to the strike, lockout or conduct having regard to the degree of fault, the cause of the strike, lockout or conduct, the ability to pay, the extent of harm etc.

4.2. Restrictions on the right to strike or lockout

A "strike" is defined as a total or partial stoppage of work by employees if the stoppage is to compel their employer, any other employer or an employer's association to which the employer belongs, to accept, modify or abandon any demand that may form the subject matter of a dispute of interest. However, the right to strike as enshrined in the ELRA is not absolute. Thus, the following are the restrictions:

4.2.1. Persons Who Cannot Strike

The law envisages that although there is a right to strike accorded to employees, there are some categories of employees and employers who do not have a right to strike or engage in a lockout. The following categories cannot absolutely engage into or contemplate a strike or a lockout:

(a) **Persons engaged in an essential service**. However, the persons employed and employers in essential services can strike or engage in a lockout if there is a collective agreement providing for minimum services during a strike or lockout and that agreement has been approved by the essential services committee (see ss. 76, 77 of the ELRA). The essential services are listed under s. 77(2) as including water and sanitation, electricity, health services and associated laboratory services, fire fighting services, air traffic control and civil aviation telecommunications and any transport services required for the provision of these services (s.77).

(b) **Persons engaged in minimum services**. The employer and employees may enter into a collective agreement for the provision of minimum services during the strike or lockout. Alternatively, the employer may apply in the prescribed manner to the essential services committee for the designation of a minimum service if a minimum service is necessary to prevent damage to property, machinery or plant during a strike or lawful lockout and there is no collective agreement providing for minimum services during a strike or lockout. When this agreement has been reached or a designation has been made by the essential services committee for the provision of minimum services, those employees engaged in such minimum services have no right to strike (ss. 76 and 79).

(c) **Persons bound by an agreement that requires the issue in dispute to be referred to arbitration**. Where parties to a dispute have entered into an agreement that their dispute is to be referred to arbitration, then neither of them can engage in a strike or lockout.

(d) **Persons bound by a collective agreement or arbitration award that regulates the issue in dispute**. These have no right to strike or to engage in a lockout.

(e) **Persons bound by a wage determination that regulates the issue in dispute during the first year of that determination.** These persons are also not allowed to engage in a strike or lockout.

(f) **Magistrates, prosecutors and other court personnel**. This category of employees does not have a right to strike or lockout

4.2.2. Subject matter of strike

Under the ELRA, it is not every kind of a dispute that entitles an employer or employees a right to lockout or strike respectively. Thus, for the employees and employer to have a right to strike and lockout respectively, the dispute must be a dispute of interest. By definition, a dispute of interest is any dispute except a complaint. The law provides that if the dispute is a complaint, the employer and employees has no right to lockout or strike (s. 76(1)(g) of the ELRA.

Test Yourself 4

Explain whether employers have a duty to remunerate during strike and lockouts.

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5. Procedures for engaging in a lawful in a strike or lockout

The law provides that where procedures for engaging in a lawful strike or lawful lockout have not been followed, no person is allowed to engage or to take part or to conduct himself in a manner that contemplates a strike or lockout. In order to have a lawful strike, the following conditions/ procedures must be fulfilled.

a) The dispute in respect of the strike must be a dispute of interest
b) The dispute must have been in the prescribed form to the Commission for Mediation and Arbitration and remained unresolved owing to the failure of the Commission to do so at the end of the period of mediation.

c) The strike must be called by a trade union and a ballot has to be conducted under the trade union's constitution in which a majority of the voters, votes for the strike for it to be lawful.
d) The employees or their trade union must have given a 48 hours' notice to their employer of their intention to strike after the failure by the Commission to resolve.

Where the dispute relates to the unilateral alteration of the terms of contract, the employees or trade union may require the employer not to implement any proposed change to terms and conditions or if he has implemented them to restore the terms and conditions of employment which applied before the change. If the employer doesn't comply with such requirement within 48 hours, the employees may commence the strike without waiting for the determination in mediation or getting the approval of majority or issuing the 48 hours' notice.

6. Secondary strike or lockout

Section 81 defines the term "secondary strike" as a strike that is either in support of a lawful strike (the primary strike) by other employees against their employer (the primary employer) or a strike that is in opposition to lockout (the primary lockout) imposed by another employer (the primary employer) against its employees. This shows that there can be a series of strikes but all premised on one major strike (primary strike) or on a lockout. The procedure for a secondary strike is as follows:

a) It must be called by a trade union.
b) There must be a relationship between the secondary and the primary employer that may permit the exercise of the pressure.
c) A fourteen days' notice of the commencement of the secondary strike must have been given to the secondary employer.
d) The secondary strike must be proportional by taking into account the effect of the strike on the secondary employer and the possible effect that the strike may have on resolving the dispute giving rise to the primary strike or primary lockout.

It is worth noting that the procedures provided under the ELRA concerning strikes and lockouts **shall not apply** where a trade union and an employer or an employer's association has entered into a collective agreement which provides for the procedures to be followed in a strike or lockout (ss. 80(4), 81(4) and 82(2).

7. Protest Action

Section 4 of the ELRA defines a "protest action" as **a** total or partial stoppage of work by employees for the purpose of promoting or defending the social-economic interests of workers but not for the purpose referred to in the definition of strike or a dispute in respect of which there is a legal remedy. A protest action is a right granted to an employee under section 85 of the ELRA. An employee may take part in a protest action if:

a) the protest action has been called by a registered trade union or a registered federation of trade unions;
b) the trade union or federation has served a notice on the Council stating the reasons for the protest action and the duration and form of the protest action;
c) thirty days have elapsed from the date the notice was served; and
d) the union or federation has given at least 14 days' notice of the commencement of the protest action.

Test Yourself 5

Write a brief note on protest action.

Answers to Test Yourself

Answer to TY 1

Compulsory arbitration is only prescribed in respect of specified categories of disputes as discussed above. However section 93 creates a room and possibility for parties to an employment contract or dispute to choose to submit a dispute for arbitration even though they are not legally bound to do so. However if such parties so decide the provisions of the Arbitration Act, shall apply to any agreed submission of a dispute to arbitration.

Answer to TY 2

A labour officer with a prescribed certificate and at a reasonable time may enter the premises and:

- require that premises or any part thereof shall not be disturbed during an inspection;
- search and examine any information books, document or object;
- seize, make a copy of any information, book, document or object;
- take sample of any object found;
- take measurements, readings recordings or photographs; and
- question any person on the premises

In any other case he may:

- order, in the prescribed form, any person to appear before him at a specified date, time and place and to question that person
- require any person who has control over any information, book, document or object to furnish it and explain any entry in the information, book or document or the object;
- examine, make copy or seize any book, document or object

Answer to TY 3

The provisions of section 74 (a) of the Act provides for a procedure and machinery of disputes arising out of collective agreements. This provision envisages three types of disputes amenable to settlement under this procedure; (a) disputes concerning application of the agreement; (b) disputes concerning interpretation of collective agreements; and (c) disputes concerning implementation of the agreement.

In terms of forum, the provision section 74 (a) provides that the dispute shall first be referred to the Commission for mediation; and, under the provisions of section 74 (b), "if the mediation fails, any party may refer the dispute to the Labour Court for decision." Uncharacteristically, this provision falls short of defining the jurisdiction of the Labour Court when seized with a dispute concerning the application, interpretation or application of a collective agreement.

Answer to TY 4

The law provides that an employer shall not be obliged to remunerate an employee for services that the employee does not render during a lawful strike or lawful lockout. But the employer is bound to continue doing the following during a lawful strike or lawful lockout:

- he shall continue to make his contribution and employees contribution to any funds that the employee is required to belong to by the law or under the contract of employment
- if the employer provides accommodation, the provision of food or other basic amenities of life, the

© GTG employer shall continue to provide that accommodation, food or amenities of life

After the end of the strike or lockout, the employer may deduct any of the employee's contribution made to the fund during a strike or lockout from the remuneration of the employee. The employer may also deduct the agreed value of the accommodation, food or amenities from the employee's remuneration with the consent of the employee.

Where a strike or lockout is not in compliance with this Act, or a trade union or employer or employer's association engages in a prohibited conduct, the Labour Court shall have exclusive jurisdiction to issue an injunction to restrain a person from engaging in an unlawful strike or lockout or to engage in any prohibited conduct. The Labour Court shall also have an exclusive jurisdiction to order the payment of just and equitable compensation for any loss attributable to the strike, lockout or conduct having regard to the degree of fault, the cause of the strike, lockout or conduct, the ability to pay, the extent of harm etc. (s. 84)

Answer to TY 5

This is a new development in the Tanzanian employment laws. A protest action is a right granted to an employee under s. 85 of the ELRA. Under s. 4, the phrase "protest action" is defined as **a** total or partial stoppage of work by employees for the purpose of promoting or defending the social-economic interests of workers but not for the purpose referred to in the definition of strike or a dispute in respect of which there is a legal remedy.

An employee may take part in a protest action if:

- the protest action has been called by a registered trade union or a registered federation of trade union
- the trade union or federation has served a notice on the Council stating the reasons for the protest action and the duration and form of the protest action
- thirty days have elapsed from the date the notice was served and
- the union or federation has given at least 14 days notice of the commencement of the protest action.

SECTION F

INTRODUCTION TO PUBLIC PROCUREMENT LAW

F1

STUDY GUIDE F1: INTRODUCTION TO PUBLIC PROCUREMENTLAW

Get Through Intro

The concept of public procurement has emerged in the past three decades as a result of the structural Adjustment Programmes and the development of various international trade policies. Public procurement system has been an issue of public debate over the years.

This Study Guide will introduce to the learners what public procurement means and the laws governing public procurement in Tanzania. Learners will be introduced to the basic concepts such as public procurement system, tender document, methods of procurement, and types of procurement and consequences of non-compliance to the established standards of public procurement.

Learning Outcomes

a) Define and explain the concept of public procurement
b) Explain procurement methods, types and tendering process
c) Describe the applicability of laws governing public procurement
d) Identify institutional mechanisms for enforcing procurement laws in Tanzania
e) State the consequences of non-compliance to the Public Procurement Act.

Define and explain the concept of public procurement
Explain methods of procurement, types and tendering process
Describe applicability of laws governing public procurement in Tanzania
[Learning Outcomes a, b & c]

1. **Meaning Public Procurement**

Definition

Public Procurement or procurement is defined by the article 2 of the UNCITRAL Model Law on Public Procurement as the acquisition of goods, construction or services by a procuring entity.

The Tanzania Public Procurement Act of 2011 defines public procurement as buying, purchasing, renting, leasing or otherwise acquiring any goods, works or services by a procuring entity and includes all functions that pertain to the obtaining of any goods, works or services, including description of requirements, selection and invitation of tenderers, preparation and award of contracts.

Public procurement is a system that was promoted by the World Bank and other international financial institutions in order to improve fair, competitive, transparent, non-discriminatory and value for money procurement standards and practices; and setting of standards for the public procurement systems economic efficiency and value for money.

2. **Laws Governing Public Procurement in Tanzania**

In Tanzania, the Public Procurement System is governed by the Public Procurement Act No. 7 of 2011 which came into force on 30 December, 2011. Prior to the enactment of the Public Procurement Act of 2011, the public procurement system was governed by the Public Procurement Act, 2004. In 2002 a Country Procurement Review Assessment was conducted. The report recommended reforms from centralised to decentralised procurement system. As a result the Public Procurement Act No. 21 of 2004 was enacted. The Public Procurement Act, 2011 is complimented by the Public Procurement Regulations, GN No. 446 of 2013. The two laws provide the basic legal framework governing public procurement in Tanzania.

3. **Institutions Regulating Public Procurement in Tanzania**

Section 7 of the Public Procurement Act, 2011 established the Public Procurement Regulatory Authority (PPRA) whose objectives according to section 8 of the Act are to:

a) ensure the application of fair, competitive, transparent, non-discriminatory and value for money procurement standards and practices;
b) set standards for the public procurement systems in the United Republic of Tanzania;
c) monitor compliance of procuring entities; and
d) build, in collaboration with Public Procurement Policy Division and other relevant professional bodies, procurement capacity in the United Republic.

Section 5 of the Public Procurement Act of 2011 establishes a Public Procurement Policy Division within the Ministry of Finance to be headed by a person with appropriate academic and professional qualifications and experience of not less than ten years in procurement related functions. The functions of the Public Procurement Policy Division include:

a) develop a National Procurement Policy;
b) review procurement policies, regulations, circulars and other related directives with a view of updating the same;
c) monitor the implementation of Public Procurement Policies;
d) advise the Central Government, local governments and statutory bodies on issues related to procurement policies; and
e) develop and manage procurement cadre.

4. **Types of procurement and procurement methods**

Article 27 of this UNCITRAL Model Law on Public Procurement provides for ten types of procurement methods as follows: open tendering; restricted tendering; request for quotations; request for proposals without negotiation; two-stage tendering; request for proposals with dialogue; request for proposals with consecutive negotiations; competitive negotiations; electronic reverse auction; and single-source procurement.

Countries like Tanzania are not bound to enact all of the above methods of procurement but are free to select the methods they consider most appropriate for their local circumstances. Doing so would be burdensome to procurement officials. This is because it will add to more administrative procedures, make decision-taking excessively complex and compromise capacity building.

However, of all the procuring methods, open tendering is considered mandatory, that is it must be provided for in all legislation. The procedures of open tendering are considered to be the 'gold standard' in respect of procurement without special features.

Correspondingly Section 64(1) of the Public Procurement Act provides that Procuring entity engaging in the procurement of goods, works, services, non-consultancy services or disposal by tender shall apply competitive tendering, using the methods prescribed in the regulations depending on the type and value of the procurement or disposal. This section provides also that, in any case, the successful tenderer shall be the tenderer evaluated:

a) to have the capacity and capability to supply the goods, to provide the services or to undertake the assignment or
b) the highest evaluated offer in case of services for revenue collection or disposal of public assets.

The Public Procurement Regulations, 2013 group public procurement methods into three categories as follows:

1) Open tendering procedures (international competitive tendering; national competitive tendering; restricted tendering).
2) Procurement method involving negotiations (two-stage tendering; request for proposal with simultaneous negotiations; conducting simultaneous negotiations; request for proposal with consecutive negotiations; competitive negotiations; single source procurement for goods or services;
3) Procurement methods that do not involve negotiations (shopping; minor value procurement; micro value procurement; force account; community participation in procurement; procurement of commodities; procurement of food stuff for schools, training institutions, hospitals and prisons.

Part IX of the Public Procurement Regulations 2013 deals with procedures for selection and employment of consultants. One specific aspect dealt with under this part by the regulations is methods of procurement. Regulation 253 on selection of a method of procurement provides that a procuring entity shall procure consultancy services using the methods prescribed under regulations 254, 255, 256 and 257, respectively.

Regulation 254 provides for International Competitive selection method, regulation 255 for national competitive selection method, while regulation 256 on its part provides for restricted competitive selection method and regulation 257 provides for single-source selection method.

Regulation 258(1) provides further that the selection method, procedure and evaluation criteria to be adopted, for all complex assignments, shall be determined by the procuring entity in consultation with the relevant regulatory body prior to the invitation of consultants to submit proposals.

5. **Tendering Process**

Tender or solicitation document means a written or electronic document or request for proposal inviting tenderers to participate in procuring or disposal by tender proceeding and includes documents inviting potential tenderers for pre-qualification. Tendering process includes: advertising, submissions, evaluations and award of contract for supply of goods or service

6. **Tender Documents**

The aspect of tender documents is covered by sections 69 and 70 of the Public Procurement Act No. 7 of 2011. Section 69(1) provides that the procuring entity shall provide tender documents immediately after first publication of the tender notice to all suppliers or contractors who respond to the tender notice and pay the requisite fee, if required, for which a receipt shall be given. All prospective tenderers shall be provided with the same information, and be assured of equal opportunities to obtain additional information.

Tender documents shall not however include requirements and terminologies which discriminate unfairly against participation by tenderers. Subsection (3) to section 69 mentioned above may be deviated however, where circumstances demand provided that, any deviation is made on basis of provisions of the Regulations made under the Public Procurement Act.

Section 70(1) requires the procuring entity to use the appropriate standard model tender documents specified in the Regulations for the procurement in question. They must be worded so as to permit and encourage competition and such documents shall set forth clearly and precisely all the information necessary for a prospective tenderer to prepare tender for the goods, services and works to be provided.

Regulation 203 provides that prior to the detailed evaluation of tenders; the tender evaluation committee shall carry out a preliminary examination of the tenders to determine whether or not: each tender is substantially responsive to the requirements of the tender documents; the required securities have been provided; the documents have been properly signed; and the tenders are otherwise generally in order.

A tender is considered to be substantially responsive if it conforms to all the terms, conditions and specifications of the tender document without material deviation or reservations.

Test Yourself 1

Identify the ten types of procurement methods as provided in Article 27 of The UNICTRAL Model LAW on Public Procurement

State the consequences of noncompliance to the Public Procurement Act.
[Learning Outcome e]

7. Noncompliance with Public Procurement Act

The issue of consequences of noncompliance with the Public Procurement Act may differ depending on the nature of noncompliance and also depending on who has failed to comply. For instance, if a prospective tenderer fails to comply with the standard procedure of tendering he may suffer by not having his tender evaluated. If a failing person is an officer of the procuring entity, it may depend on the nature of the obligation, whether the noncompliance is due to negligence or malice and so forth. Each of such mentioned scenarios introduced above is considered in some details below:

1) **Where noncompliance leads to dissatisfaction of tenderers**

The Public Procurement Act places mechanisms for dealing with cases where tenderers are of the view that the Act was not complied with. The mechanisms are as follows:

a) **Making of a complaint**

The Public Procurement Act establishes an internal complaint and appeals mechanisms. Section 96(1) provides that any complaints or dispute between procuring entities and tenderers which arise in respect of procurement proceedings, disposal of public assets by tender and awards of contracts shall be reviewed and decided upon a written decision of the accounting officer of a procuring entity giving reasons for his decision.

On receiving a complaint under section 96 the accounting officer may, depending on the nature of the complaint, constitute an independent review panel from within or outside his organization which shall review the complaint and advise him on the appropriate actions to be taken.

If after proper investigation, it is established that, the Chairman of the tender board, any member of the tender board, the secretary of the tender board or any other public officer of the procuring entity has violated the provisions of the Act and the regulations made under it, the accounting officer shall take appropriate actions against him.

However, for such a complaint to be entertained it must be submitted within twenty eighty days from the date the tenderer submitting it became aware of the circumstances giving rise to the complaint or dispute or when that tenderer should have become aware of those circumstances, whichever is earlier.

Moreover, according to section 96(5) the accounting officer shall not entertain a complaint or dispute or continue to entertain a complaint or dispute after the procurement contract has entered into force. If the accounting officer decides to entertain a complaint or dispute as the case may be the accounting officer shall, within fourteen days after the submission of the complaint or dispute deliver a written decision which shall state the reasons for the decision; and if the complaint or dispute is upheld in whole or in part, indicate the corrective measures to be taken.

Where the accounting officer does not issue a decision within the time specified in subsection (6), the tenderer submitting the complaint or dispute to the procuring entity shall be entitled immediately thereafter to institute proceedings under section 97 and upon institution of such proceedings, the competence of the accounting officer to entertain the complaint or dispute shall cease. The decision of the accounting officer shall be final unless the tenderer applies for administrative review to the Appeals Authority.

b) **Appeals**

Section 97(1) provides that a tenderer who is aggrieved by the decision of the accounting officer may refer the matter to the Appeals Authority for review and administrative decision. The cause of action is limited to where:

i. the accounting officer does not make a decision within the period specified under the Act; or
ii. the tenderer is not satisfied with the decision of the accounting officer

In any of such cases itemized above the tenderer may make a complaint to the Appeals Authority within fourteen working days from the date of communication of the decision by the accounting officer. A tenderer may submit a complaint or dispute directly to the Appeals Authority if the complaint or dispute cannot be entertained under section 96 because of entry into force of the procurement or disposal contract, and provided that the complaint or dispute is submitted within fourteen days from the date when the tenderer submitting it became aware of the circumstances giving rise to the complaint or dispute or the time when that tenderer should have become aware of those circumstances.

The Appeals Authority shall, upon receipt of a complaint or dispute, give notice of the complaint or dispute to the procuring entity in which case the procuring entity shall be required to submit all the relevant documentations and information pertaining to the particular tender. The Appeals Authority may, unless it dismisses the complaint or dispute, issue one or more of the following remedies:

i. declare the legal rules or principles that govern the subject matter;
ii. prohibit the procuring entity from acting or deciding unlawfully or from following an unlawful procedure;
iii. require the procuring entity that has acted or proceeded in an unlawful manner, or reached an unlawful decision, to act or to proceed in a lawful manner or to reach a lawful decision;
iv. annul in whole or in part an unlawful act or decision of the procuring entity;
v. revise an unlawful decision by the procuring entity or substitute its own decision for such a decision; or
vi. require the payment of reasonable compensation to the tenderer submitting the complaint or dispute as a result of an unlawful act, decision or procedure followed by the procuring entity.

The Appeals Authority is required under subsection (6) of section 97 to issue a written decision concerning the complaint or dispute within forty five days, stating the reasons for the decision and the remedies granted, if any. According to subsection (7) of section 97 the decision of the Appeals Authority shall be final unless it is subject to judicial review under section 95 of the Public Procurement Act. The decision of the Appeals Authority shall also be binding on the parties to the complaint or appeal and such decision may be enforced in any court of competent jurisdiction as if it were a decree of the court.

8. **Procurement related offences**

a) Fraud and corruption

Section 83 of the Public Procurement Act prohibits procuring entities and tenders from engaging in fraudulent and corrupt activities in procurement process. Both are supposed to transact in a transparent and accountable manner. Where any person or tenderers is proved to have engaged in fraudulent, corrupt or coercive practices during procurement process, that person or tenderer shall be required to re-imburse the amount of funds disbursed to him and his shall be declared ineligible for a period of not less than 10 years to be awarded a public financed contract.

b) Other offences

Section 104 of the Public Procurement Act lists a number of other offences that may arise from procurement processes. They offences include:

i. knowingly giving false or misleading information or evidence in purported compliance with a summons issued under the Act
ii. contrary to the Act, interfering with or exerting undue influence on any officer or employee of the Authority, Appeals Authority or procuring entity or member of tender board in the performance of his functions or in the exercise of his her power under the Act;
iii. opening any sealed tender, including such tenders as may be submitted through electronic system and any document required to be sealed, or divulge their contents prior to the appointed time for the public opening of the tender documents;
iv. conniving or colluding to commit a fraudulent, corrupt, collusive, coercive or obstructive act as defined in section 3;
v. causing loss of public properties or funds as a result of negligence in the implementation of the Act.

A person convicted of the above offences shall be liable to a fine of not less than ten million shillings or to imprisonment for a term of not less than seven years or to both, and in addition to the penalty imposed in this section, the court shall order that the amount of loss incurred by the complainant be compensated, failure of which, the court shall issue an order of confiscation of personal property of the person convicted in order to recover the loss.

However, where a procuring entity consistently contravenes the Act, it shall, on the direction of the Authority, have its procurement function transferred to the Agency until the Authority is satisfied that the causes of the contravention have been rectified.

9. Roles of accounting officer in a procuring entity

Section 3 of the Public Procurement Act defines an ‘accounting officer’ to mean a Government officer appointed in accordance with the provisions of the Public Finance Act or a public officer statutorily appointed to hold a vote or subvention and accounts for all monies expended from that vote or subvention. According to section 36 (1) of the Act, the accounting officer shall have the overall responsibility for the execution of the procurement process in the procuring entity, and in particular, is responsible for:

i. establishing a tender board in accordance with this Act;
ii. appointing the members of the tender board specified in the Second Schedule;
iii. causing to be established a Procurement Management Unit staffed to an appropriate level;
iv. approving all procurement opportunities;
v. appointing the evaluation committee and negotiation team;
vi. communicating award decisions;
vii. signing contracts for the procurement activities on behalf of the procuring entity;
viii. handling complaints by suppliers, contractors or consultants;
ix. submitting a copy of complaints and reports of the finding to the Authority;
x. ensuring that the implementation of the awarded contract is in accordance with the terms and conditions of the award;
xi. submitting to the Authority a list of contracts awarded, annual procurement plan and a list of blacklisted firms;
xii. implementing decisions made by the Authority and Appeals Authority after investigation or adjudication of a complaint; certifying the availability of funds to support the procurement activities;

In addition, section 96 of the Act entrusts the accounting officer with powers of settling complaints or disputes between the procuring entity and tenderers which arise in respect of procurement proceedings, disposal of public assets by tender and awards of contracts. In the exercise of these powers, the accounting officer may, depending on the nature of the complaint, constitute an independent review panel from within or outside his organization which shall review the complaint and advise him on the appropriate actions to be taken.

Test Yourself 2

Briefly explain the consequences of non-compliance of section 104 of the Public Procurement Act

Answers to Test Yourself

Answer to TY 1

Article 27 of this Model law provides for ten types of procurement methods as follows:

- Open tendering;
- Restricted tendering;
- Request for quotations;
- Request for proposals without negotiation;
- Two-stage tendering;
- Request for proposals with dialogue;
- Request for proposals with consecutive negotiations;
- Competitive negotiations;
- Electronic reverse auction; and
- Single-source procurement

Answer to TY 2

On conviction, due to non-compliance with s.104, the person shall be liable to a fine of not less than ten million shillings or to imprisonment for a term of not less than seven years or to both, and in addition to the penalty imposed in this section, The court shall order that the amount of loss incurred by the complainant be compensated, failure of which, the court shall issue an order of confiscation of personal property of the person convicted in order to recover the loss.