DIRECTORS' PERSONAL LIABILITY IN FINANCIAL DISTRESS: WHAT KENYAN LAW REQUIRES YOU TO DO BEFORE IT'S TOO LATE

Introduction

In Kenya, directors of companies typically enjoy the protection of limited liability, meaning that a company's debts are normally separate from the personal assets of its directors. However, this protection is not absolute.

When a company faces financial distress or insolvency, directors can be held personally accountable for failing to uphold their statutory and fiduciary obligations. Such failures can result in financial liability, criminal sanctions and disqualification from serving as a director.

Legal Framework Governing Director's Duties and Liability

Directors' responsibilities in Kenya are primarily defined under two statutes:

1. **The Companies Act, 2015** which establishes directors' general duties, governance standards and consequences for breaches.
2. **The Insolvency Act, 2015** which regulates the conduct of companies in insolvency and imposes specific duties on directors to safeguard creditors' interests.

These statutory obligations are reinforced by fiduciary principles recognised in Kenyan case law, which require directors to act honestly, with care and in the best interests of the company. In insolvency scenarios, the duty focus shifts to the interests of creditors, who effectively become the residual risk bearers.

Core Duties of Directors

Under the Companies Act, directors owe a range of statutory and fiduciary duties, including:

1. Acting in good faith and in the best interests of the company;
2. Exercising care, skill, and diligence in their decisions;
3. Avoiding conflicts of interest; and
4. Acting within their powers.

The Shift in Duties When Insolvency Emerges

A significant shift occurs when a company is unable to pay its debts as they fall due or when liabilities exceed assets. At this stage, directors' duties pivot the duty to consider creditors' interests takes precedence.
Directors are expected to ensure transparent reporting of the company's financial position.

CM ADVOCATES LLP

Personal Liability in Insolvency

1. Wrongful Trading

Under Section 506 of the Insolvency Act, if a director knew or ought reasonably to have known that there was no practical possibility of keeping the company solvent and failed to take all reasonable steps to minimize losses to creditors, the court may order the director to contribute to the company's assets to compensate creditors.

This encourages early and responsible intervention to protect creditors when insolvency becomes foreseeable.

2.Fraudulent Trading (Before and During Liquidation)

When a company carries on business with the intent to defraud creditors, directors and officers involved may be held personally liable for company debts. Fraudulent trading constitutes both a civil basis for contribution orders and a criminal offence, punishable by fines or imprisonment.

Continuing to incur credit obligations knowing the company cannot repay, with the intention of shielding assets from creditors, constitutes fraudulent trading.

Statutory Obligations During Insolvency

Once insolvency proceedings begin, directors must prepare and submit a verified statement of the company's financial position to creditors within prescribed timelines.
Failure to comply without reasonable excuse can attract penalties including fines.

Consequences of Non-Compliance

Directors who fail to meet their duties may face:

1.Personal Financial Liability
Courts may order directors to repay, restore or account for company assets, or contribute financially for losses caused by fraudulent conduct.

2.Disqualification from Directorship
Under Section 224 of the Companies Act, directors found unfit may be barred from managerial or directorial roles up to 15 years.

3.Criminal Sanctions
Fraudulent trading or failing to meet statutory obligations can result in fines and/or imprisonment.

Practical Steps to Mitigate Risk

Directors can significantly lower their exposure to personal liability by taking timely and responsible action, including the following measures:

a) Conducting Early Financial Reviews. Regularly assess the company's financial health. Where it becomes apparent that the company's debts exceed its assets, or it is unable to meet its obligations as they fall due, immediate professional guidance should be sought.
b) Strengthening Governance Practices. Ensure board meetings are convened consistently, proper minutes are recorded and critical decisions especially those concerning cash flow management and dealings with creditors are carefully documented.
c) Professional Advice. Engage legal, financial and insolvency professionals early to demonstrate due diligence.
d) Transparent Communication with Creditors which can enable restructuring options.
e) Avoid Resignation as an Escape. Resigning from the board does not automatically absolve a director from responsibility. Liability may still arise from decisions or inaction during their tenure.

Conclusion

Financial distress is one of the most legally sensitive periods in the life of a company. Decisions made at this stage can either protect directors and preserve value or expose them to personal liability, regulatory sanctions and long-term reputational harm.

Kenyan law is clear, once insolvency becomes a real possibility, directors must act carefully, transparently and with creditors' interests firmly in view.

At our **Corporate Restructuring and Special Situations Practice (CRSS Practice)**, we support companies and their boards through periods of financial strain, regulatory exposure and operational uncertainty. Our focus is not only on stabilising the business, but also on ensuring that directors discharge their statutory and fiduciary duties properly.

If you would like to consult on this article or any other related matter, you may contact the contributors on the emails below or the **Corporate Restructuring and Special Situations Practice** team via email at crsspractice@cmadvocates.com.

Do also visit our website https://cmadvocates.com/en for more information about us and our services.

CONTRIBUTOR

Maureen Odongo
Senior Associate Advocate
Email: modongo@cmadvocates.com
CM Advocates LLP

Head Office - Nairobi, Kenya
I&M Bank House, 7th Floor, 2nd Ngong Avenue
T: +254 20 2210978 / +254 716 209673
P.O. Box 22588 – 00505, Nairobi Kenya
E: law@cmadvocates.com

Mombasa Office - Kenya
Links Plaza, 4th Floor, Links Road, Nyali
T: +254 041 447 0758 / +254 41 447 0548
P.O. Box 90056 – 80100, Mombasa Kenya
E: mombasaoffice@cmadvocates.com