Shah & another v Shah & another; Ganeshay Limited (Nominal Defendant) (Civil Application E034 of 2023) [2023] KEHC 24133 (KLR) (27 October 2023) (Ruling)

Neutral citation: [2023] KEHC 24133 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT ELDORET

CIVIL APPLICATION E034 OF 2023

JRA WANANDA, J

OCTOBER 27, 2023

BETWEEN

PRADIPKUMAR BHAGWANJI SHAH ..... 1ST APPLICANT

ATUL BHAGWANJI SHAH ..... 2ND APPLICANT

AND

BHAVIN ROHIT SHAH ..... 1ST RESPONDENT

ROHIT ZAVERCHAND SHAH ..... 2ND RESPONDENT

AND

GANESHAY LIMITED ..... NOMINAL DEFENDANT

RULING

1. Before the Court is the Application brought by way of the Notice of Motion dated 23/02/2023 and filed by the Applicants on 24/02/2023. The same is filed through Messrs Swaka Advocates and seeks the following orders;

    i. Spent

    ii. That the Honourable Court be pleased to grant the Applicants leave to commence and institute derivative suit against the Respondents seeking relief on behalf of Ganeshay Company Limited in respect of acts and omissions by the Respondents involving negligence, default, breach of duty and breach of trust in their capacity as directors of Ganeshay Company Limited on such terms as the Court may consider appropriate.

    iii. That the Honourable Court be pleased to grant leave to the Applicants to continue the derivative claim seeking relief on behalf of Ganeshay Company Limited in respect of acts and omissions by the Respondents involving negligence, default, breach of duty and breach of trust

in their capacity as directors of Ganeshay Company Limited on such terms as the Court may consider appropriate.

iv. [Spent] .....

v. That the Honourable Court be pleased to grant a temporary injunction restraining the Respondents by themselves, their agents, assigns and/or employees or whomsoever is acting on his behalf from attaching, transferring, selling, conveying, charging, leasing, removing or in any dealing with the assets of the Nominal Defendant Company pending the hearing and determination of the derivative suit.

vi. That the Honourable Court be pleased to issue an order compelling the Respondents to produce book of accounts, audited financial statements, loan status statements and reports, loan agreements and/or all financial statements and accounts of the Nominal Defendant in their custody from 2017 to date.

vii. That the Court be pleased to issue any other orders expedient in the circumstance and in the interest of justice.

viii. That costs be provided for.

2. The Application is stated to be brought under "Article 159(2) and 25 of *the Constitution* of Kenya 2010, Sections 1A, 1B, 3A of the *Civil Procedure Act*, Cap. 21 Laws of Kenya, Section 238, 239 and 241(2) of the *Companies Act* 2015, Order 51 Rule 1 of the *Civil Procedure Rules* 2010 and all enabling provisions of the law." It is premised on the grounds set out on the face thereon and supported Affidavit sworn jointly by the Applicants, Pradipkumar Bhagwanji Shah and Atul Bhangwanji Shah.

3. In the Affidavit, the Applicants deponed that they are directors of the Nominal Defendant, that the parties incorporated the company dealing in the distribution of fast moving consumer goods (FMCG), the parties are the only and equal shareholders within the company, the Applicants were passive, they were never and have never been involved actively in the management or affairs and the day to day running which role was reserved for the Respondents who are father and son, the Respondents were in charge and in control of the company, deciding on all aspects of the company such as hiring, firing and remuneration of employees and directors, purchase and disposition of company assets, importation and distribution of goods, finance, accounting and bookkeeping and all such matters, the Respondents are the sole signatories to the bank accounts opened and operated on behalf of the company, the accounts were purely operated by the Respondents, the Respondents have been overdrawing the company's accounts which funds have been redirected towards achieving the Respondents' personal objects and selfish use without an iota of regard to the prosperity and financial well-being of the company, the Respondents withdrew Kshs 10,000,000/- from the company which amounts they failed to document and account for, the said funds have never been returned to the company and that the Respondents had exclusive borrowing powers over the company's assets which powers they have abused to the company's detriment,

4. The Applicants deponed further that the Respondents registered a charge over the company's property to secure a credit facility which was done without notice or approval by the Applicants in line with the company's articles, the bank has been demanding for the repayment of the loan in default of which it intends to exercise its powers of sale and disposing the security to recover the debt, the company's overdraft facility has reached over Kshs 40,000,000/- despite the Applicants' attempt to cancel the same which attempts have been frustrated by the Respondents who in machination with others have managed to outmanoeuvre all the Applicant' attempts, as at February 2018 the company's overdraft facility stood at Kshs 13,000,000/- but the same has ballooned to over Kshs 40,000,000/-, alarmed by

the foregoing, the 1st Applicant wrote to the bank and directed that accounts held by the company at Prime Bank be frozen owing to mismanagement, rampant abuse and misuse of company finances and resources and fraud against the company perpetrated by the Respondents, the bank responded and informed the 1st Applicant that the Applicants were not signatories to the account and requested him to submit an official request letter for the same to be effected which the 1st Applicant did, despite being aware of the company's financial dealings the Respondents have continued trading and borrowing further compounding the companies liabilities and inability to settle and clear its debts.

5. The Applicants deponed further that the Respondents entered into unsanctioned business relationship with Bhumi Distributors, a company which the Respondents wholly owned and controlled which relationship primarily served to benefit the Respondents, the Respondents also allocated some of the company's business and resources to the said Bhumi Distributors, the Respondents also failed to avoid, declare and/or disclose the existence of a conflict of interest which hampered their ability to discharge the duties owed to the company, the suppliers have gone unpaid for long durations thus leading to heavy accumulation of debts, the mismanagement and misuse of company resources left the company haemorrhaging due to heavy and unexplained losses despite a boom in business, the Respondents failed to keep and maintain proper books of accounts, the Respondents have been issuing loans to themselves from the company which they have failed to repay, alarmed by the rampant theft and mismanagement, the Applicants requested the Respondents to avail the necessary documents and accounts for inspection, the same have never been supplied, having grown weary of the misdirection, lies, concealment and utter lack of integrity, transparency and accountability the Applicants demanded and requisitioned for an audit to be conducted, the Respondents fought and challenged the auditors appointed and have been frustrating and derailing the audit process, the Respondents are in possession of all financial statements and books of account but have failed to avail the same, the Respondents have dismissed the Applicants concerns calling them petty and of no significance, the company has been drowning in debt and losses, the Respondents refused to give access to the company's network and that the Applicants have attempted to resolve the dispute amicably. According to the Applicants, they have made out a *prima facie* case warranting exercise of the Court's discretion in favour of the Applicants.

Response

6. The Application was opposed by the Respondents *vide* the Replying Affidavit sworn jointly by the Respondents and filed on 13/03/2023 through Messrs Charles Gomba & Co. Advocates.

7. In the Affidavit, the Respondents deponed that the Application is a knee-jerk reaction and/or retaliatory pleading as a result of the Respondents filing a derivative suit against the Applicants in Comm Suit No. E420 of 2022 – *Bhavin Rohit Shah & anor. v Pradipkumar & 2 Others*, the Court in the said case, upon reviewing the evidence presented granted the Respondents leave to institute a derivative suit on and for behalf of a company known as Remashwar Limited against the Applicants for mismanagement of that company, it is only after the Respondents filed the said suit that the Applicants decided to file this matter purely as a retaliatory measure, this point is made clear by the Applicant's Affidavit in which they state that they have never been involved in the active management of the company, it therefore defies logic for them to claim that there is mismanagement of the company if they are not aware of the company's financial standing, they have never withdrawn any money or taken an overdraft facility without approval/resolution, the sum of Kshs 10,000,000/- was sanctioned by the company and returned and that, contrary to the Applicants' accusations, the overdraft facility has not reached over Kshs 40,000,000/- as sensationally claimed by the Applicants.

8. The Respondents further deponed that the claims of misuse of funds were baseless, the Applicants failed to substantiate the same to the bank despite being requested to do so, the same have not been supported by any evidence, the averments are of no substance as the company has always had its books audited, the Respondents have always conducted their duties as directors with due diligence with utmost accountability, they have honoured their fiduciary and statutory mandate and have always submitted the company's documents including Annual Returns, it is the Applicants who have abandoned their roles as directors and left the sole management to the Respondent and that the Application is an afterthought merely filed to get even with the Respondents and has not attained the threshold of being granted leave to institute a derivative suit.

9. Subsequently, on 23/03/2023, the Respondents filed a joint Further Affidavit in which they deponed that the company's Accounts are in order including tax obligations and they annexed a Tax Compliance Certificate. This Further Affidavit was clearly filed without leave of the Court and its filing was unprocedural. However, looking its contents being very brief, I do not deem it to be in any way prejudicial to the Applicants.

Hearing of the Application

10. It was then directed, and agreed, that the Application be canvassed by way of written Submissions. Pursuant thereto, the Applicant filed his on 2/06/2023 while the Respondent filed on 22/06/2023.

Applicant's Submissions

11. For the definition and import of derivative actions, Counsel for the Applicants cited the case of *Ghelani Metals Limited & 3 others v Elesh Ghelani Natwaral & another* (2017) eKLR and contended that the Respondents have mismanaged and misdirected the company and its resources culminating in heavy financial loss, the company's business ground to a halt due to the rampant mismanagement and misuse by the Respondents. Counsel cited Section 238 and 239 of the *Companies Act* and submitted that derivative suits involve a two-stage process, the first stage requires the Court to satisfy itself that based on the evidence provided, there is prima facie case and the Applicant need not show that the claim will succeed. He also cited the case of *Yusuf Abdi Adan v Hussein Ahmed Farah & 3 Others* [2019] eKLR. Regarding the second stage, Counsel cited the case of *Mohamedin Mohamed & another v Ibrahim Ismail Isaak & another* [2021] eKLR.

12. Counsel further submitted that the evidence discloses a *prima facie* case, the Applicant has proven the existence of a cause of action owing to the company against the Respondents, the Respondents have breached their statutory and fiduciary duties, the Respondents have managed the affairs of the company negligently culminating in the cessation of operations by the company, under the Respondent's stewardship the company's debt has ballooned to disproportionate and uncontainable levels, the company has failed to hold and convene meetings and the company has ultimately collapsed, there is a real risk of loss and damage to the company, the Respondents have not denied being in charge of the activities of the company, the company's debt as at 31/12/2018 according to the statements provided by the Respondents stood at Kshs 27,171,062/-, as at 31/12/202 it stood at Kshs 41,593,864, an increase of Kshs 14,422,802 notwithstanding that the company ceased operations in 2019. Counsel posed the question why would the company borrow money after operations ceased and where did the borrowed funds disappear to?

13. Counsel added that the company disposed assets worth Kshs 12,541,819 yet there was no significant change in the company's financial position, the funds in question are unaccounted and undocumented, all the events were taken without consent, approval or authorization, the Respondents have not produced any Resolution or minutes of any meeting, a vote requires a simple majority for the

same to pass, the company's shareholding structure vis a vis the Applicants and Respondents means that neither party has a majority, the company could thus not have authorized the actions complained of, the 1st Respondent advanced himself Kshs 10,000,000/- from the company's account and the Respondents have attached a copy of minutes of the meeting approving the lending, interestingly, only two directors were present at the meeting, the Respondents are father and son, the quorum is incomplete, the agenda has not been disclosed and the company secretary who is required to take the minutes is absent and has not been signed, a textual reading of the minutes reveals that the company was allegedly paying a debt owed to the 1st Respondent as opposed to lending him money, the minutes have been engineered subsequent to the filing of the this Application to try and justify the illegality, the funds were returned only after the Applicants demanded for the same, the sums were repaid only 5 days later despite the company having extended a 1 month period within which the monies were to be repaid, from the email correspondence attached in the Applicant's bundle the Respondents are seen apologizing for the withdrawal and promising not to withdraw any more funds without permission and that the Annual Report and Financial Statements were never presented to the Applicants for approval and adoption, the same are signed by the Respondents only,

14. Counsel added that the parties herein had another company jointly, Rameshwar Distributors, which has equally collapsed due to the mismanagement and lack of accountability by the Respondents, the Nominal Defendant and the sister company were engaged in business with the Respondent's company, Bhumi Distributors, it is very suspect that Bhumi Distributors is still in operation and carrying on business while the other two collapsed yet all three companies were under the same management, the Respondents poached a majority of the company's employees, including its accountants who were the primary record keepers, there existed a conflict of interest, the Respondents sought their own personal and financial gratification at the company's expense.

15. Counsel submitted further that the Application and suit are aimed at achieving and promoting the company's best interests, the Respondents have alleged that this action is a mere retaliatory response to the suit filed in Milimani, the Applicants have an inherent and inalienable right to institute proceedings seeking redress, the existence of the suit at Milimani does not bar the institution of further proceedings between the parties, the subject of the proceedings herein is Ganeshay Distributors, not Rameshwar Distributors, it would be unjust to lock the Applicants from the hall of justice merely on account of the existence of the case at Milimani and that the Respondents earned a salary from the company which cannot be said for the Applicants. Counsel cited the case of *Isaiah Waweru Njumi & 2 Others v Muturi Ndungu* [2016] eKLR.

16. On whether the Applicants have met the threshold for grant of a temporary injunction, Counsel cited Order 40(1) (a) and (b) of the *Civil Procedure Rules*, the case of *Mugo wa Karanja v Ecobank (Kenya) Limited & another* [2019] eKLR and *American Cyanamid Co. v Ethicom Limited* (1975) AER 504 and submitted that three elements were of great importance, namely, that there must be a serious/fair issue to be tried, damages are not an adequate remedy and the balance of convenience lies in favour of granting or refusing the Application. He then also cited the cases of Giella Cassman Brown Limited (1973) EA 358, *Nguruman Limited v Jan Bonde Nielsen & 2 others*, CA No. 77 of 2012 (2014), and *Mrao Ltd v First American Bank of Kenya Ltd* (2003) eKLR

17. Counsel added that the company has no real assets other than the leasehold property which has been offered as collateral to secure the loan facilities, the company has not been servicing the loans, the statements attached are for the year 2021 and do not give a true and accurate account of the accounts, if the Court does not intervene the company will lose all its assets, a once vibrant company is now on its deathbed breathing its last unless the Court can resuscitate it and preserve it life-force through issuance of a temporary reprieve and that the Applicants have set out a *prima facie* case.

18. On "irreparable harm", Counsel cited the cases of *Pius Kipchichir Kogo v Frank Kimeli Tenai* [2018] eKLR and *Mawji v International University & another* (1976-80) KLR 229 and submitted that the Respondents' actions have resulted in heavy financial loss to the company and halting of operations, the company has lost significant business, creditors have gone unpaid and the company has lost its reputation, this is proof of irreparable harm and loss that cannot be adequately compensated through an award of damages, there is real and actual threat that the company may lose its property as creditors attempt to recover their dues.

19. On "balance of convenience", Counsel cited the cases of Pius Kipchichir Kogo (*supra*) and *Paul Gitonga Wanjau v Gathuthis Tea Factory Company Ltd & 2 Others* (1976-80) KLR 229 and submitted that the good to be achieved must outweigh any injustice to be occasioned upon the Respondent, the balance of convenience tilts towards grant of the orders, the company's existence and reputation are at stake, it is important that the Respondents be held to account for their transgressions, the orders are sought to preserve the company's assets from further erosion which could cripple and deliver the final blow.

20. On whether the Respondents should be compelled to produce the items listed in prayer 6 of the Application, Counsel submitted that the Applicants, as shareholders, have a right to access the company's financial information, the Respondents, despite requests, failed to supply and furnish complete copies of the financial status of the company, this refusal and mulishness by the Respondents has translated into heavy financial losses and loss of reputation, it is in the best interest of the company that the Respondents be compelled to avail all financial statements and records including the original source documents and access to the company's accounting system.

Respondents' Submissions

21. Counsel for the Respondent cited Section 238(3) of the *Companies Act* and submitted that the evidence presented falls short of the statutory requirement, on the contrary, the evidence provided reveals the position of diligent directors. He cited the case of *Ghelani Metals Limited & 3 others v Elesh Ghelani Natwaral & another* (2017) eKLR.

22. On whether a *prima facie* case has been established, Counsel submitted that the Applicant's case is not genuine but a knee-jerk reaction, the Applicants have alleged that the Respondents have mismanaged the company leading to massive debts, they have nonetheless failed to produce any evidence of a creditor's demand to that effect, the Applicants have also alleged that the Respondents failed to file company's Annual Returns with the Registrar of Companies, this baseless allegation was disproved by the Respondents' who produced copies of the audited Statements, the Respondents also produced an extract from e-citizen showing that the Annual Returns were lodged, they also produced a copy of the Tax Compliance Certificate, they also produced a copy of the Plaint in HC Comm Suit No. E420 of 2022 in which the High Court at Nairobi granted the Respondents herein leave to institute a derivative suit against the Applicants, it is as a result of the said suit that the Applicants decided to lodge a retaliatory suit with no basis at all. According to Counsel therefore, no prima facie case has been established.

23. Counsel added that as regards the injunctive prayer, the Applicants have not provided any evidence to warrant the orders sought. He cited the case of *Robert Mugo wa Karanja v Ecobank & anor* (2019) eKLR and *Tony Kent v Polcino Oasis Limited* (2014) and submitted that the Applicants have not demonstrated a *prima facie* case. He added that the Respondents have produced the documents already cited above and that it therefore defies logic how the company will suffer irreparable injury. He submitted further that the balance of convenience is in favour of an injunction yet no breach of

statutory duty has been demonstrated and that the balance of convenience is in favour of an injunction not being granted as it will bring the company's activities to a halt.

24. Regarding mandatory injunction, Counsel cited the case of *Tony Kent v Polcino Oasis Limited* [2014] eKLR and submitted that this prayer has been overtaken by events as the Respondent produced all the audited Statements, Returns to the Registrar of Companies and Tax Compliance Certificate.

25. In conclusion, Counsel submitted that the prayers sought are found in statute but also creatures of equity all of which warrant the Court's discretion, a Court when exercising its discretion has to weigh in several factors including how the Applicant has approached the Court, the maxim "he who approaches the Court must do so with clean hands" applies and the evidence demonstrates that the Applicants hands are soiled with dirt.

Analysis and Determination.

26. Upon considering the Application, the Affidavits and Submissions filed, I find the issues that arise for determination to be as follows:

    i. Whether the Applicants have demonstrated that leave to institute and continue derivative action ought to be granted.

    ii. Whether the Applicants have demonstrated that a temporary injunction ought to be granted restraining the Respondents from attaching, transferring, selling, conveying, charging, leasing, removing or in any way dealing with the assets of the company pending the hearing and determination of the derivative suit.

    iii. Whether there are justifiable grounds to compel the Respondent to produce documents relating to the company's accounts, audit, financial statements, loans and similar matters.

27. I now proceed to analyze and determine the said issues.

i.Whether the Applicants have demonstrated that leave to institute and continue derivative action ought to be granted

28. In determining this issue, I have to be cautious not to dwell too much in dissecting the Applicants' intended suit before the Court that will eventually handle the substantive suit should this Court grant leave for file the suit. I will therefore refrain from making conclusive or final determinations.

29. Regarding derivative suits, Section 283(3) of the *Companies Act*, 2015 provides as follows:

> "(3) A derivative claim under this part may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company."

30. On its part, Section 239(1) of the *Companies Act*, 2015 provides that:

> "(1) In order to continue a derivative claim brought under this part by a member, the member has to apply to the Court for permission to continue it."

31. Further, in *Dadani v Manji & 3 Others* [2004] KLR 95, Hon. Justice Mwera (as he then was) stated as follows:

> "It is a cardinal principle in Company Law that it is for the company and not an individual shareholder to enforce right of actions vested in the company and to sue for wrongs done to

it. It is also cardinal that in the absence of illegality, a shareholder cannot bring proceedings in respect of irregularities in the conduct of the company's internal affairs in circumstances where majority are entitled to present the bringing of an action in relation to such matter (see *Foss v Harbottle* (1843) 2 Hake 461). All this is in deference to the self regulation the law allows corporations and thus limits the interference by the Courts in the running of such bodies on their own. However, if due to an illegality a shareholder perceives that the company is put to loss and damage but cannot bring an action for relief in its own name, such a shareholder can bring an action by way of a derivative suit."

32. In *Ghelani Metals Limited & 3 others v Elesh Ghelani Natwarlal & another* [2017] eKLR, Onguto J explained the following:

> " 36. It may be apposite to spare a few paragraphs on derivative actions in view of the fact that the flight path for such actions was diverted with the advent of the *Companies Act*, No 17 of 2015 ("the Act").
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> 37. Derivative actions are the pillars of corporate litigation. As I understand it, a derivative action is a mechanism which allows shareholder(s) to litigate on behalf of the corporation often against an insider (whether a director, majority shareholder or other officer) or a third party, whose action has allegedly injured the corporation. The action is designed as a tool of accountability to ensure redress is obtained against all wrongdoers, in the form of a representative suit filed by a shareholder on behalf of the corporation: see *Wallersteiner v Moir* (No.2) [1975] 1 All ER 849.
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> 38. Until 2015, in Kenya, the common law guided derivative actions in Kenya. Ordinarily under common law, one had to fall under the exceptions to the rule in *Foss v Harbottle* [1843] 2 Hare 461 that "a company is a separate legal personality and the company alone is the proper Plaintiff to sue on a wrong suffered by it": see also *Hawes v Oakland* 104 U.S 450 [1881]. The exceptions to the rule in *Foss v Harbottle* were mainly where there was fraud on a minority caused by majority shareholder(s). The action to be commenced had also to be in the best interest of the company and without any ulterior motive: see *Nurcombe v Nurcombe* [1985] 1 All ER 65.
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> 39. The rule in *Foss v Harbottle* along with its exceptions held sway locally as well: see *Rai & Others v Rai & Others* [2002] 2 EA 537. A party seeking to 'by-pass' the company had, in limine, to show that he fell within the exceptions to the rule: see *Murii v Murii & another* [1999] 1 EA 212.
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> 40. With the advent of the Act, the law fundamentally changed. The requirement to fall under the exceptions to the rule in *Foss v Harbottle* was replaced with judicial discretion to grant permission to continue a derivative action. Judicial approval of the action is what now counts and such approval is based on broad judicial discretion and sound judgment without limit but with statutory guidance.

33. Applying the above principles to the facts of this case, my view is that it is important in such an Application to clearly describe to the Court the specific prayers that the Applicant wishes to present before the substantive Court that shall hear the derivative suit should leave be granted. It may even be advisable to present to the Court a sample or draft of the intended Plaint that an Applicant seeks to file

in the derivative action. It is not enough, in my view, for an Applicant to simply raise allegations after allegations without also presenting to the Court the specific prayers it seeks to make. In the absence of a clear submission on the prayers sought to be presented, how and on what basis is the Court expected to exercise its discretion? However, this alone should not by itself render the Application fatal. I will therefore consider other aspects of the Application.

34. Regarding the merits of the matter before Court, the Applicants have stated that the Respondents were in charge and in control of the company, deciding on aspects of the company such as hiring, firing of employees, remuneration of employees and directors, purchase and disposition of company assets, importation and distribution of goods, finance, accounting and book-keeping and all matters touching on the company and that the Respondents were the sole signatories to the company bank accounts.

35. The Applicants have then faulted the Respondents for mismanaging the company by trading and borrowing while the company is financially distressed, that they failed to exercise reasonable care, skill, prudence and diligence, that they failed to pay suppliers and creditors and to service loans and overdraft facilities taken with the bank and thus exposing the company to litigation and threat of insolvency. In my opinion, these acts, even if true, may by themselves not necessarily prove wilful and/or deliberate mismanagement to justify institution of litigation against the Respondents. The acts may amount to incompetence or lapse in judgment but may not by themselves per se justify the filing of a derivative suit. The mere failure to pay suppliers or creditors does not also by itself appear to be actionable against the Respondents in a derivative action. Such failure may very well be due to various other genuine factors outside the control of the Respondents. Logically, derivative action connotes fraudulent or deliberate actions by directors calculated to fleece the company for personal gain or serious acts of negligence or breach of duty or breach of trust by directors resulting into unnecessary or avoidable damage or losses to the company. The acts referred to above do not, in my view, satisfy the contemplated criteria.

36. In this regard, Lenaola J (as he then was), in the case of *Jacob Juma v Evans Kidero* (2016) eKLR, while citing the decision of the Court in *Shirawuse Limited and another v Pianesi Gino* (2012) eKLR stated the following:

> " It is a cardinal principle in company law that it is for the company and not the individual shareholder to enforce rights of action vested in the company and sue for wrongs done to it .... that in the absence of illegality, a shareholder cannot bring proceedings in respect of irregularities in the conduct of the company's internal affairs in circumstances where the majority are entitled to present the bringing of an action in relation to such matters. However, if due to an illegality a shareholder perceives that the company is put to loss and damage but cannot bring an action for relief in its own name, such a shareholder can bring an action by way of a derivative suit.... (but) mere irregularity in the internal management of a company cannot be a basis for one to bring derivative suit for such can be rectified by a vote/resolution at the company's meeting..."

37. Of the allegations that appear to fall within the matters contemplated in a derivative action, the accusation that the Respondents failed to lodge the company's financial statements as required under Section 683 of the *Companies Act* and that the Respondents have also failed to file Annual Returns as required under Section 705 of the Act may indeed meet the criteria. However, in their response, the Respondents have produced documents demonstrating that they, to an extent, complied with these requirements. I am however alive to the "holes punched" by the Applicants as shall be referred to hereinbelow.

38. However, there is a third category of other allegations made against the Respondents which are obviously weighty and which would no doubt fall within the contemplation of derivative suits. These include the allegations that the Respondents failed to declare or disclose their conflict of interest by causing the company to trade with other companies owned by the Respondents, acting in excess of their powers to the detriment of the company by, for instance, taking loans without the board's approval, offering company assets as collateral for loans without the board's approval, taking personal loans from the company and failing to repay them, failing to declare or account for such loans, failure to call directors meetings and purporting to pass Resolutions without calling board meetings and disposing of company assets but failing to account for proceeds of such disposal. It is also not disputed that the 4 parties herein hold equal shareholding with each side cumulatively holding 50% thereof. How then did the Respondents who hold 50% of the shareholding procure company Resolutions without the approval of the Applicants who hold the other 50%? How were the Resolutions arrived at?

39. In respect to the documents produced by the Respondents, there are also some unanswered questions that may need to be more closely interrogated in a derivative suit. These include the Auditor's Report not being stamped and also not bearing the Auditor's signature, non-production of the Auditor's practising certificate nor disclosure of the practicing number and the bank statements not being certified. Further unanswered matters include the fact that there seems to have been an unexplained overdraft of over Kshs 16 million taken through the Respondents and the loans also seem to be accumulating at an alarming rate. Further, the Auditor's Report appears to inconclusively indicate that company operations were stopped in the year 2018 which indication seems to contradict the statements by the Respondents. I also note that the bank statements produced by the Respondents are not recent.

40. Regarding the Respondents' response to these grave allegations, my perusal of the Respondents' Replying Affidavit reveals a conspicuous silence thereto. The Respondents may very well have genuine and convincing answers to the said questions but if so, they have in their wisdom chosen not to present them at this stage. Non-disclosure of answers is at the Respondents' discretion and this Court cannot purport to direct the Respondents on how to present their case. However, under such circumstances, this Court is left with no alternative but to find that the allegations made by the Applicants, not being controverted, disclose a prima facie case sufficient to be more closely interrogated in a derivative suit.

41. I note that the Respondent's major response is that allegedly the Applicant's case is not genuine but a "knee-jerk reaction" retaliation to the filing by the Respondents of similar proceedings against the Applications vide Milimani High Court Commercial Suit No. E420 of 2022 in which the High Court at Nairobi granted the Respondents leave to institute a derivative suit against the Applicants over the alleged mismanagement of a sister company. In my view, this alone cannot justify locking out the Applicants from access to Court provided the Applicants demonstrate the existence of a prima facie case, which as I have already found, they have.

ii.Whether the Applicants have demonstrated that a temporary injunction ought to be granted restraining the Respondents from attaching, transferring, selling, conveying, charging, leasing, removing or in any way dealing with the assets of the company pending the hearing and determination of the derivative suit

42. The conditions for the grant of an interlocutory injunction are well known as was set out in *Giella v Cassman Brown and Co. Ltd*, 1973 E.A 360 and reiterated in *Mrao v First American Bank of Kenya Ltd and 2 others* 2003 KLR 125 as follows.

> " These are that, an applicant must establish a *prima facie* case with a probability of success, that unless injunctive orders are granted he will suffer irreparable harm which would not

be adequately compensated for by damages and that if the court is doubt, it will decide the matter on a balance of convenience."

43. I have already made a finding that the Applicants have established a prima facie case justifying grant of leave to the Applicants to commence a derivative suit against the Respondents. Regarding this further prayer to for injunction, it may be logical for one to argue that once this Court grants such leave, it becomes functus oficio and that any consequential matters should be placed before the Court before which the derivative suit shall be filed. However, I may also mention that I do not know of any express provision that bars this Court from issuing, at this stage of seeking leave, any further orders subsequent to granting leave. However, considering the nature and extent of allegations made herein, I feel that, by issuing the injunction orders, I shall technically be pre-judging issues shall be pending for determination before the derivative suit Court. This will be tantamount to usurping that Court's mandate,

44. Further, by issuing injunction orders, this Court may later be called upon to enforce the orders. Since the derivative suit may have been filed by such time, the litigants may then be placed in a complicated situation where there may be two parallel proceedings touching on the same subject matter before different Courts.

45. For the above reasons, my finding is that the Applicants ought to place the prayers for injunction before the Court that will be properly seized of the derivative suit. Accordingly, I decline to issue the injunctive orders sought by the Applicants and leave that to the derivative suit Court.

iii.Whether there are justifiable grounds to compel the Respondents to produce documents relating to the company's accounts, audit, financial statements, loans and similar matters

46. For the same reasons as above, including the need to avoid the risk of prejudging issues still pending determination, my finding is that the Applicants ought to place this prayer before the Court that will handle the derivative suit. Similarly, therefore, I decline to issue the orders compelling the Respondents to produce the said documents and also leave that discretion to the Court that shall handle the substantive suit.

Final Orders

47. In light of the above findings, I make the following orders:

    i. Prayer 2 and 3 of the Application dated 23/2/2023 filed by the Applicants are hereby allowed with the result that the Applicants are granted leave to commence and/or continue a derivative suit against the Respondents seeking relief on behalf of Ganeshay Company Limited in respect to the acts and/or omissions alleged therein.

    ii. In terms of Section 239 of the *Companies Act*, the intended derivative suit is to be lodged, instituted and or filed within twenty-one (21) days from the date of delivery of this Ruling.

    iii. The rest of the prayers made in the said Application would be best handled by the Court that shall be seized of the substantive derivative suit intended to be filed. The same may therefore be sought, renewed and/or placed before that Court.

DELIVERED, DATED AND SIGNED AT ELDORET THIS 27TH DAY OF OCTOBER 2023.

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WANANDA J. R. ANURO

JUDGE