



**IN THE HIGH COURT OF KENYA**

**AT NAIROBI**

**MILIMANI LAW COURTS**

**COMMERCIAL AND TAX DIVISION**

**CORAM: D. S. MAJANJA J.**

**CIVIL CASE NO. 008 OF 2020**

**BETWEEN**

PAUL WANYOIKE NGUGI.....1<sup>ST</sup> PLAINTIFF

GEOFRY KIRAGU GACHANJA.....2<sup>ND</sup> PLAINTIFF

WILLIAM MWANGI NGUGI.....3<sup>RD</sup> PLAINTIFF

GEORGE MWANGI NDUNGU.....4<sup>TH</sup> PLAINTIFF

JAMES GITAU NGARUIYA.....5<sup>TH</sup> PLAINTIFF

NGANGA MUNJARO.....6<sup>TH</sup> PLAINTIFF

MWINDIKA THUU.....7<sup>TH</sup> PLAINTIFF

GEOFFREY NDUNGU MUGO.....8<sup>TH</sup> PLAINTIFF

SIMON NJOROGE GUCHU.....9<sup>TH</sup> PLAINTIFF

CHARLES NJOROGE THIRU.....10<sup>TH</sup> PLAINTIFF

**AND**

JOSEPH GACHANJA GUCHU.....1<sup>ST</sup> DEFENDANT

LEWIS KARIRU KIBUGA.....2<sup>ND</sup> DEFENDANT

STEPHEN THIONG'O KAMAU.....3<sup>RD</sup> DEFENDANT

ONESMUS MBURU GITAU.....4<sup>TH</sup> DEFENDANT

DAVID GITAU KABIRIRI.....5<sup>TH</sup> DEFENDANT

SAMUEL KIMANI THIRU.....6<sup>TH</sup> DEFENDANT

**RULING**

1. At paragraph 2 of the plaint dated 14<sup>th</sup> January 2020, the plaintiffs state that they, “bring this suit on their own behalf and on behalf of

other persons who are all members of **KIHURUINI INVESTMENT COMPANY LIMITED** pursuant to section 780 of the Companies Act 2015 or affected by the cause of action herein and who may by leave of the Court be enjoined to the suit,” against the defendants who are the current directors of Kihuruini Investment Company Limited (“the Company”).

2. The plaintiffs complain that at the annual general meeting which took place on 19<sup>th</sup> July 2019, the members rejected the single item on the agenda tabled by the defendants, that is, the sale of the **LR No. 36/7/521 situated at Eastleigh Section 7** (“the suit property”) at a price of Kshs. 110 million. Thereafter, the plaintiffs discovered that the defendants had evicted all tenants from the building, fenced it off, removed all the doors and earmarked the suit property for sale to a purchaser who had been convinced that the annual general meeting had approved the sale. The plaintiffs’ intervention by the Registrar of Companies and National Government on the matter was without success.

3. The plaintiffs and other members of the Company are aggrieved by the actions of the Company. They allege that there was no resolution to sell the suit property. They also accuse the defendants of failing to file annual returns for the Company since 2013, failing to render audited accounts of the Company, failing to allow elections of directors and frustrating election of new directors, failing to conduct annual general meetings of the Company in violation of the Articles of Association and provisions of the **Companies Act, 2015** (“the **Companies Act**”), failing to update the register of members and allow inspection of the same, disposing of company assets and properties and embezzling funds.

4. The plaintiffs also claim that the last dividend to members was paid after a period of 5 years and each member received only Kshs. 700/- for the entire period as dividend. They pray that the court do send inspectors pursuant to **section 786** of the **Companies Act** to investigate the affairs of the Company and report back to Court before any sale of the Company property can take place.

5. The plaintiffs therefore seek the following reliefs:

A. An injunction restraining the Defendants from selling, disposing of, alienating gifting transferring and /or in anyway adversely dealing with LR No. 36/7/521 situated at Eastleigh Section 7.

B. The Defendants do furnish this Honourable Court with Audited statements of Account of KIHURUINI INVESTMENT COMPANY LIMITED as from the year 2013 to December 2019.

C. An injunction restraining the Defendants from selling, disposing of, alienating, gifting, transferring and/or in any way adversely dealing with any of the properties of the Company until a court authorised inspector inspects the affairs of KIHURUINI INVESTMENT COMPANY LIMITED.

D. Costs of the suit.

6. Simultaneously with the plaint, the plaintiffs filed a Notice of Motion dated 14<sup>th</sup> January 2020 made, inter alia, under **Order 40 rule 1, 2, 3, 4, 8 and 10** of the **Civil Procedure Rules** and **section 780** of the **Companies Act** seeking orders restraining the defendants from selling the suit property pending the hearing and determination of the suit. The application was supported by the affidavit of the 1<sup>st</sup> plaintiff sworn on 14<sup>th</sup> January 2020 reiterating the facts set out in the plaint which I have outlined above.

7. When the defendants were served with court process, they filed a Notice of Preliminary Objection dated 20<sup>th</sup> January 2020. They prayed that the suit and motion be struck out on the ground that they were filed in violation of **sections 238 and 239** of the **Companies Act**. In addition, the defendants stated that the suit did not disclose any cause of action and that it was grounded on scandalous allegations and it was frivolous and vexatious.

8. When confronted with the preliminary objection, the plaintiffs then filed a Notice of Motion dated 21<sup>st</sup> January 2020 made under **section 239** of the **Companies Act** in which they sought the following order:

[1] THAT the Applicants herein be granted leave to continue with the claim in HC COM CIVIL CASE NO. 008 of 2020, PAUL WANYOIKE NGUGI & 9 OTHERS VS JOSEPH GACHANJA GUCHU & 6 OTHERS as a derivative suit.

9. The application was supported by the affidavit of the 1<sup>st</sup> plaintiff sworn on 20<sup>th</sup> January 2020 in which he reiterated the contents of the plaint and added that the suit raises substantial issues of law which need to be canvassed before the court. He raised issues of breach of trust by directors, acts and omissions by the directors that deserve protection of the court. The plaintiffs assert that this case is not intended to settle scores with the defendants but rather protect and safeguard the property of the Company.

10. The 1<sup>st</sup> plaintiff also adds that the plaintiffs had requisitioned a special/ordinary meeting in accordance with **section 277** of the **Companies Act** to be held on 24<sup>th</sup> January 2020 and that they seek orders of the court to compel the defendants to allow the special meeting to proceed. They also pray for the court to send inspectors pursuant to **section 786** of the **Companies Act** to investigate the affairs of the Company. The plaintiffs therefore seek the court’s permission to proceed with this suit for and on behalf of the Company.

11. The respondents opposed the application for leave to continue the suit as a derivative action through the affidavits of Stephen Thiong’o Kamau, the Chairman of the Board of Directors of the Company, sworn on 27<sup>th</sup> January 2020 and that of Joseph Gachanja Guchu, a director of the Company, sworn on 27<sup>th</sup> January 2020.

12. Mr Kamau depones that it is not true that the directors of the Company are trying to sell the suit property as alleged by the plaintiffs. He deponed that at the Company’s annual general meeting held on 19<sup>th</sup> July 2019, “the members of the Company, through a unanimous vote, passed a resolution authorizing the Directors to go ahead and secure a partner to finance the development of the Company’s property

known as LR No. 36/7/521. It is true that members did not authorise the sale of this property.” He further states that directors are not trying to sell the property but are only developing the suit property as authorised by the shareholders.

13. Mr Kamau further depones that the Company has been holding annual general meetings as evidenced by minutes of meetings held on 19<sup>th</sup> July 2019, 30<sup>th</sup> September 2018 and 28<sup>th</sup> April 2017. That at those meetings the auditors presented audited accounts of the Company and directors were elected at every meeting. He denied that the plaintiffs have been denied access to the Company records and that the directors have disposed of assets or properties of the Company as alleged. He also avers that the plaintiffs have attended all the annual general meetings and have not raised any of the issues they now raise in the plaint and application.

14. The Chairman complains that the 1<sup>st</sup> plaintiff has ulterior motives in bringing this suit and application as he has been involved in a long running dispute with the Company directors. He is accused of erecting illegal structures around the suit property which he was renting out to other traders for his own benefit and for personal gain. That he demolished part of the fence to the suit property and that his conduct has been subject of the police investigation. He depones that the 10<sup>th</sup> plaintiff, Charles Njoroge Thiru, is deceased and his signature is forged while the 4<sup>th</sup> plaintiff, Onesmus Mburu Gitau, is not a director of the Company. That out of the 29 persons who purportedly requisitioned a special general meeting, some are not members of the Company or are deceased. Mr Kamau stated that he was never served with a notice to requisition a meeting as alleged. In his view, this suit cannot continue as a derivative suit as it has not been brought for the benefit of the Company or its members but for the personal benefit of the plaintiffs.

15. In his replying affidavit, James Gachanja Guchu, deponed that he knows all the plaintiffs personally. He stated that the 10<sup>th</sup> plaintiff, Charles Njoroge Thiru, died in April 2013 and that the document bearing his signature purported to be authority to plead is a forgery. He further states that as the Company Secretary, he was not served with the notice calling for special general meeting. He also asserts that 170 of the Company has opposed the filing of this suit.

16. The 1<sup>st</sup> plaintiff filed a supplementary affidavit sworn on 12<sup>th</sup> February 2020. He denied the allegation made by Mr Kamau and stated that the plaintiffs were raising genuine concerns. He stated that the main agenda of the meeting held on 19<sup>th</sup> July 2019 was to sell the property and that the only resolution of the meeting was that the property shall not be sold. He recalled that no other resolution was passed on that day and that the directors were not authorised to secure a partner to finance development of the property. He denied that an annual general meeting was held in 2019 or that accounts were presented. The 1<sup>st</sup> plaintiff denied that he erected illegal structures around the suit premises or demolished part of the Company property. He admitted that Charles Njoroge Thiru was deceased but that the family had tried to have his representative registered as members but to no avail hence his estate insisted on participating in these proceedings to air their frustrations. He also stated that the requisition for the special general meeting was received and the Chairperson signed the notice for the meeting.

17. A director of the Company and 6<sup>th</sup> defendant, Samuel Kimani Thiru, filed a replying affidavit sworn on 13<sup>th</sup> February 2020. He stated that he had been a director of the Company since 2013 and that the last time the board of directors met was in September 2013 after the annual general. He was therefore not involved in appointing the advocate on record. He recalled that the last annual general meeting was on 30<sup>th</sup> December 2018 and on that date there were no elections but one of the directors was replaced and that the last election for directors was in 1996.

18. As regard the suit property, Mr Thiru depones that the Board of Directors met several times with investors who wanted to take over the property and develop it on a long term lease but no agreement was reached. That the issue of selling the suit property was proposed by the Chairman and Secretary and accepted by the majority of the Board but when put before the membership on 19<sup>th</sup> July 2019, it was rejected. Mr Thiru recalled that after the proposal was rejected the meeting ended and nothing else was discussed and no resolution was made to get an investor. He accused the Chairman and Secretary of trying to dispose of the property to an investor.

19. From the facts of this case, the issue for consideration is whether the court should grant leave to the plaintiffs to proceed with this suit as a derivative suit under the provision of **section 238 and 239** of the **Companies Act** which provide as follows:

238 (1) In this Part, "derivative claim" means proceedings by a member of a company—

- (a) in respect of a cause of action vested in the company; and
- (b) seeking relief on behalf of the company.

(2) A derivative claim may be brought only—

- (a) under this Part; or
- (b) in accordance with an order of the Court in proceedings for protection of members against unfair prejudice brought under this Act.

(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.

(4) A derivative claim may be brought against the director or another person, or both.

(5) It is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company.

(6) For the purposes of this Part—

(a) "director" includes a former director;

(b) a reference to a member of a company includes a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law.

239. Application for permission to continue derivative claim

(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.

(2) If satisfied that the application and the evidence adduced by the applicant in support of it do not disclose a case for giving permission, the Court—

(a) shall dismiss the application; and

(b) may make any consequential order it considers appropriate,

(3) If the application is not dismissed under subsection (2), the Court—

(a) may give directions as to the evidence to be provided by the company; and

(b) may adjourn the proceedings to enable the evidence to be obtained.

(4) On hearing the application, the Court may—

(a) give permission to continue the claim on such terms as it considers appropriate;

(b) refuse permission and dismiss the claim; or

(c) adjourn the proceedings on the application and give such directions as it considers appropriate.

20. The provisions I have set out provide the framework for the instituting claims by members of the Company on behalf of the Company. Prior to the enactment of the *Companies Act*, such suits were governed by the rule in *Foss v Harbottle* [1843] 67 ER 189 which established the general principle that a wrong alleged to have been done to a company, can only be remedied by an action by the company itself. However, several exceptions to the rule developed including the derivative action which allowed a minority shareholder to bring a claim on behalf of the Company. In *Ghelani Metals Limited and 3 Others v Elesh Ghelani Natwarlal and Another* ML HCCC No. 102 of 2017 [2017] eKLR, Ong'uto J., explained the effect of the *Companies Act* on the common law principle as follows:

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.

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.

21. The learned judge added that:

44. Statutory procedure is now the exclusive method of pursuing derivative claims. The Act sets out what sorts of company claims may be pursued and is also explicit that derivative claims may only be pursued under the Act. The question must only be the factors the court ought to consider before approving a derivative claim.

45. There appears, in my view, to exist a two stage process. The court must first satisfy itself that there is a prima facie case on any of the causes of action noted under s.238(3). S.239(2) of the Act provides that the application for permission will be dismissed if the evidence adduced in support "do not disclose a case" for giving of permission. The essence of judicial approval under the Act is to screen out frivolous claims. The court is only to allow meritorious claims. All that the applicant needs to establish, through evidence, is a prima facie case without the need to show that it will succeed.

22. It is clear from **section 238** of the *Companies Act*, that a derivative action can only be commenced in respect of a cause of action arising from actual or proposed act or omission involving negligence, default, breach of duty or trust by a director of the company by a member of the company. In this case it is not disputed that the plaintiffs are members of the Company although it is admitted that the 10<sup>th</sup> plaintiff is now deceased. That however does not detract from the fact that the other 9 plaintiffs have a right to apply to the court for leave. The issue whether one of the alleged plaintiff's is deceased is a factor to consider in the exercise of discretion whether the claim should proceed.

23. The next question is whether the court should exercise its discretion in favour of the plaintiffs. I have set out the factual basis of the parties' contention above. Counsel for the plaintiffs, Mr Ambani, reiterated that the plaintiffs have established the directors intended to dispose of the suit property to the detriment of the Company and that is why the shareholders resolved at the meeting of 19<sup>th</sup> July 2019 that the suit property should not be sold. He also pointed out that the plaintiffs had enumerated other complaints in relation to the manner in which the Company was being run and which entitled them to relief.

24. Mr Masolia, counsel for the 6<sup>th</sup> defendant, supported the plaintiffs' case. He submitted that his client, as a director of the Company, had been left out of decisions of the Company including the decision to appoint counsel to the Company in these proceedings. He urged the court to hear the plaintiffs' complaints which were legitimate.

25. Counsel for the other respondents, Mr Amuga, submitted that the application was brought on a false ground as it was clear that there was no resolution to dispose of the suit property which fact had been clearly communicated to the 1<sup>st</sup> plaintiff. He further submitted that since the directors had no intention to sell the property in light of the resolution made by members of the Company, there was no basis to proceed with the derivative suit hence the court should not grant the orders sought.

26. The question as to whether to grant leave is one of fact dependent on the circumstances of each case. **Section 241** of the *Companies Act* sets out circumstances under which the court shall refuse and the considerations the court shall take into account when granting leave to the application to continue the suit as a derivative suit.

241. (1) If a member of a company applies for permission under section 239 or 240, the Court shall refuse permission if satisfied—

(a) that a person acting in accordance with section 144 would not seek to continue the claim;

(b) if the cause of action arises from an act or omission that is yet to occur—that the act or omission has been authorized by the company;

(c) if the cause of action arises from an act or omission that has already occurred — that the act or omission—

(i) was authorised by the company before it occurred; or

(ii) has been ratified by the company since it occurred.

(2) In considering whether to give permission, the Court shall take into account the following considerations:

(a) whether the member is acting in good faith in seeking to continue the claim;

(b) the importance that a person acting in accordance with section 143 would attach to continuing it;

(c) if the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—

(i) authorised by the company before it occurs; or

(ii) ratified by the company after it occurs;

(d) if the cause of action arises from an act or omission that has already occurred—whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company

(e) whether the company has decided not to pursue the claim;

(f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in the member's own right rather than on behalf of the company.

(3) In deciding whether to give permission, the Court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest (direct or indirect) in the matter.

27. The issue in contention in this case, as set out in the plaint and depositions filed by the parties, concerns the sale or otherwise of the suit property. All the parties agree that on 19<sup>th</sup> July 2019, the members of the Company agreed that the suit property should not be sold. In this respect therefore, the Company has exercised its plenary power to stop or foreclose the sale of the suit property and removed the issue out of the hands of the directors. The directors, as stated in the 1<sup>st</sup> defendant's deposition, accept this position. Since the Company has already resolved not to proceed with the sale, this court cannot proceed on a course that is already prohibited by the Company.

28. There is a dispute whether the meeting resolved to allow the directors to source for investors to finance development or to develop the suit property. This issue however, is not pleaded in the plaint as a cause of action in relation to acts or omissions or breaches of trust by the directors. Besides, the management of the Company resides in the Board of Directors. I would also point out under Clause 27 of the Articles of Association, the directors have, inter alia, power to raise money for the purpose of the Company's business.

29. Under **section 241(2)(c)** of the *Companies Act* the court is required to take into account whether the act that is likely to occur may be ratified by the company. The development of the suit property, the borrowing of money to develop the property and the involvement of an investor are all matters that that can be ratified by the members of the Company hence a derivative suit would not serve its utility. There is no evidence, at least at this stage, to show that the breaches had taken place that would entitle the plaintiffs to take over the rights of the Company. In other words, developing the suit property, is an action that may be ratified by a majority of the members of the Company.

30. Since the suit property is not under threat of sale and such action has been prohibited by the Company resolution, I decline to grant leave to the plaintiff to continue with this suit as a derivative action in respect of prayer of A of the plaint.

31. As regards prayers B and C of the plaint and the complaints regarding the holding of a special general meeting, I hold that such actions may be commenced by the plaintiffs in their own right against the Company and not the directors. The Company is not a party to this suit hence it is a non-starter.

32. The Notice of Motion dated 21<sup>st</sup> November 2020 is dismissed. It follows that this suit cannot survive on the court rolls for the reasons I have set out above. It is hereby struck out with costs to the defendants.

**DATED and DELIVERED at NAIROBI this 13<sup>th</sup> day of MARCH 2020.**

**D. S. MAJANJA**

**JUDGE**

Mr Ambani instructed by Mwangi Wahome and Company Advocates for the plaintiffs.

Mr Amuga instructed by Amuga and Company Advocates for the 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup> and 5<sup>th</sup> defendants.

Mr Masolia instructed by Masolia Loveto and Company Advocates for the 6<sup>th</sup> defendant.