



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

(FORMERLY NAIROBI ELC NO. 1132 OF 2015)

BETWEEN

DAVID NJIHIA MBUGUA1ST PLAINTIFF

PAUL KIANIA MBUGUA2ND PLAINTIFF

AND

MONICAH WANJIRU MBUGUA..... 1ST DEFENDANT

JANE WAMBUI MBUGUA2ND DEFENDANT

RULING

Introduction and Background

1. Before I deal with the applications for consideration, it is important to outline the background of the matter. The plaintiffs are the sons of Johnson Mbugua Mugo (“Mugo”) through his deceased wife Mary Wanjiru Mbugua while the 1st and 2nd defendants are his wives. The dispute between the parties revolves around a company, J.M. Mugo Investments Company Limited (“the Company”) incorporated as a family company. Although the plaintiff’s shareholding in the Company is contested by the defendant, the plaintiffs, in their plaint, admit that, “*The Defendants are the majority shareholders of the company while the Plaintiffs were the minority shareholders in the said family company.*”

2. The gravamen of the plaintiffs’ case as set out in the plaint dated 4th November 2015 concerns a property known as LR No. 1/543 (Original No. 1/148/3) (“the suit property”) which was originally owned by the Company. By a conveyance dated 14th August 2015, the Company transferred the suit property to the defendants as proprietors in common in equal shares.

3. The plaintiffs contended that the conveyance of the property was fraudulent and to the detriment of the Company as Mugo was, at the material time, old and was suffering from dementia and had at the time appointed David Njihia Mbugua, Stephen Kiania Mbugua and Samuel Mugo Mbugua to act as his attorney by a Power of Attorney dated 17th July 2010 registered as IP/A154504/1. Their case was that Mugo could not participate in the resolution conveying the suit property to the defendants. In summary, they seek to annul the transfer of the suit property to the defendants so that it reverts to the Company.

4. The defendants filed a statement of defence dated 25th July 2015. They admitted transfer of the suit property but denied that it was to the detriment of the shareholders of the Company. They stated that the transfer of the suit property was deliberated upon by directors of the Company with a view to settle a longstanding family dispute in which Mugo had given the late Mary Wanjiru Mbugua a property; LR No. 209/4586 without the knowledge and to the exclusion of the defendants who had equal rights as his wives. The defendants averred that even though Mugo had donated his power of attorney, he still retained the capacity to exercise his donated powers. They denied the allegations of fraud against them. The defendants pleaded that the suit was filed prematurely without obtaining leave to institute the suit as a derivative suit.

The applications

5. In light of the objection raised by the defendants, the plaintiffs filed *Nairobi ELC Misc. No. 290 of 2015 (David Njihia Mbugua and*

Paul Kiania Mbugua v Monicah Wanjiru Mbugua and Jane Wambui Mbugua) seeking an order that, “the applicants be granted leave to institute a derivative suit.”

6. The defendants filed an application dated 18th April 2019 seeking to strike out the suit and **Nairobi ELC Misc. Application No. 290 of 2015** on the ground that the plaintiffs had not obtained leave to institute a derivative action in so far as the suit challenged the decision of the Company to transfer the suit property to the defendants and that the Environment and Land Court did not have jurisdiction to determine the matter as it related to the management of a Company and not land.

7. On 13th December 2019, Bor J., ordered that this suit and the application be transferred to the Commercial and Tax Division for disposal. Thereafter the defendants filed a Notice of Motion dated 17th February 2020 seeking to strike out the suit on the ground that the plaintiffs had not obtained leave to file a suit as a representative suit and that the Company was not joined to the suit. They further contended that the plaintiffs did not have the standing to agitate the suit as they are neither shareholders nor directors of the Company.

8. On 28th February 2020, I directed that the applications be heard together. Due to the COVID-19 pandemic, the parties agreed to canvass the application by written submissions. The plaintiffs filed written submissions dated 22nd April 2020 and 2nd July 2020 while the defendants filed written submissions dated 27th April 2020.

Issue for determination

9. The main issue for determination under both applications is whether the court should grant permission for the plaintiffs to proceed with the suit as a derivative suit. If the answer is in the negative, then the suit will be struck out.

10. As I stated elsewhere, the plaintiffs do not dispute that they are minority shareholders. At para. 4 of the plaint, the plaintiffs have set out the shareholding according to the CR 12 dated 28th September 2015 issued by the Companies Registry as follows;

Johnson Mbugua Mugo	2 shares
Monica Wanjiru Mbugua	16,666 shares
Jane Wambui Mbugua	16,666 shares
Mary Wanjiru Mbugua	2 shares
David Njihia Mbugua	4,166 shares
Stephen Muchai Mbugua	4,166 shares
Paul Kiania Mbugua	4,166 shares
Martin Mbugua Nguru	4,166 shares

11. In their defence, the defendants admit the shareholding but deny that David Njihia Mbugua, Stephen Muchai Mbugua, Paul Kiania Mbugua and Martin Mbugua Nguru are shareholders or directors of the Company. In short, that the defendants hold 33,332 shares out of 50,000 shares which accounts for about 66% of the Company shareholding.

12. It is also not disputed that the suit property belonged to the Company before it was transferred to the defendants as a gift by the conveyance dated 14th August 2015.

Plaintiffs’ Submissions

13. The plaintiffs’ application is for permission of the court to proceed with this suit as a derivative suit in their capacity as the minority shareholders and directors on the ground that they have been oppressed by the defendants who are the majority shareholders of the Company. They are aggrieved by the fraudulent transfer of the suit property by the defendants who they accuse of acting in breach of trust.

14. The plaintiffs’ case is that the gift or transfer of the suit property was legitimized by meetings held in contravention not only of the Articles of Association but also **sections 281 and 285** of the **Companies Act, 2015 (“Companies Act”)** which provide that such meetings can only be held by giving a 21-day notice to the members of the Company stating the venue, time and the agenda of the meeting. In this case, counsel pointed out that the minutes of the alleged meetings show that meetings were held at different and undisclosed venues and the plaintiffs were never given notice of the meetings.

15. The plaintiffs further contended that Mugo lacked the mental capacity to convene or chair any meetings and in that regard, append his signature to the minutes, appreciate what was going on and execute the conveyance dated 14th August 2015. Consequently, the conveyance of the suit property to the defendants was illegal, null and void. The plaintiffs relied on the medical reports prepared by Dr. Daniel R Mukiri dated 1st July 2010 and by Mariakani Cottage Hospital dated 6th December 2010 to demonstrate that Mugo lacked mental capacity to attend and control meetings let alone execute a conveyance. The plaintiffs’ submitted that their case regarding Mugo’s mental health was fortified by the fact that on 17th July 2010, he executed a Power of Attorney appointing the 1st plaintiff, David Njihia Mbugua, Stephen Kiania

Mbugua and Samuel Mugo Mbugua as his attorneys to act on his behalf.

16. Counsel for the plaintiffs submitted that the defendants choreographed a fraudulent scheme tailored at oppressing the minority directors and shareholders for their own benefit. The plaintiffs added that in order to consummate the fraudulent scheme, the defendants purported to record the gift in the minutes as necessary to quell family wrangles and in so doing left out the donees of Mugo's power of attorney and the minority shareholders. The plaintiffs contended since the transfer of the suit property was as a result of a fraudulent and corrupt scheme, they are entitled to challenge and set aside the transfer in **section 26** of the **Land Registration Act** as having been fraudulently and illegally obtained. The plaintiffs added that the fraud cannot be ratified by the Company.

17. The Plaintiffs relied on **section 238** of the **Companies Act** and cited **Wilmot Mwadilo and 2 Others v Eliud Timothy Mwamunga & Sagalla Ranchers Limited VOI HCCC No. 1 of 2017 [2017] eKLR** where the learned judge stated that for a party to succeed in a derivation action, the applicant must demonstrate the following: -

- a. The proceedings must be in respect of a cause of action vested in the company;
- b. The proceedings must be seeking relief on behalf of the company;
- c. The proceedings must be for protection of members against unfair prejudice brought under the **Companies Act**.
- d. The proceedings are in respect of a cause of action arising from an actual or proposed act or
- e. The omission must involve negligence, default, breach of duty or breach of trust by a director of the company;

18. Counsel submitted that the plaintiffs have established facts falling within the aforesaid conditions as the suit is instituted for and on behalf of the Company and for the benefit of the Company as they seek an order compelling the defendants to transfer and register the Company as the sole proprietor of the suit property.

Defendants' Submissions

19. The defendants opposed the application on the basis that the Company was a family concern and under the Memorandum of Objects, it was established inter alia, "*To distribute any property of the Company among the members in specie or in kind.*" They contended that it was formed for the welfare of the family and in reality the Company was a nominee of Mugo who transferred the suit property to it. On 25th July 2015, the members and shareholders of the Company held a meeting and resolved to transfer the suit property to the defendants. The defendants contended that the meeting was quorate and held in accordance with the Articles of Association and was attended by Mugo and the defendants. Following the meeting, Mugo executed the conveyance dated 14th August 2015 in respect of the suit property from the Company to the defendants.

20. Based on the aforesaid facts, Counsel for the defendants submitted that the plaintiffs challenge to the Company's decision to transfer the suit property carried out in accordance with the Articles of Association of the Company was futile. They submitted that the acts complained of were acts of the Company and as such, the matter cannot proceed as a derivative suit.

21. Counsel for the defendants submitted that the plaintiffs have not pleaded any fraud with particularity and that there is no evidence whatsoever that Mugo was suffering from any mental disability. He submitted that Mugo was legally capable of managing his affairs and that the evidence shows he actively participated in the affairs of the Company by attending meeting and executing the conveyance.

22. The defendants also denied that there was a breach of fiduciary duty as the Articles of Association permits the defendants to act as vendor or purchaser of Company property provided the interest is disclosed. Moreover, Article 14 of the Articles of Association empowered Mugo to undertake the transaction alone.

23. The defendants submitted that the plaintiffs are neither majority directors or shareholders and under Article 12 of the Articles of Association, any resolution put to vote at any General Meeting shall be decided by a simple majority thereby giving the defendants an assailable majority. The defendants therefore urge that the court should not grant permission to the plaintiffs to proceed with the suit.

A derivative action under the Companies Act

24. Whether the court should grant permission to the plaintiffs to proceed with this suit as a derivative suit is governed by **sections 238** and **239** of the **Companies Act** which provides 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.

25. The aforesaid provisions provide the framework for 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.

26. In **Ghelani Metals Limited and 3 Others v Elesh Ghelani Natwarlal and Another ML HCCC No. 102 of 2017 [2017] eKLR**, Onguto 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.

27. 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.

28. In considering whether to grant permission, the court is also guided by **section 241** of the **Companies Act** which sets out circumstances under which the court shall refuse the application and the considerations the court shall take into account when granting permission to the applicant to continue the suit as a derivative suit. The section provides as follows:

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. [Emphasis mine]

Determination

29. From the facts that have emerged, this case is essentially a family dispute but for the fact that the family interests are bound in a Company incorporated by Mugo as the family patriarch, it is company law as set out under the **Companies Act**, that the family dispute must be decided. The evidence before the court is clear that a resolution was taken by the Company on 25th August 2015 to gift the suit property to the defendants and upon that resolution that the suit property was transferred by the Company to the defendants by a conveyance dated 14th August 2015.

30. It is common ground that the suit property was registered in the name of the Company and, as Counsel for the defendants pointed out, the Company's Memorandum of Objects provide that the Company is established, “*To distribute any of the property of the Company among the members in specie or in kind.*” It was therefore within the power of the Company to convey any of its property to any of the members whether the plaintiffs or defendants. In that regard, that power is exercisable by the Board of Directors or through the Company at an annual general meeting.

31. The gravamen of the plaintiffs' case is that the meeting at which the resolution to convey the suit property to the defendants either did not take place as documented or if it did, it was contrary to the Articles of Association and the **Companies Act**. Further that at the material time, Mugo did not have the mental capacity to make any decision on the matter. I am aware that at this stage I need not make any definitive findings on this issue but even if I accept the facts as true and correct, the question I have to ask in line with **section 241(2)(d)** of the **Act** is whether the acts or omission complained of, having taken place, “*would be likely to be, ratified by the company*”.

32. Under **section 238(3)** of the **Companies Act**, breach of trust by the directors is one of the grounds upon which a derivative action may be brought. The plaintiffs contend that by manipulating Mugo and causing the Company to transfer the suit property to themselves, the defendants committed breach of trust. Article 16 of the Articles of Association of the Company provides that;

No director shall be disqualified by his office from contracting with the company either as vendor or purchaser, or otherwise nor shall any such contract or arrangement entered into by or on behalf of the company in which any director shall be in any way interested be avoided nor shall any director so contracting or being so interested be liable to account to the company for any such profit realised by any contract or arrangement by reason only of such director holding that office or of the fiduciary relation thereby established but it is declared that the nature of his interest must be disclosed by him at the meeting of the directors at which the contract or arrangement is determined if his interest then exists or in any other case at the first meeting of the directors after the acquisition of the interest.

33. In light of the objects of the Company which empowers it to transfer property to the members and Article 16 above, a transfer to any of the director is only voidable at the instance of the Company. I would add that the defendants are not merely directors but also shareholders entitled to benefit from the Company. The defendants are the majority shareholders of the Company which means that even if the matter was put to a vote of all shareholders at a General Meeting, the result would be to uphold the transaction, which as I have stated, is wholly within the objects and power of the Company.

34. At this stage, I would point out that the plaintiffs have raised complaints about fraud and forgery against the defendants. I cannot say whether the claims have merit nor comment on them as this would obviously prejudice the legal process the plaintiffs have commenced by lodging criminal proceedings against the defendants. What is clear though is the criminal law, which serves a different purpose, must take its course. However, even if the transaction is annulled on account of fraud, the suit property merely reverts to the Company which, the shareholders, by a majority vote will resolve that the property be transferred to the defendants. Likewise, the existence of caveats placed on the suit property by the plaintiffs is a matter to be resolved in another forum.

35. Finally, a word on Mugo's mental capacity. The plaintiffs' case is that that he lacked mental capacity as a result of senile dementia, diabetes and hypertension. I note the medical reports relied on were made in 2010. In his report dated 1st July 2010, Dr Githegi noted that, "*Mr Mbugua will never be able to attend the court of law and therefore somebody else should be appointed to attend to represent him.*" Thereafter, Mugo executed a power of attorney on 17th July 2010 in favour of his sons.

36. At the time the application for leave was made in 2015, Mugo was aged 87 years. What is not clear from the evidence is his mental status in 2012 when the impugned transaction took place. It is also worth noting that the advocate who drew and witnessed the Power of Attorney, Maina Irungu of L. Maina Irungu and Company Advocates is the same advocate who drew and witnessed the conveyance of the suit property. Nothing was said of his complicity or involvement in the matter nor the fact that the plaintiffs also relied on a Power of Attorney executed when their own evidence shows that Mugo was suffering from dementia.

37. I do not understand the law to state that a person who has given a power of attorney cannot act on his own. What may have to be resolved is whether at the time of giving the power of attorney or attending the meeting or executing the conveyance, Mugo had mental capacity to understand what he was doing not merely as Dr Githengi concluded that he will never be able to attend court.

Conclusion and Disposition

38. Since this matter to be resolved by reference to **sections 238, 239 and 341** of the **Companies Act**, I am not convinced that the Plaintiffs have made out a case for grant of permission to proceed with this suit as a representative suit. The suit property belonged to the Company, the acts complained were within the power of the Company and even if the suit proceeded and was successful, the same acts would be ratified by the Company.

39. Since I have declined to grant permission for the plaintiffs to continue with this suit as a derivative suit, I dismiss the application in **Nairobi ELC Misc. Application No. 290 of 2015**. Consequently, this suit is hereby struck out with costs to the defendants.

DATED and DELIVERED at NAIROBI this 3rd day of AUGUST 2020.

D. S. MAJANJA

JUDGE

Mr Chigiti, SC., instructed by Chigiti and Chigiti Advocates for the plaintiffs.

Mr Miyare instructed by Miyare and Company for the defendants.