



**REPUBLIC OF KENYA**

**IN THE HIGH COURT OF KENYA**

**AT NYAHURURU**

**MISC. CIVIL APPL. NO.39 OF 2018**

**JOACHIM MWANGI GITHINJI & 7 OTHERS.....APPLICANTS**

**- V E R S U S -**

**PETER GICHERU MBUTHIA & 8 OTHERS.....RESPONDENTS**

**OL KALOU DAIRY LTD.....AFFECTED PARTY**

**R U L I N G**

By the Notice of Motion dated 14/11/2018, the 8 applicants, seek the following orders against the 9 respondents;

**1. spent**

**2. That the applicants be granted leave to prosecute a derivative action on behalf of Ol Kalou Dairy (2016) Ltd – the Affected Party;**

**3. That leave granted to the applicants to institute a derivative action do operate as stay of any annual general meeting or any other special meeting that may be convened by the Board of Directors of Ol Kalou Dairy (2016) Ltd, pending the hearing and determination of the application;**

**4. That the leave do operate as protection restricting all activities of the Board of Directors and the Affected Party, specifically operations touching on over drawing the affected party's bank accounts, convening any annual special meeting and or borrowing monies from Financial Institutions.**

**5. An order of indemnity by Ol Kalou Dairy Ltd for the costs and expenses reasonably incurred in prosecuting the instant application.**

The grounds upon which the application is brought are that the respondents being directors of the Affected Party, have failed or neglected to convene an annual general meeting from the year ending 31/12/2016 in terms of Section 310 of the Companies' Act; that the audited financial statements for the year ending 31/12/2016 and presented on 15/9/2017 revealed unsupported financial claims which subjected the Affected Party to loss; that the directors have failed to supply the Registrar of Companies with audited annual accounts for the year ending 31/12/2016 and failed to prepare the accounts of the same year; that the respondents have misappropriated the Affected Party's funds and stage managed the loss of Kshs.8,000,000/=; that the respondents convened a General Meeting on 15/9/2017 and were supposed to convene another Special General Meeting within 6 months to adopt the auditor's report or make recommendations but they failed to do so; that the respondents have been convening general meetings un-procedurally by including nonmembers; that such nonmembers were deployed to the special general meeting scheduled for 5/10/2018 to cause mayhem and confusion and that is why the applicants believe that it is just and expedient that the court grant them leave to institute a derivative suit.

The application was opposed. Counsel for the respondents, Ms. Wangeci, filed grounds of opposition on 21/11/2018 to the effect that the applicants have not adduced sufficient grounds to qualify for leave to bring a derivative action on behalf of the Affected Party, Ol Kalou Dairy Ltd; that the prayer to injunct the Affected Party from holding an Annual General Meeting amounts to restraining the company's operations and is inconsistent with the best interests of the company. Lastly, that the suit as filed is defective and bad in law because the applicants have not commenced any derivative action on behalf of the company pursuant to the provisions of Section 238 of the Companies Act, 2015.

Isaac Muchiri Kabaiku, the Chairperson of the Board of Directors, Ol Kalou Dairy 2016 Ltd (4<sup>th</sup> Respondent) filed a replying affidavit dated 22/11/2018. He deponed that in 2016, the company converted from a private to a public Ltd Company and changed its name as per certificate (MK2); that at the Annual General Meeting of 15/9/2017, the new Auditors, Mbaya & Associates qualified the company assets on

grounds that the letter they had written to the majority debtor, that is, New KICC Ltd, requesting for reconciliation of accounts had not been replied to and the variances in accounts could not be explained; that as a result, shareholders refused to adopt the said accounts and requested for a Special General Meeting to discuss the accounts within 60 days; that because the company was transiting to a public company, there was a delay; that a committee was convened by the Chairman of the Board to reconcile the debt owed by New KCC; that it came up with a report explaining the variances and the Kshs.82,279,064 errors and that therefore the Affected Party was not owed Kshs.82,000,000/= (82 million); that at the Special General Meeting of 5/10/2018, all the shareholders were required to produce their share certificates for verification with the register and all who attended were *bonafide* members. The respondent attached a list of those present, IMK7.

As to whether the respondents had failed to file financial statements with the Registrar of Companies, it was urged that due to the ongoing digitization process at the Registry, the Company Secretary is in the process of complying and the Registrar is aware. The deponent also urged that if the court grants the order stopping the Annual General Meeting, which is a mandatory requirement, then the operations of the company would stall.

As regards allegations that the respondents stage managed loss of over Kshs.8,000,000/=. It was urged that the allegations are unsubstantiated and no report has been made to police for investigation and that this application is made in bad faith.

Having heard the rival submissions, I think that the two issues I need to resolve are:

1. **Whether the application is incompetent;**
2. **Whether the court can grant the prayer for leave to commence a derivative suit.**

***Blacks Law Dictionary, 10<sup>th</sup> Edition*** defines a derivative action as:

**“A suit by a beneficiary of a fiduciary to enforce a right belonging to the fiduciary; a suit asserted by a shareholder on the corporation’s behalf against a third party because of the corporation’s failure to take some action against the third party.”**

Under Section 238 of the Companies Act, for a party to succeed in a derivative suit, he must demonstrate the following:

1. **He must be a member of the company which includes a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of the law;**
2. **The proceedings must be seeking relief on behalf of the company;**
3. **The proceedings must be for the protection of members against unfair prejudice brought under the Companies Act;**
4. **The proceedings are 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.**

A derivative action has been described as an exercise of the exception to the Rule in *Foss v Harbottle (1843) 2 HANES 461*. The Court of Appeal in *Grace Wanjiru Munyinyi & another v Gedion Waweru Githunguri & 5 others (2002) 2 EA 537* which summarized the Company Law Principle that was established in *Foss v Harbottle (Supra)*:

**“The classic definition of the rule in Foss vs Harbottle is stated in the judgment of Jenkin LJ in Edwards vs Halliwell [1950] 2 ALL ER 1064 at 1066 as follows. (1) The proper plaintiff in an action in respect of a wrong alleged to be done to a corporation is, prima facie, the corporation (2) where the alleged wrong is a transaction which might be made binding on the corporation and on all its members by a simple majority of the members, no individual member of the corporation is allowed to maintain an action in respect of that matter, because, if the majority confirms the transaction, caditquaetstio; or, if the simple majority challenges the transaction, there is no valid reason why the company should not sue. (3) There is no room for the operation of the rule if the alleged wrong is ultra vires the corporation, because the majority shareholders cannot confirm the transaction (4). There is also no room for the operation of the rule if the transaction complained of could be validly sanctioned only by a special resolution or the like because a simple majority cannot confront a transaction which requires the concurrence of a greater majority. (5) There is an exception to the rule where what has been done amounts to fraud and the wrongdoers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue.”**

**The rule in Foss vs Harbottle still stands in Kenya. The exception to the rule referred to above may be taken advantage of by minority shareholders if they can show fraud but they cannot do so by way of a petition. They can only do so as plaintiffs in a derivative action.”**

In *Dadani v Manji & 3 others HCC.913/2002 (2004) 1 KLR*, the court said:

**“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.”**

Ms. Wangeci submitted that the application is incompetent because it should have been anchored on a suit and that it is only through a plaint

that a cause of action could have been disclosed.

I have considered several authorities and it seems that the courts have been quite flexible on the procedure of instituting a derivative suit. Whether one files an application for leave first, the court will consider the said application and if it discloses a prima facie case, then the suit will subsequently be filed. On the other hand, the application for leave may be filed contemporaneously with the plaint. In the persuasive decision by J. Musinga as he then was, in ***Misc.Appl.273/2012 in the matter of CMC Holdings*** the court held that the fact that the plaint was filed in a different court file from the one where leave was granted could not invalidate the derivative suit because that was a procedural issue and Article 159(2)(d) of the Constitution empowers the court to dispense justice without undue regard to procedural technicalities.

In ***C.A.101/2004 Amin Akberali Manji v Hemanthi Kure & Al Taf Dadan***, the Court of Appeal upheld the High Court's decision to have an application for leave filed within the main suit. I find that the fact of filing a Miscellaneous application seeking leave to file a derivative suit cannot deny the applicants the right to leave. All they have to do is establish that they have a prima facie case sufficient for the court to grant them leave.

### **What is a prima facie case in a Civil Case?**

In ***Mrao Ltd v First American Bank of Kenya Ltd (2003) KLR 125***, the court rendered itself thus:

**“A prima facie case in a Civil Application includes but is not limited to a genuine and arguable case. It is a case which on the material presented to the court, a tribunal properly directing itself concludes that there exists a right which has apparently been infringed by the opposite party as to call for an explanation or rebuttal from the latter.”**

The issues that seem to arise from the applicant's pleadings are:

- 1. Whether the affected party has suffered financial loss of Kshs.82,279,064/=;**
- 2. Whether the respondents have failed or neglected to convene Annual General Meetings from the year ending 31/12/2016 as per Section 310 of the Companies Act;**
- 3. Whether the respondents have failed to supply the Registrar of Companies with the annual audited financial statements for the year ending 2016.**

It was the applicant's case that the financial statements for the year ending 31/12/2016 audit which were presented on 15/9/2017 revealed unsubstantiated claims of Ksh.82,279,064/= . The said report was exhibited as JMG III. In reply to the said report, the respondent in their replying affidavit, stated that a reconciliation of accounts with the major debtor, New KCC Ltd had not been done because of the process of transition from a private to a public company but that a committee was convened to do the reconciliation and come out with a report (IMG4) and it emerged that the sum of Kshs.82,000,000/= was a result of accounting errors and it turned out that New KCC did not owe the said sum.

The applicants contend that the said audit report was prepared by a committee comprising of people who are not qualified in accounts and who were also interested in the matter and hence not independent. Indeed a look at the annexure IKM4 confirms that it does not amount to a proper statement of accounts that explains the variations in the figures. It does not amount to a proper audit report explaining the variations and disparities.

The respondent urged that since the said accounts prepared by the committee were later ratified by the Special General Meeting of 5/10/2018 the same cannot be questioned. Section 241 of the Companies Act provides:

**241 “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 commission that is yet to occur, that the act or omission has been occasioned 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 authorized by the company before it occurred; or**
  - ii. Has been ratified by the company since it occurred.”**

Although the Special General Meeting of 5/10/2018 may have ratified the financial statement, yet the applicants contend that most of the members of the company are illiterate farmers who do not understand accounts. I think that the applicants have demonstrated that there are still questions whether indeed the financial statements presented to the Special General Meeting on 15/9/2017 were accurate and a true reflection of the financial status of the company.

On the allegation that the respondents stage-managed the loss of Kshs.8 million, in the further affidavit dated 27/11/2018, it was stated that there were allegedly three instances of theft of company monies on 19/5/2017, 18/8/2017 and 12/9/2017 resulting in a loss of about

KShs.5,500,000/=; that some senior officers were charged in Criminal Case No.1579/2017 but their cases were withdrawn by the respondents under mysterious circumstances. The cases having been withdrawn, it is important for the shareholders to know why and where the KShs.5,500,000/= million went to.

On the allegation that the respondents have refused or neglected to hold Annual General Meetings from the year ending 31/12/2016, it seems one meeting was held on 15/9/2017 and another was supposed to be held within 6 months to adopt the auditors recommendations but there is no evidence that one was held till a Special General Meeting was held on 5/10/2018 when the applicants came to court. Another Annual General Meeting was scheduled to be held on 30/11/2018 which the applicants sought to stop but the court declined to do so. It seems some meetings have been held.

There is also an allegation that the respondents have failed to file the company's financial statements with the Registrar of Companies. The respondents' response is that the filing of the statements was delayed due to the digitalization that is ongoing at the Registrar's Office and that the Company Secretary was following up and that the Registrar is aware anyway. No evidence has been adduced to confirm the above position.

Having considered the rival arguments, I am satisfied that the applicants have established that prima facie, there are grounds upon which leave should be granted to commence a derivative suit and I hereby grant it. The suit be filed and served within 21 days hereof.

**Dated, Signed and Delivered at NYAHURURU this 24<sup>th</sup> day of May, 2019.**

.....

**R.P.V. Wendoh**

**JUDGE**

**PRESENT:**

M/S. Ng'ethe holding brief for Mr. P. Chege for Applicant

Ms. Wangeci for respondent

Soi – Court Assistant