



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT KIAMBU

CIVIL CASE NO 15 OF 2018

1. JAMES PETER MBIYU WAMBUI

2. SUPERIOR MACNUTS PROCESSORS COMPANY LTD....PLAINTIFFS

VERSUS

WAWERU KURIADEFENDANT

RULING

1. Before me is an application by way of Notice of Motion filed on 11th May, 2018 and brought *inter alia* under Sections 238 and Section 239 of the Companies Act, the Companies (General) Regulations, 2015, Order 51 Rule 1 of the Civil Procedure Rules and Section 3A of the Civil Procedure Act. For the purpose of this ruling the order sought is that the Court be pleased to grant leave to the 1st Plaintiff/Applicant to continue this suit as a derivative action, pursuant to Section 238 and 239 of the Companies Act, 2015 Laws of Kenya.

2. The application is premised on the grounds on the face of the application and further expanded in the supporting affidavit of the Applicant.

3. **James Peter Mbiyu Wambui**, the 1st Plaintiff/Applicant swore the supporting affidavit. He deposed that he seeks leave to continue the suit as a derivative action to protect the interests of the 2nd Plaintiff. He deposed further that he and the Defendant, each hold a 50% to 50% shareholding in the 2nd Plaintiff; that the Defendant is in charge of the day to day activities of the company. Further, that both parties opened a company account at Standard Chartered Bank to facilitate the business of the 2nd Plaintiff and managed to secure lucrative business opportunities, in particular with **Dynasty Universal Ltd.** and **Wu Huazhong**. He complains that the Defendant diverted the said business and proceeds to his personal account and benefit.

4. The Applicant asserted that the Defendant had caused the closure of the company business premises without his consent and caused the landlord to deny him entry into the company premises. Thus, he contends that the Defendant was in breach of his fiduciary duty and is guilty of fraud. He states that an inventory of the assets of the company showed that crucial equipments were missing from the company premises. In his view, the Defendant is not qualified to be a director, that he is currently under police investigation and moreover numerous meetings in an attempt to resolve the said issues have been unsuccessful. He contended that it is impossible for the 2nd Plaintiff to institute these proceedings as the Defendant is a co-director with him.

5. The Defendant filed his replying affidavit on 19th June, 2018. The gist of his response is that the 1st Plaintiff has not met the threshold for the grant of leave to prosecute a derivative suit on behalf of the 2nd Plaintiff. He asserts that the actions performed by himself are ordinarily sanctioned by the Applicant and himself prior to execution. He deposed that both parties are mandatory signatories to the company's bank account. The Defendant denied that there was any contract entered into between the company and the alleged clients or that he diverted any company business for his personal benefit.

6. He contended that the business of macadamia nuts is seasonal and that the 1st Plaintiff had full access to the business premises and would frequent the same. He further deposed that he had agreed with the 1st Plaintiff that he would refund his contribution to enable them part ways. He denied paralysing the operations of the company and stated that it is the 1st Plaintiff who is in possession of the company's statements of account. In his opinion the 1st Plaintiff/Applicant is not deserving of the orders sought as he has not tabled cogent evidence against the Defendant, or shown any evidence regarding his efforts to resolve the wrangles. He further states that the Applicant does not represent a genuine interest in the 2nd plaintiff and has abused the criminal process by involving police in the dispute.

7. The court directed that the prayer for leave to continue the suit as a derivative action be canvassed by way of written submissions. On his part the 1st Plaintiff/Applicant submitted that the Defendant and himself hold 50-50 shares in the 2nd Plaintiff. He repeated accusations against the Defendant as contained in his affidavit. The Applicant invoked Section 239 of the Companies Act which requires one to apply to the court for permission in order to continue with a derivative claim. Reliance was placed on the case of **Isaiah Waweru Ngumi & 2 others V Muturi Ndung'u (2016) eKLR** where **Ngugi J** set out some considerations applicable to such application. Counsel outlined the factors the

court should consider in this case to determine in particular, whether the Applicant has established a prima facie case.

8. It was submitted that the offending actions attributed to the Defendant in the pleadings and as particularized are neither denied nor explained. The Applicant submitted that a prima facie case has been made out. Lastly, counsel submitted that there was equal share holding of the 2nd Plaintiff thus the 1st Plaintiff cannot move the 2nd Plaintiff to institute proceedings against the Defendant. He cited the decision in **Amin Akberali Manji & 2 others v Altaf Abdulrasul Dadani & Another (2015) eKLR** where it was held that in a 50/50 shareholding no one party is in control, it is a stalemate. It was the Applicants' submission that if the claims against the Defendant are proved, the corporation would benefit.

9. The Defendant through his Counsel submitted that the Applicant has not met the requisite legal threshold for grant of leave to continue the suit as a derivative action. To support his submissions, he also placed reliance on the case of **Isaiah Waweru Ngumi & Another vs Muturi Ndung'u** as to the test applicable in considering an application of this nature. Counsel argued that the Applicant has demonstrated that he has all along not acted in good faith. It was submitted that the applicant's claim of fraud has not been established to prima facie standard. A second authority cited by the Defendant is the decision of **Onguto J** (as he then was) in **Ghelani Metals Ltd and 3 Others v Elesh Ghelani Natwarlal and Another [2017] eKLR**

10. The court has considered the material canvassed in respect of the prayer for leave to continue the derivative suit herein. That an application for such leave may be made either contemporaneously at the time of filing of the suit, or after the suit has been filed is not in dispute. Also not disputed is the business relationship between the Applicant and the Defendant. The two were joint directors of the 2nd Plaintiff in the material period. The business of the 2nd Plaintiff involved the processing of macadamia nuts for sale to customers. The question that fails to be determined is whether the Applicant has made a case for the granting of leave to continue the derivative suit herein.

11. Part XI of the Companies Act makes provision in respect of the procedure and considerations that govern the bringing of derivative actions.

Sections 238 provides *inter alia* that;

“(2) A derivative claim may be brought only –

a) under this part

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)

(6)”

12. Under Section 239, a successful applicant for permission to continue a derivative claim, must present evidence in justification of the application. Section 241(1) prescribes situations where permission shall be refused including where the Applicant acting in manner inconsistent with Section 144 (as to exercise of independent judgment by a director) and the action complained of being one capable of ratification by the company. Section 241(2) further enumerates considerations to be taken into account by the court before which an application under Section 239 and 240 of the Act has been made.

13. The considerations are:

“a) Whether the member is acting in good faith in seeking to continue the claim;

b) The important that a person acting in accordance with Section 143 would attach to it (this speaks to the promotion of the success of the company for the benefit of its members as a whole);

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 the circumstances would be likely to be –

i) authorized by the company before it occurs

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 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 perusal interest (direct or indirect) in the matter”

14. The requirement for leave and the circumscription of situations in which an individual member may sue on behalf of a company is intended discourage frivolous suits and to protect the integrity of the corporate personality of and the operations of a company from undue internal and external interference.

15. At the stage of leave, the burden placed upon the Applicant is to establish a prima facie case that his application falls within the boundaries set out in the Act. I agree with this proposition as stated in the case of **Isaiah Waweru**. Moreover, I associate myself entirely with the approach adopted by **Ngugi J** in **Isaiah Waweru's** case which both parties have relied on, and by **Onguto J** (as he then was), in **Ghelani Metals Limited and 3 Others v Elesh Ghelani Natwarlal & Another [2017]e KLR**. To the effect that, the considerations in Part XI of the Companies Act are not exhaustive, and would admit in proper cases, the application of principles relating to common law exceptions to the rule in **Foss V Harbottle [1843]2 Hare 461**, some of which are evidently incorporated in Part XI of the Companies Act.

16. **Tuiyott J**, in his recent decision in **Morris and Company [2004] Ltd v Diamond Trust Bank & 4 Others [2018]e KLR** succinctly delineated the operation of the principles of common law in respect of matters of this nature by stating that:

“To be noted however, is that the factors set out by Section 241 are not a closed list and other factors applicable in similar common law tradition can be applied in the exercise of the discretion of court as to whether or not to grant leave. The caution always being that these should not be inconsistent with the express provisions of statute ...” (emphasis added)

17. In **Isaiah Waweru's** case, **Ngugi J** enumerated some of the applicable considerations in an application of this nature, observing inter alia that:

“Among other things, the court considers the following:

a) Whether the Plaintiff has pleaded particularized facts which plausibly reveal a cause of action against the proposed defendants. If the pleaded cause of action is against the directors, the pleaded facts must be sufficiently particularized to create a reasonable doubt whether the board of directors' challenged actions or omissions deserve protection under the business judgment rule in determining whether they breached their duty of care or loyalty.”

18. These statements are useful, because at the interlocutory stage, the Applicant's pleadings and affidavit material are essential in assisting the court to gauge the nature of the challenged actions and omissions, and secondly in filtering otherwise frivolous suits.

19. The Plaintiffs' pleadings in the instant case contain averments to the effect that the 2nd Plaintiff has two director/shareholders namely, the 1st Plaintiff and the Defendant, each holding a 50:50 stake; that the Defendant was responsible for the day to day operations of the 2nd Plaintiff; that the Defendant allegedly diverted company business in respect of a company client, namely **Wu Huazhong** for his own benefit and substantial proceeds from the said business relationship into his personal bank account; that the Defendant has failed to account for a sum of KShs.4,034,578.00 earned from business dealings with a company client namely **Dynasty Universal Ltd**; that the Defendant made a unilateral decision to close down the operations of the 2nd Plaintiff and has carted off machinery and equipment belonging to the 2nd Plaintiff and has thwarted the 1st Plaintiff's attempts to address these matters, thereby paralyzing the business activities of the 2nd Plaintiff.

20. At paragraph 21 the Plaintiffs plead particulars of fraud by the Defendant to be the:

“i) Closure of the 2nd Plaintiff business without consent.

ii) Diversion of 2nd Plaintiff legitimate business proceedings into his personal account.

iii) Failing to account for business proceeds.

iv) Expropriation, concealment and removal of 2nd Plaintiff property.

v) Obtaining and/or acquiring the 2nd Plaintiff's property by deception.

vi) Processing of the 2nd Plaintiff's products as his own.”

21. The reliefs sought include a declarations that all the revenue generated through the diversion of the company's business belongs to the 2nd Plaintiff, and that the diversion thereof into the Defendant's personal account was unlawful, and a mandatory injunction to compel the Defendant to produce and deliver all assets, books, records and machinery belonging to the 2nd Plaintiff to the said company.

22. These allegations are repeated in the affidavit supporting the instant motion and the Further Affidavit. In substantiation of the allegations of fraud, the applicant has heavily relied on copies of bank statements in respect of the Defendant's bank account at Equity Bank, reflecting payments of relatively large sums of money into the account by **Wu Huazhong** and **Equatorial Nut Processors**.

23. The Defendants answer to the allegations of fraud, is firstly that the account statements were unlawfully obtained, and secondly, that the 1st Plaintiff/Applicant has made surmises and extrapolations without supporting evidence, from mere perusal of the transactions therein; and thirdly, that there is no evidence that **Equatorial Nut company** and **Wu Huazhong** were a clients of the 2nd Plaintiff.

24. Moreover, that the payments received from the sole customer of the second Plaintiff, namely, **Dynasty Universal Ltd** were applied to the operations of the company pursuant to a joint decision of the two directors. The Defendant enumerates the operational and licensing challenges faced by the 2nd Plaintiff that allegedly led to the closure of the business. He blames the Applicant for the breakdown in communication between the directors, accusing him of bad faith.

24. Evidently, the relationship between the 1st Plaintiff and the Defendant, as shareholders and directors of the company is far from cordial. What the Court of Appeal observed in **Amin Akberali Manji**, where two directors/shareholders with equal shares were held in a tangle leading to a stalemate appears to be true also in this case: the two shareholders herein wield equal power in the company. At this stage, the court can only make provisional findings on the issue, but prima facie, there may be legitimate questions to be answered by the Defendant in connection with payments received from **Dynasty Universal Ltd**, as it appears, even from his own depositions that he was the person primarily responsible for the day to day running of the company.

25. As regards the alleged diversion of proceeds from business transactions with **Wu Huazhong** and **Equatorial Nut Co. Ltd**, the Defendant did not deny the receipt thereof, but appeared content to state that these entities were not clients of the 2nd Plaintiff, and was reticent as to the purpose of the said payments. The admitted unilateral decision to close down the business premises of the 2nd Plaintiff is in my view a matter that calls for justification by the Defendant. On the face of it, these actions represent a real threat to the company's existence as a going concern. All in all, I am persuaded that the Applicant's pleadings demonstrate a reasonable cause of action as would bring this application within the provisions of Section 238(3) of the Companies Act.

26. The above finding also serves to determine the consideration under Section 241(2) (d) and 241(1) (c) of the Act, as a patently fraudulent act which jeopardizes the success of the company and its ability to make profits for the benefit of all members, may not be one capable of ratification by the company. The act of unlawful diversion of company business if proved, is potentially an act which violates the company's objects and it is doubtful that the same could validly be ratified by the company (see the holding in **Prudential Assurance Company Ltd v Newman Industries Ltd. and Others [1982] 1 AllER as cited in Amin Akberali Manji**)

27. Is the Applicant acting in good faith? There is no dispute that the company's business premises have been shut down and the business has stalled. On the face of it, the company faces an existential threat. Moreover, it is not clear what the status of the assets of the company is. The allegation by the Defendant that the Applicant's actions are motivated by bad faith, because the said Applicant involved the police in obtaining bank statements is not adequate rebuttal to the concern that the business of the company has stalled and its monies not accounted for.

28. There is nothing to disclose bad faith on the part of the Applicant. Conversely, it seems that his concerns are consistent with the promotion of the success of the business as a going concern. Besides, there is no proof of the allegation that the Applicant is driven by the ulterior motive of removing the Defendant from his position as a director so as to take over and dispose of the assets of the company for his own benefit.

29. As regards the question whether the company has decided not to pursue the claim, the two directors herein are caught up in a stalemate. And it would be futile for the Applicant to demand that the company pursues the claim as his co-director being the potential Defendant would evidently resist such a decision. Finally, the Applicant could not successfully bring the claim in his own right as the subject matter relates to what is stated to be proceeds and property of the 2nd Plaintiff and therefore the cause of action is properly vested in the company.

30. In the result, this court is satisfied that the application is merited. Permission is granted in terms of prayer (2) of the motion filed on 11th May, 2018. The Applicant is awarded the costs of the application.

DELIVERED AND SIGNED AT KIAMBU THIS 23RD DAY OF NOVEMBER, 2018

C. MEOLI

JUDGE

In the Presence of:

Miss Mulumba holding brief for Mr. Gachau for Applicant/Plaintiff

Respondent/Defendant – No appearance

Court Clerk - Kevin