



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT BUSIA

CIVIL SUIT NO.8 OF 2015

MOHAMED MUYONGA WEKESA (*sueing on behalf of himself as a share-holder of Kizazi Kipyua Building & Construction Ltd*)

and on its behalf by way of derivative

Suit.....**PLAINTIFF/
APPLICANT**

VERSUS

NICHOLAS OYEN ATUKEI.....

.....**1ST**
DEFENDANT/RESPONDENT

EMMANUEL BARASA

SIMIYU.....2ND
DEFENDANT/RESPONDENT

RULING

1. Mohamed Muyonga Wekesa (Mohamed) seeks to continue this suit as a Derivative Action on behalf of Kizazi Kipyua Building and Construction Company Limited (The Company) and has sought that Leave through the Notice of Motion dated 9th December 2015.

2. Alongside that request, Mohamed seeks the following Injunctive Relief:-

3. That 1st Defendant be restrained from convening or conducting any meeting in respect of KIZAZI KIPYA BUILDING AND CONSTRUCTION COMPANY LIMITED or interfering with its management pending the hearing and determination of this application in the first instance and thereafter pending the hearing and determination of the suit.

3. In resisting the Application the Defendants have raised a Preliminary Objection through a Notice dated 14th December 2015. In it the Defendants contend that:-

“This Honourable Court has no Jurisdiction to hear and determine this case as the parties are Directors of KIZAZI KIPYA BUILDING AND CONSTRUCTIONS COMPANY LIMITED and they have not exhausted all the internal disputes mechanism provided under Section 31 of KIZAZI KIPYA BUILDING CONSTRUCTION COMPANY Articles of Association hence this suit is premature”.

4. In his affidavit of 9th December 2015 Mohamed gives his story. He claims to be a Shareholder of the Company with 500 shares. The 2nd Defendant was also a founding Member with equal Shares of 500. Mohamed's grievance is the manner in which the 2nd Defendant sold his Shares to the 1st Defendant. Mohamed asserts that the sale was unlawful and sets out the reasons in paragraph 7 of his affidavit. At this stage it serves no purpose to restate them.

5. Mohamed had also complained about the 1st Defendant's intention to convene a meeting of the Company on 10th December, 2015 (a date now passed). That meeting never came to be as the Court issued Restraining Orders on 9th December 2015 whose purpose was, inter alia, to injunct the 1st Defendant from convening or conducting any meeting of the Company pending the Interpartes hearing and determination of the Motion.

6. It is the position of Mohamed that he seeks to continue this action so as to protect the Company from the unlawful and fraudulent transfer of Shares from the 2nd Defendant to the 1st Defendant.

7. The Preliminary Objection taken up by the Defendants brings into focus Article 31 of the Articles of the Company which reads:

'Whenever any differences arises between the company on the one hand any of the members, their executors, administrators, or assigns on the other hand, touching the true intent or construction, or the incidents, or consequences of these Articles, or of the statues, or touching anything then or thereafter done, executed, omitted, or suffered in pursuance of these Articles, or any claim on account of any such breach or alleged breach, otherwise relating to the premises, or to these Articles or to any statutes affecting the Company, or to any of the affairs of the Company, every difference shall be referred to the decision of an arbitrator, to be appointed by the Association of Arbitrators Kenya Chapter, or if they cannot agree upon a single arbitrator to the decision of two arbitrators, of whom one shall be appointed by each of the parties in difference'.

8. In confronting the Preliminary Objection, Mohamed argues that it is baseless as the Defendants have not filed a Statement of Defence and that the Objection is not supported by Pleadings. Secondly, that there is no proof that the Objection is brought with the authority of the 1st Defendant.

9. It is further contended that the 1st Defendant is not a member of the Company and there is therefore no dispute for Referral to Arbitration. As an alternative it was argued that the Arbitration clause as framed was not meant to apply amongst members inter se. That it applies between the Company and a Member. For this point the Court was referred to the decision in the matter of **KANGAWANA INVESTMENTS COMPANY LTD** (2012) eKLR in which Odunga J held:

"In my considered view, the said article is meant to protect the interest of the company as against those of the members. It is not meant to cater for interests of the members who decide to fight amongst themselves. If it was intended to apply to disputes between members inter se, one would have expected the same to use such phrases as "or between members of the company". Here the clause is clear that on one hand there must be a company. From the evidence on record, it is clear that allegations of impropriety are majorly directed against the 1st respondent with little if any allegation being directed against the Company. In the circumstances it is my finding and I so hold that clause 29 aforesaid is of no assistance to the applicant. See Nairobi High Court (Commercial & Admiralty Division) Miscellaneous Application No.832 of 2010 (OS) – Daniel Njogu Vs. Wilson Gichihi Gachagwi.

10. Article 31 seems to have a typographic omission but nevertheless makes sense. It bears reproducing it:-

'Whenever any differences arises between the company on the one hand any of the members, their executors, administrators, or assigns on the other hand, touching the true intent or

construction, or the incidents, or consequences of these Articles, or of the statues, or touching anything then or thereafter done, executed, omitted, or suffered in pursuance of these Articles, or any claim on account of any such breach or alleged breach, otherwise relating to the premises, or to these Articles or to any statutes affecting the Company, or to any of the affairs of the Company, every difference shall be referred to the decision of an arbitrator, to be appointed by the Association of Arbitrators Kenya Chapter, or if they cannot agree upon a single arbitrator to the decision of two arbitrators, of whom one shall be appointed by each of the parties in difference’.

It seems to me that the word “AND” was inadvertently omitted between the words ‘one hand’ and “any”. The purpose of the Article is however easily discernable. It is to refer the type of differences stated therein arising between the Company of the one hand and its members (their Executors/Administrators or Assigns) on the other for Arbitration before a single Arbitrator. The manner of appointment of the Arbitrator is also prescribed in the Article.

11. I would have to agree with Mohamed that on a literal construction of the Article the differences for referral are those that arise between the Company and its members and not Members inter se. There may however be merit in the observation of Kimaru J. in **ABDIRAHAMAN AFFI ABDALLA VS. OSUPUKO SERVICE STATION LTD & ANOTHER(2012)** eKLR while interpreting a Clause similar to Clause 31. There the learned Judge observed;

“With respect, Mr. Chalang’s contention overlooks one fundamental Principle of Company Law. That Principle ordains that a Company’s Articles of Association give rise to a contract not only between every Member and the Company, but also among the Members of the Company inter se. The logical conclusion to be drawn form that principle is that the Members of the 1st Plaintiff Company are bound by the Company’s Articles among themselves, and therefore Article 31 becomes an arbitrating agreement among all the Members”.

Those rival positions notwithstanding, the very nature of the action before me is that the party to the dispute is the Company. In seeking leave to continue the suit as a Derivative Action on behalf of the Company, the Plaintiff is, if unwittingly, expressly admitting that the aggrieved party is the Company. I therefore find that the Company is the one side of the dispute.

12. Mohamed, however, maintains that the Arbitration Clause would still not apply because the 1st Defendant is not a valid member of the Company. What do I make of this? The dispute in its simplest form is whether the transfer of Shares from the 2nd Defendant to the 1st Defendant is lawful. The very heart of the dispute is who between the 1st Defendant and the 2nd Defendant is now a valid member of the Company. Both the 1st Defendant and the 2nd Defendant would have any interest in the outcome. The party raising the question is the Company. In so far as the dispute is in respect to transfer of Shares and in so far the persons resisting the challenge are the alleged transferor and transferee, this dispute is between the Company and a Member.

13. Having so found, the Court turns to consider whether the dispute is of an Arbitral nature. The manner in which Shares can be transferred is prescribed by Articles 9 and 10 of The Articles of Association of the Company. It is these and other provisions of the Articles of Association of the Company which are alleged to have been breached by the Defendants. The dispute therefore touches on the true intent, construction or consequences of the Articles. In addition, it would touch on acts done, executed, omitted or suffered in pursuance of those Articles. No doubt, it is a dispute in the genre of dispute contemplated by the Arbitration clause.

14. An Arbitration commenced under clause 31 is the forum agreed by the parties as the forum to determine the matters now before court. The matters are subject of that Arbitration Agreement. The Defendants however chose to raise this important jurisdictional issue by way of a Preliminary Objection. There was then an attempt by the Defendants, in their submissions, to seek Stay of these proceedings.

15. But an invocation for Stay cannot be by implication. It has to be by application as provided in Section 6 of The Arbitration Act. The provisions of that Section are:-

(1) A Court before which proceedings are brought in a matter which is the subject of an arbitration agreement shall, if a party so applies not later than the time when that party enters appearance or otherwise acknowledges the claim against which the Stay of proceedings is sought, Stay the proceedings and refer the Parties to arbitration unless it finds-

(a) That the Arbitration agreement is null and void, inoperative or incapable of being performed; or

(b) That there is not in fact any dispute between the Parties with regard to the matters agreed to be referred to Arbitration.

(2) Proceedings before the Court shall not be continued after an application under Subsection (1) has been made and the matter remains undetermined.

(3) If the Court declines to Stay legal proceedings, any provision of the Arbitration agreement to the effect that an award is a condition precedent to the bringing of legal proceedings in respect of any matter is of no effect in relation to those proceedings.

16. There are decisions that the Court cannot, suo motu, Stay proceedings and make a reference to Arbitration (See generally JOSEPH CHACHA MWITA & 3 OTHERS VS. UHURU KENYATTA & OTHERS (2002) eKLR and SOPHIA WANJIKU KIMANI & 2 OTHERS VS. MRARADIA GATUYE RUMWE & 4 OTHERS (2014)eKLR). The rationale would seem to be that a party to an Arbitration Agreement is the one to insist that the contractual choice of forum be respected.

17. But what is the Court to do where the party has sought the Stay and Reference by way of a Preliminary Objection filed alongside Appearance and before filing Defence? I take the view that the Court may consider the request, after according the Plaintiff full opportunity, if on the material before it, the Court can reach a decision whether or not the request (save for the non-filing of a Formal Application) meets the requirements of Section 6 of The Arbitration Act. This may assist in the efficient and timely disposal of such matters.

18. In the matter at hand, the Defendant raised the issue of jurisdiction at the time of Entering Appearance. The Plaintiff has had full opportunity to react on whether or not the matter should be dismissed or Stayed and then referred to Arbitration. Upon hearing respective arguments, this Court has made a finding that there is a valid Arbitral Agreement in Clause 31 of the Articles and that the dispute herein falls for dealing within that agreement. In a word there is merit in Staying these proceedings and referring the parties to Arbitration. But before making this Order, this Court needs to determine the other two issues raised by the Plaintiffs.

19. It is not incompatible with an Arbitration agreement for a Party to request the High Court, before or during Arbitration proceedings for an Interim Measure of Protection and for the High Court to grant such request (Section 7 of The Arbitration Act). The Applicant has sought an Interim Measure in the way of an Injunction. The Court has Jurisdiction to hear and determine the Application even if it will ultimately Stay the proceedings and make a Referral Order. Simultaneously, he has sought to continue this matter as a Derivative Action. This latter Application needs to be dealt with first.

20. So as to be entitled to commence or continue a Derivative Action, the Applicant must demonstrate that:-

(a) the company is entitled to the relief claimed and

(b) the action is an exception to the Rule in **FOSS VS. HARBOTTLE**.

See **DAVID LANGATVS.ST.LUKES ORTHOPEADIC & TRAUMA HOSPITAL LTD & 2 OTHERS (2013) eKLR**. At the stage of seeking permission, the Applicant need only demonstrate, on prima facie, that a cause of Action may accrue to the Company and that the intended action is for the benefit of the Company.

21. Mohamed challenges the transfer of Shares and appointment of the 1st Defendant as a Director and cites the following reasons:-

(a) No valid share transfer notice has been issued to the Company as required by Article 9 of the Article of Association of the Company.

(a) No valid approval of the Board of Directors of the Company was sought and granted in respect of the alleged sale and transfer of the shares between the Defendants.

(c) The transaction leading to the transfer of Shares was predicated on resolution that contains a forged signature of the Plaintiff.

(d) The resignation of the 2nd Defendant was not presented to the Company as required by the law and the Articles of Association.

(e) The purported Company Secretary who allegedly authenticated the minutes of the purported meeting is not the duly appointed Secretary of the Company.

(f) The meeting purportedly leading to the transfer of the shares to the 1st Defendant and the resignation of the 2nd Defendant as a director was not duly convened in accordance with the Articles of Association of the Company.

(g) The notification of change of Directors file by the Defendants with the Registrar of Companies is invalid as the procedure for the resignation of a Director and the appointment of a new Director were not duly complied with.

(h) The 1st Defendant could not purport to be appointed to the Office of Director that had no valid vacancy.

(i) The 1st Defendant could not purport to be appointed as director of the company without being entered into the list of members.

(j) The instruments that were submitted to the Registrar of Companies for transfer of Shares and change of directorship were not duly authenticated with the company seal as required.

22. The response to allegations by Mohamed is in a Replying Affidavit sworn by the 1st Defendant on 14th December, 2015. Specifically in respect to the impropriety of the transfer of Shares to himself and his appointment as Director, the 1st Defendant avers:-

“That the dealings on the Shares of the Company and appointment of the Directors were lawful and hence all the reason advanced in paragraph No.7 are denied”.

23. The denial of impropriety is very general and does not address the specific allegations raised by Mohamed. Take for example the issue of Transfer Notice. Article 9(ii) of The Articles of Association provides:-

“Expect where the transfer is made pursuant to Sub-Article (vi) or (viii) here-of, the person proposing to transfer any shares (herein-after called ‘the proposing transferor’) shall give notice in writing (herein-after called “a transfer notice”) to the company that he desires to transfer the same. Such notice shall specify the sum he fixed as the fair value, and shall

constitute the company, his agent, for the sale of the share to any member of the company (or person selected as a foresaid) willing to purchase the share (herein-after called “the purchasing member”) at the price so fixed, or at the option of the purchasing member, at the fair value to be fixed by the Auditor in accordance with Sub-Article (vi) hereof, a transfer notice in respect of each. A transfer notice shall not be revocable except with sanction of the Directors.

Mohamed asserts that no Transfer Notice issued to the Company. But the Defendants have not confronted that assertion by demonstrating that the Notice was either given or unnecessary.

24. On the material before Court, I find and hold that Mohamed has established on a prima facie basis, that the allegation of impropriety in the Transfer of Shares is not trivial.

25. A Company is an artificial person and only acts through its Members and Directors. In the present case the shareholding of Mohamed and the 2nd Defendant (or the 1st Defendant) is on a 50:50 basis. The shareholding of either member though not a majority is significant. Anything done by either member on behalf of the Company is therefore equally significant. It is therefore obvious that it is in the interest of the Company that the shareholding and Directorship of either member is not tainted by impropriety. The Company would have a real interest that the propriety of the Shareholding and Directorship of the Company be enquired into and resolved. An action to resolve that issue is therefore to the benefit of the Company.

26. This Court finds that the request for Leave to continue with Derivative Action is meritorious and allows it.

27. Should this Court issue the Injunctive relief sought? The prayer is couched as follows:-

“That 1st Defendant be restrained from convening or conducting any meeting in respect of KIZAZI KIPYA BUILDING AND CONSTRUCTION COMPANY LIMITED or interfering with its management pending the hearing and determination of this application in the first instance and thereafter pending the hearing and determination of the suit.

28. This Court has in determining the issue for permission found that Mohamed has on a prima facie basis established that the Company is entitled to the claim sought. On the material before Court that claim may indeed have good prospectus of success.

29. Yet before granting any injunctive Order, this Court should be concerned that the Order will not stifle or choke the Daily operations and affairs of the Company in a manner that is inimical to the good of Company. A balance has to be struck so that any hardship caused by the restraining Order does not outweigh the benefit of the Order to the Company. The onus of demonstrating this lies with the Party seeking the relief.

30. The Applicant has not fared particularly well on this. Although it has made a request that the 1st Defendant be restrained from interfering with the Management of the Company, it is not explained how the Company will operate with only one Director given that the Application does not seek the reinstatement of the 2nd Defendant as Director. It is not obvious to the Court that to grant the relief in the manner it is sought will not be detrimental to the Company. This Court declines to grant the Order.

31. My final Orders:-

(i) The Plaintiff is granted Leave to continue this Suit as a Derivative Action on behalf of KIZAZI KIPYA BUILDING AND CONSTRUCTION COMPANY LIMITED.

(ii) The Application for Injunction is declined.

(iii) This suit is Stayed and referred to Arbitration in terms of Clause 31 of The Articles of Association of The Company.

32. As there was no outright victor or loser in the matter before me, I direct that each party bears its own costs.

DATED AT NAIROBI THIS 15th DAY OF JUNE, 2016.

F. TUIYOTT

JUDGE

READ, DELIVERED AND DATED AT BUSIA THIS 28TH DAY OF JUNE, 2016.

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KORIR

JUDGE

PRESENT:

N/a for Plaintiff

N/a for Defendant

Orwasa Court Clerk