



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA

AT MOMBASA

CIVIL SUIT NO. 560 OF 2000

KULDEEP SINGH SEHRA1ST PLAINTIFF

NARAIN SINGH SEHRA 2ND PLAINTIFF

V E R S U S

BULLION BANK LTD 1ST DEFENDANT

NITIN N. SHAH 2ND DEFENDANT

INFINITY GEMSTONES LTD 3RD DEFENDANT

RULING

ON NOTICE OF MOTION DATED 7TH APRIL, 2014

1. The two Plaintiffs and the 2nd Defendant are share holders of the 3rd Defendant Company. The two Plaintiffs hold 25% shares each while the 2nd Defendant holds 50%.
2. Plaintiffs filed this case seeking judgment against the 1st and 2nd Defendants for Kshs. 7,463,158/- to be paid to the 3rd Defendant; and against 1st Defendant for general damages for breach of contract; and against the 2nd Defendant for general damages for breach of trust.
3. The Plaintiffs allege in their Amended Plaint that from August 1996 the 3rd Defendant maintained a bank account No. 7730-01 at the 1st Defendant's Bank, Mombasa Branch. The mandate of operating that account, given by the 3rd Defendant, required that any cheque be signed by at least two Directors of the 3rd Defendant. That however in breach of that mandate the 1st Defendant permitted the 2nd Defendant to withdraw Kshs. 7,463,158/- between October 1996 and February 2000. Plaintiffs alleged that the 1st Defendant was negligent in that regard while they alleged that the 2nd Defendant acted fraudulently by solely signing the respective cheques.
4. The Defendants, other than the 3rd have Defences on record whereby they deny the Plaintiffs' claim. It seems also as though the 3rd Defendant filed a Defence and Counter-Claim but in my perusal of this file I was unable to trace it.

5. The application under consideration filed by 1st Defendant seeks an order for the Plaintiffs' suit to be struck out on the ground that the same is bad in law, an abuse of the Court process and on the ground that it does not disclose any reasonable cause of action. That order is sought under various grounds but the pertinent ones are-

- **The 3rd Defendant is a limited liability company and a legal person with the capacity to sue and be sued in its own name.**
- **Under the *Rule in Foss v Harbottle*, in any action in which a wrong is alleged to have been committed and or done to or against the Company, the proper claimant or person to commence proceedings for purposes of remedying the wrong is the company itself and therefore the Company itself is the Proper Plaintiff.**
- **The proper Plaintiff rule reflects the elemental legal principle that only the right holder is entitled to enforce the right.**
- **Under the exception in the rule in Foss v. Harbottle, the minority shareholder can bring a suit on behalf of the Company as a derivative action.**
- **Such derivative action must be filed with the leave of the Court.**
- **In this case the Plaintiffs are not minority shareholders considering that they hold 50% shares in the 3rd Defendant.**
- **Further the Plaintiffs did not seek leave of Court to commence a derivative action on behalf of the 3rd Defendant Company.**
- **The Plaintiffs have no *locus standi* to institute the suit on behalf of the Company.**
- **This suit does not disclose any reasonable cause of action therefore this Honourable Court should strike out the Plaintiffs' suit with costs to the Defendant.**
- **It is in the interest of justice and the overriding objective principle established under Section 1A and 1B of the Civil Procedure Act that this suit be struck out.**

6. In submissions 1st Defendant cautioned the Court in how it approaches the application for striking out the suit by referring to the Court of Appeal decision of **D.T. DOBIE & CO. (KENYA) LTD -Vs- MUCHINA (1982)KLR** where Madan J.A. stated-

“The Court ought to act very cautiously and carefully and consider all facts of the case without embarking upon a trial thereof before dismissing a case for not disclosing a reasonable cause of action or being otherwise an abuse of the process of the Court. At this stage, the Court ought not to deal with any merits of the case for that is a function solely reserved for the Judge at the trial as the Court itself is not usually fully informed so as to deal with the merits “without discovery, without oral evidence tested by cross-examination in the ordinary way.” (Sellers LJ (supra). As far as possible indeed, there should be no opinion expressed upon the application which may prejudice the fair trial of the action or make it uncomfortable or restrict the freedom of the trial Judge in disposing of the case in the way he thinks right.”

7. The Court was also referred to two other Cases which 1st Defendant requested do guide the Court as it considers the application as follows-

“The case of BLUE SKY EPZ LIMITED -Vs- NATALIA POLYAKOVA & ANOTHER [2007]eKLR the Court held that:

‘The power to strike out pleadings is draconian, and the court will exercise it only in clear cases where, upon looking at the pleading concerned, there is no reasonable cause of action or defence disclosed ...’

The power to strike out pleadings was further espoused by Swinfen Eady L.J in MOORE –Vs- LAWSON AND ANOR (1975)31 TLR 418 at 419 who stated as follows-

“It is a very strong power indeed. It is a power which, if it not be most carefully exercised might conceivably lead a court to set aside an action in which there might really after all be a right and in which the conduct of the Defendant might be explicable in a reasonable way. Unless it is a very clear case indeed It has been said more than once that the rule is only to be acted upon in plain and obvious cases and in my opinion, the jurisdiction should be exercised with extreme caution ... It cannot be doubted that the Court has an inherent jurisdiction to dismiss an action which is an abuse of the process of the Court. It is a jurisdiction which ought to be very sparingly exercised and only in exceptional cases”

8. That the above authorities notwithstanding 1st Defendant submitted that because of the hopelessness of this case the Court in applying the overriding objective of Section 1B of the Civil Procedure Act, should strike out the suit. That to allow this case to remain on record would negate that overriding objective which requires the efficient use of available judicial and administrative resources.
9. 1st Defendant sought the striking out of this suit on the ground that the Plaintiffs being holders of 50% shares of 3rd Defendant, that is each holding 25% ought not to have commenced this action on behalf of 3rd Defendant Company because of the rule of **FOSS –Vs- HARBOTTLE** case. 1st Defendant relied on the case **EDWARD –Vs- HALLIWELL & OTHERS [1950]ALL ER 1064** where Jenkins L.J. stated-

“The Rule in Foss –Vs- Harbottle, as I understand it, comes to no more than this. First, the proper Plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is prima facie the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quaestio*.”

10. That although there are exceptions to **FOSS –Vs- HARBOTTLE** such as where a minority shareholder can bring a claim on behalf of the Company, the Plaintiffs were not minority shareholders and that the Plaintiff had failed to obtain the leave of the Court to bring a derivative action. 1st Defendant referred to decision of Mwera, J (as he then was) in the case **DADANI –Vs- MANJI & 3 OTHERS [2004]KLR 95** viz-

“It is a cardinal principle in Company Law that it is for the Company and not an individual shareholder to enforce rights of actions vested in the Company and to sue for wrongs done to it. It is also cardinal that in absence of illegality a shareholder cannot bring proceedings in respect of irregularities in the conduct of the Company’s internal affairs in circumstances where the majority are entitled to prevent the bringing of an action in relation to such matter (see Foss v. Harbottle (1843)2 Hare 461). All this is in deference to the self-regulation the law allows corporations and thus limits the interference by courts in the running of such bodies on their own. However, 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.”

11. In that case Mwera, J referred to the Learned Author Joffe in “**Law, Practice and Procedure**” viz-

“Where the shareholders seek to enforce a right not invested in himself by the Company of which he is a member for example a claim for the Company’s property misappropriation by the Director, he can only do (if at all) by means of a derivative claim. The derivative action is a claim brought by an individual shareholder in his own name but on behalf of the Company. The reason the claim takes this form is that the minority shareholder is not in a position to see that the claim is brought in the name of the company itself to enforce the Company’s rights.”

12. Learned Counsel for the 2nd and 3rd Defendant supported the application.

13. Plaintiff’s Learned Counsel submitted that although the 3rd Defendant’s mandate to the 1st Defendant in operation of the 3rd Defendant’s Bank account was that the Plaintiffs’ ought to have signed cheques that both the 1st and 2nd Defendants in breach of that mandate had allowed withdrawal of the amount claimed from 3rd Defendant’s account. That accordingly that had caused loss to the Plaintiffs who are 3rd Defendant’s shareholders. That accordingly this case fell under the exceptions of the rule of **FOSS –Vs- HARBOTTLE**. That the rule did not apply to acts which are ultra vires or illegal, which Learned Counsel submitted was the case here.

ANALYSIS

14. The Notice of Motion is brought under the provisions of Section 1A and 1B of the Civil Procedure Act Cap 21 and Order 2 Rule 15(1) (a) of the Civil Procedure Rules. Section 1A(1) of Cap 21 sets out the overriding objective of Cap 21 viz-

“1A(1) The overriding objective of this Act and the rules made hereunder is

to facilitate the just, expeditious, proportionate and affordable resolution of the civil disputes governed by the Act.”

The Court is required to give effect to the overriding objective in its application of that Act and Rules.

15. The Rule under which the Notice of Motion is brought is Rule 15 of Order 2 of the Civil Procedure Rules. That Rule provides the Court with the power to strike out a suit at any stage of suit. Rule 15 provides-

“15.(1) At any stage of the proceedings the Court may order to be struck out or amended any pleading on the ground that-

- a. **it discloses no reasonable cause of action or defence in law; or**
- b. **it is scandalous, frivolous or vexatious; or**
- c. **it may prejudice, embarrass or delay the fair trial of the action; or**
- d. **it is otherwise an abuse of the process of the court, and may order the suit to be stayed or dismissed or judgment to be entered accordingly, as the case may be.**

(2) No evidence shall be admissible on an application under Subrule (1)(a) but the application shall state concisely the ground on which it is made.”

16. The issue to determine is whether this case falls within the provisions of Subrule 1(a) to (d) of

Rule 15, the Plaintiffs having not obtained leave to file this derivative action and having filed the action when they are not minority shareholders.

17. An incorporated Company has an entity that is distinct to its members or shareholders. That is to say it has a legal personality which has been described as an artificial person. It then follows that when a wrong is done to that Company the correct party to seek redress is that Company. Lord Denning MR so stated in the case WALLERSTEINER –Vs- MOIR (No. 2) [1975]QB 373 to wit-

“It is a fundamental principle of our law that a company is a legal person, with its own corporate identity, separate and distinct from the Directors or Shareholders, and with its own property rights and interests to which alone it is entitled. If it is defrauded by a wrongdoer, the Company itself is the one person to sue for the damage. Such is the rule in Foss v Harbottle (1843)2 Hare 461.”

In discussing the Rule of Foss –Vs- Harbottle in the case DAVID LANGAT –Vs- ST. LUKES ORTHOPEADIC & TRAUMA HOSPITAL LTD & 2 OTHERS [2013]eKLR Justice Munyao Sila had this to say-

“The rationale in that line of reasoning is that a company is a separate legal entity from the members who compose it and as such, if any right of the company is violated, it is the company which can bring an action through the majority.

It was held that, “If the thing complained is a thing which, in substance, the majority of the company are entitled to do, or something has been done irregularly which the majority of the company are entitled to do regularly or if something has been done illegally which majority of the company are entitled to do legally, there can be no use in laying litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes.

It was held that, it is an elementary principle of law relating to joint stock companies that the court will not interfere with the internal management of the company, acting within their powers and jurisdiction to do so. It was further held that in order to redress a wrong done to the company or to recover monies or damages due to the company the action should be brought by the Company itself.”

18. Justice Mwera in DADANI case (supra) discussing derivative action had this to say-

“A Derivative Claim:

Minority Shareholder: Law, Practice and Procedure by Joffe Butterworths 2000) defines such cause as:

“... Where the shareholder seeks to enforce a right not invested in himself but the company of which he is a member, for example a claim of the company’s property fraudulently misappropriated by the Directors, he can only do so (if at all) by means of a derivative claim. The derivative claim is a claim brought by an individual shareholder in his own name but on behalf of the company. The reason the claim takes this form is that the minority shareholder is not in a position to see that the claim is brought in the name of the company itself to enforce the company’s rights.”

19. The strict Rule of Foss –Vs- Harbottle does have exceptions as can be seen from the discussion of Justice Mwera, above in DADANI case (supra). Such exception was also the subject of discussion in the case EDWARD AND ANOTHER –Vs- HALLIWELL AND OTHERS (supra) as follows-

“The cases falling within the general ambit of the rule are subject to certain exceptions. It has been noted in the course of argument that in cases where the act complained of is wholly ultra vires the company or association the rule has no application because there is no question of the transaction being confirmed by any majority. It has been further pointed out that where what has been done amounts to what is generally called in these cases a fraud on the minority and the wrongdoers are themselves in control of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring what is known as a minority shareholder’s 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. Those exceptions are not directly in point in this case, but they show, especially the last one, that the rule is not an inflexible rule and it will be relaxed where necessary in the interests of justice.”

20.1st Defendant submitted that Plaintiffs did not fall within that exception because combined they both held 50% shares of 3rd Defendant and they are therefore not minority shareholders. There are two responses I would make on that submission.

21. Firstly is that each Plaintiff is a minority shareholder and the 2nd Defendant, the alleged wrong doer, holds 50% shares. Secondly as pleaded in the Plaint the 2nd Defendant is in control of the running of the 3rd Defendant and would obviously not vote in favour of a suit being filed against him. Since he holds 50% shares it would follow that the alleged wrong done to the 3rd Defendant would never come to Court. That indeed would lead to injustice to the Company. Justice Munyao Sila in the case **DAVID LANGAT –Vs- LUKE OTHOPEADIC & TRAUMA HOSPITAL LTD** (supra) was also faced with two Directors of the Company who each held 50% shares in the Company. This is what he had to say-

“I think to insist that there must be a majority and minority before the exceptions in the Rule in Foss v Harbottle can be applied has the capacity to lead to injustice. In my view the court has inherent jurisdiction to ensure that justice is done. This inherent jurisdiction is indeed the very foundation of the exceptions to the Rule in Foss v Harbottle. These exceptions are founded in equity and are meant to cure the hardship and injustice that may be occasioned to the company and to its shareholders by a strict application of the Rule in Foss v Harbottle.

I can do no better than echo the words of Lord Denning MR in Wallersteiner v. Moir (No.2).

‘But suppose [the company] is defrauded by insiders who control its affairs – by directors who hold a majority of the shares – who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorize the proceedings to be taken.’

I wholly agree with that view of the Learned Judge. The Plaintiffs here allege that the 2nd Defendant defrauded the 3rd Defendant’s Company. To disallow the suit would be for the Court to shut its eyes to that alleged wrong. That, in itself would be contrary to the overriding objective. I do therefore find that Plaintiffs’ case falls within the exception of **Foss –Vs- Harbottle**.

21.The other issue to consider is whether the Plaintiffs’ suit will be defeated for lack of leave to file derivative action. May be the first question to be asked on this issue is when should leave be granted? Before the suit is filed or after? In my view leave can be granted either before the suit is filed or after it is filed. In the case of **DAVID LANGAT** (supra), the Learned Judge granted leave to amend the Plaint to include the wronged Company as a Defendant. In the case of **DADANI**

(supra) the Learned Judge had this discussion on when leave should be granted and stated-

“In approaching this aspect the Court again refers to Joffe (*Joffe, V. (2000) Minority Shareholders: Practice and Procedure London Butterworths*). Under a subheading “Procedure” before action he says-

“There is no approval pre-action protocol in relation to derivative claim.”

Then the Learned Judge continued the discussion thus-

“Then under “Application for permission to continue” with the derivative action Joffe says inter alia:

‘Before proceedings with a derivative claim a Claimant ought too at least be required to establish a prima facie case (i) that the company is entitled to the relief claimed and (ii) that the action falls within the proper boundaries of the exception to the rule of Foss Vs Harbottle.’”

22. It follows from the various previous decisions that leave can be obtained either before suit or after suit depending on where justice would best be served. The Applicant would however be required to meet certain parameters, such as-

“... The onus on the claimant to adduce evidence establishing a prima facie case, not only as to the entitlement of the company to the relief to which the claimant asserts it is entitled to but also as to the propriety of the derivative proceedings.

.... After the claim form has been issued, the claimant is required to make an application which must be supported by written evidence – for permission to continue the claim.”

Since leave can be obtained before or after suit, it follows that this suit cannot be dismissed for lack of leave. Such leave can be obtained at interlocutory stage.

23. In my view the interest of justice is, in this case, best served by considering whether leave should be granted even as I rule on the 1st Defendant’s application. The reason I hold that view is two fold.

24. Firstly the parties did address themselves on whether the Plaintiffs had shown a prima facie case to the 3rd Defendant Company’s entitlement to the claim and also whether the Plaintiff had a right to bring the derivative claim. The 1st Defendant’s Learned Counsel on this submitted that Plaintiffs’ case had not shown a reasonable cause of action. He further argued Plaintiffs were not minority shareholders to entitle them come under the **Foss –Vs- Harbottle** exception.

24. The issue whether Plaintiffs were entitled to bring derivative action has adequately been dealt with in this Ruling. They were so entitled.

25. The issue whether the Company is entitled to bring the action I would

answer in the affirmative. There are photocopies of cheques filed in this case by the Plaintiffs which show a possibility that the amount claimed was withdrawn from 3rd Defendant’s account. That being so the Court needs to entertain the claim to determine whether there was, in that withdrawal, any wrong doing. So Plaintiffs have shown a prima facie case. The Plaintiffs have made out a case for derivative claim.

26. The second reason why the Court will consider whether to grant leave is in the application of the

overriding objective of the Cap 21. To order parties to file another application for such leave to be considered, whereas parties have inadvertently addressed their arguments on the same, would lead to delay of this case and would not lead to optimum use of judicial time. The Court of Appeal in considering the overriding objective in the case ABIRAHMAN ABDI –Vs- SAFI PETROLEUM PRODUCTS LTD & 6 OTHES (2011)eKLR stated-

“The overriding objective in civil litigation is a policy issue which the court invokes to obviate hardship, expense, delay and to focus on substantive justice...

In the days long gone the court never hesitated to strike out a notice of appeal or even an appeal if it was shown that it had been lodged out of time regardless of the length of delay. The enactment of Sections 3A and 3B of the Appellate Jurisdiction Act, Cap 9 Laws of Kenya, and later, Article 159 (2) (d) of the Constitution of Kenya, 2010, changed the position. The former provisions introduced the overriding objective in civil litigation in which the court is mandated to consider aspects like the delay likely to be occasioned, the cost and prejudice to the parties should the court strike out the offending document. In short, the court has to weigh one thing against another for the benefit of the wider interests of justice before coming to a decision one way or the other. Article 159 (2) (d) of the Constitution makes it abundantly clear that the court has to do justice between the parties without undue regard to technicalities of procedure. That is not however to say that procedural improprieties are to be ignored altogether. The court has to weigh the prejudice that is likely to be suffered by the innocent party and weigh it against the prejudice to be suffered by the offending party if the court strikes out its document. The court in that regard exercises judicial discretion.”

In exercising the overriding objective in favour of the Plaintiffs I am of the view that it will not lead to prejudice against the Defendants because parties addressed their argument on whether the Plaintiffs were entitled to bring the derivative action.

27. In conclusion therefore I do grant the following orders-

- a. **The Notice of Motion dated 7th April 2014 is dismissed but the costs thereof shall be in the cause.**
- b. **Leave is hereby granted to the Plaintiffs to continue with this action.**

DATED and DELIVERED at MOMBASA this 18TH day of SEPTEMBER, 2014.

MARY KASANGO

JUDGE