



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT ELDORET

MISCELLANEOUS CIVIL APPLICATION NO. 193 OF 1998

MIFRA CONSTRUCTION COMPANY LIMITEDAPPLICANT

VERSUS

ELDORET MUNICIPAL COUNCILRESPONDENT

RULING

This is an application by way of Notice of Motion brought under section 3A and 89 of the Civil Procedure Act and 35(1) (a) (ii) and (b) of the Arbitration Act 1995 and order L rule 1 of the Civil Procedure Rules. The main order sought in this application is to set aside an interim arbitral award on grounds that:-

- (i) The agreement for arbitration is illegal
- (ii) The interim award is contrary to public policy
- (iii) The awards and its reasons are contrary to section 89 of the Local Government Act;
- (iv) The arbitrator failed to fully consider the issues and authorities cited before him;
- (v) This application has been brought within the 3- month statutory period allowed therefore; and
- (vi) Section 7 of the Arbitration Act grants a Court power to grant interim measures of protection such as stay and injunction.

The application is supported by the affidavit of Simon C Lilan, advocate for the applicant. The substance of Mr Lilan's deposition is found in the submissions of Mr Gicheru for the applicant which I will turn to later. Mrs Roseline Odede for the respondent filed her grounds of opposition and the substance of her argument is outlined below.

Mr Gicheru argued that under section 35 of the Arbitration Act this Court is empowered to set aside an arbitral award for any matters set out under that section. He argued that the agreement for arbitration sought to be enforced was invalid. He stated that on 23.1.97 a preliminary objection had been taken by the applicant before the arbitrator. This objection concerned the legality of the contract sought to be enforced by the arbitration. Mr Gicheru argued that the contract in question was contrary to section 89 of the Local Government Act since two of the respondent's directors who were also councillors of the applicant had not disclosed their interest in the contract. He stated that the arbitrator had established that one of those directors, one Councillor Mbugua participated in the proceedings in which the Tender Board awarded the tender to the respondent. He went further and told this Court that the arbitrator having found that the said

Mr Mbugua had participated in the proceedings as aforesaid, nonetheless held that since a company is a separate legal entity, the acts of individuals such as Councillor Mbugua and Mr Magut (another director and councillor at the same time) could not invalidate the contract between the applicant and the respondent. Disagreeing with the arbitrator's finding on this point, Mr Gicheru referred the Court to section 89 (1) of the Local Government Act (cap 265) which reads as follows:-

“89 (1) If a member of a Local Authority has any pecuniary interest, direct or indirect, in any contract or proposed contract or other matter, and is present at a meeting of the Local Authority at which the contract, proposed contract or other matter is the subject of consideration, he shall at the meeting, as soon as practicable after the commencement thereof, disclose the fact, and shall not take part in the consideration or discussion of, or vote on any question with respect to, the contract, proposed contract or other matter;.....”

Also referring to the text of *Cheshire and Fifoot and Furmston's Law of Contract* (11th Ed) at pages 334, 337, 341 – 345, 359-361 Mr Gicheru argued that the relevant contract is invalid for illegality as it is expressly forbidden by law. He further argued that the said Mr Mbugua and Mr Magut were members of the respondent council. They had a direct pecuniary interest as defined in section 89(2) of the Local Government Act. Therefore, the arbitrator was wrong in holding that the respondent was a separate legal entity from the two gentlemen. He argued that under this section the corporate veil is lifted. He stated that since the arbitrator found that Mr Mbugua's participation amounted to a criminal act at page 342 of the ruling, then the contract was illegal. He referred the Court to the cases of *David Taylor & Son Ltd v Burnet* [1953] 1 All ER 843 and *R v Hendon Rural District Council ex P Chorley* [1933] 2 KB 696 concerning the effect of illegality on a contract. In his response to the grounds of opposition he argued that the application was proper in form since two substantive orders are sought, to wit, for stay of proceedings under section 7 of the Arbitration Act and for setting aside the arbitral award. In his view, since there is no procedure provided for this purpose, section 89 of the Civil Procedure Act and order L rule 1 should apply, so that this application could be brought by way of Notice of Motion. He argued that, in any event, *Boyer v Galloure* [1969] EA 385 established that a wrong procedure does not invalidate proceedings where it does not go to the jurisdiction and causes no prejudice to the other party's case. On the issue of whether there was an arbitral award or not Mr Gicheru has referred to section 32 of the Arbitration Act and submitted that the ruling in question was an arbitral award. He argued that section 3 of the Arbitration Act defines an “award” as either interim or final and classed the ruling in question as an interim award. He argued that section 17 of the Arbitration Act provides that a preliminary objection may be raised as to legality of an award and that the section confers on this Court jurisdiction to entertain an application for setting aside.

Mrs Odede, for the respondent, on her part argued that since this is an application under section 7 of the Arbitration Act, it must be brought by way of Summons and not under a Notice of Motion. She also argued that this application was premature as no award had yet been made. In her view, the arbitration was not over yet since the arbitrator only dealt with the preliminary objection on a point of law. She argued that no stay of proceedings is permissible where appeal is from a preliminary objection. Mrs Odede further argued that an arbitrator's finding of fact is conclusive and that under section 7(2), this Court is *functus officio* with regard to an arbitrator's finding on a question of fact. It was her argument that this application amounted to an appeal and that any orders made would have a concluding effect of terminating the entire arbitration process. In her view, this application raises new grounds and introduces new exhibits which were never furnished to the arbitrator when the ruling in question was made. She stated that exhibit 2A and 2B annexed to the affidavit of Simon C Lilan were never produced at the time the subject ruling was made. She also argued that the issue of the contract being against public policy was never raised in the arbitration. She asks this Court to ignore these matters which in her view were not part of the arbitration. She argued that the contract between the parties is neither illegal nor frustrated as no notice of frustration was given to the respondent. She conceded that even though Mr Mbugua attended the meeting for awarding tenders, he did not vote. She also argued that Mr Magut's presence was never raised during the arbitration. She argued that the requirement under section 89 of the Local Government Act, related to disclosure of interest in contract, and was not about voting. In her view, section 89(5) deals with the consequence of non-disclosure and makes the culprit criminally culpable. She argued that the purpose of the section was to prevent bias but does not deal with the capacity of the Council to deal with 3rd

parties. She argued that the presence of Mr Mbugua at the tendering meeting was a disqualification but did not illegalise an otherwise valid contract as a lawful act of the Council. Mrs Odede's view is that it has not been shown that the tendering process was unlawful. She argued that since no action had been taken against Mr Mbugua, it may be presumed that he in fact made disclosure as provided. In conclusion, she argued that in any event, the Company is a separate legal entity distinct from its directors and shareholders so that a criminal act by a director cannot invalidate or frustrate a lawful contract. She prayed that this application be dismissed.

Mr Gicheru in reply argued that under section 89 of the Local Government Act a councillor must disclose any interest in a company and must also not vote. He argued that the minutes of all meetings did not show disclosure of interest by Mr Mbugua and Mr Magut so that their subsequent bid was contrary to section 89 of the Local Government Act and, therefore, null and void. He argued that the respondent cannot hide under the doctrine of separate legal entity because the statute specifically prohibited them from voting.

I am grateful to both the counsels for able arguments.

The principal issue in this application is whether the arbitrator's award can be set aside. Without doubt, I agree with Mr Gicheru that Justice Torgbor's ruling dated 17.7.98 is an "award" as defined under the Arbitration Act. This application is therefore proper. I also do not think that the issue of form as to whether, this application should have been brought under a Summons or Notice of Motion is a matter necessary for much argument in view of the decision in *Boyes v Gathure (supra)*.

Also in *Johnson Joshua Kinyanjui v Rachel Wahito Thande* (CA No 284 of 1997) the Court of Appeal held that no application is to be defeated by use of wrong procedural mode and the judge has the discretion to hear it either in Court or in chambers.

The important matter for consideration now is whether the ruling of Justice Torgbor should be set aside. Counsel made helpful arguments concerning the legality of the contract. It is agreed that if this contract be tainted by illegality, it has no benefit for the parties. That was the basis of the preliminary objection raised before the arbitrator.

I consider the following to be relevant issues:

- (a) Did Mr Mbugua and Mr Magut disclose their interest in the contract between the applicant and the respondent?
- (b) Did they participate in the proceedings and voted for the contract in question?

It is clear from the evidence before the Court that they did, and that they were in conflict of interest as between their position as councillors and at the same time directors of the respondent. In his ruling, Justice Torgbor considered the status of the respondent as a separate legal entity to be relevant. According to Justice Torgbor, the respondent being a separate legal entity, had capacity to enter into a contract with the applicant notwithstanding that the respondent's directors who were also councilors of the applicant had a pecuniary interest in the contract. I must disagree with that position.

I think the Act is straight on this point. Section 89(1) (*supra*) talks about any pecuniary interest, direct or indirect, that requires disclosure, and withdrawal from participation, in the proceedings. If Mr Mbugua and Mr Magut were directors of the respondent, they ought to have disclosed this fact at the meeting; they ought to have refrained from participating; and ought not to have voted. If they did any of these things so that the respondent got benefit of the contract in question, then that contract was tainted with illegality. In my view, not much consideration need have been given to the lofty principle of separate entities. I also think that the issue of illegality or otherwise of the contract in question is important for first determination. It allows us to then know whether there can be any further proceedings. As Mrs Odede pointed out rightly, an arbitrator's finding will not invite quick interference of this Court. But an arbitrator must always make his determination guided by proper principles. If he fails, this Court will not hesitate to overturn his finding. I find that the Honourable Justice Torgbor was not properly guided on this issue. He

need not have focused unduly on the issue of separate entities. This complicated his function and in my view he lost the point. My finding is as follows: it is not in doubt that Mr Mbugua and Mr Magut had a pecuniary interest in the contract in question. They did not make a full and frank disclosure of the same, and they did not abstain from participating and/or voting on the matter. As a result, their own Company, the applicant benefited. I agree with Mr Gicheru that if the argument of corporate entity is pushed, this is a clear case to lift the corporate veil. We do not have to do that as the statute has already done so. This contract is clearly tainted with illegality. It is void *ab initio*, and of no effect.

Accordingly, I will allow this application with costs to the applicant.

Dated and Delivered at Eldoret this 20th day of September 2000.

ALNASHIR VISRAM

COMMISSIONER OF ASSIZE