REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

MILIMANI COMMERCIAL COURTS

AT NATIROBI

CIVIL CASE NO. 913 OF 2002

ALTAF ABDULRASUL DADANI…….…….....……PLAINTIFF

VERSUS

AMIN AKBERALI MANJI ……..…….....…..1ST DEFENDANT

HEMANTH KUMAR …….……...….....…….2ND DEFENDANT

MUSIKLAND MILLENIUM LIMITED ……...…….....…..3RD DEFENDANT

MUSIKLAND LIMITED …….…….....….4RD DEFENDANT

R U L I N G

The plaintiff's application before this court was filed on 26.11.2002 under O.6 r.13 (1) (b) Civil Procedure Rules. The main prayers were for orders:

1. That the contents of paragraphs 5 to 14, 17 to 26 and 29 to 41 of the defence be struck out and judgment be entered against the 1st, 2nd and 3rd defendants on liability.

2. That prayers (a) (b) (c) (e) (f) (h) (j) and (k) in the plaint be granted against the same 3 defendants (above) and

3. That this suit be set down for assessment of damages, and then, costs.

The application was predicated on the grounds and mainly that:

(a) This suit seeks to redress wrongs done to the 4th defendant, the company, by the same 1st, 2nd and 3rd defendants.

So this basically is intended to be what is called a derivative action. By such actions in company law, minority shareholder(s) feeling that wrongs have been done to the company which cannot be rectified by internal company mechanisms like meetings and resolutions, because the majority shareholders are in control of the company, come to court as agents of the "wronged" company to seek reliefs or relief for the company itself, all the shareholders including the wrong-doers, and not for the personal benefit of the

suing minority shareholder(s). Other aspects attendant to derivative actions may be gone into later.

The wrongs allegedly done to the 4th defendant included what was described as the closure of that company's business operations without the board of directors or members resolutions, disposing of the company's business premises, plant and equipment and goodwill to the 3rd defendant (Musikland Millenium Ltd.) without resolution of the 4th defendant; disposing of the company's stock at gross undervalue and compromising a debt of Sh.2.8 m; moving to dispose of the 4th defendant's subsidiary and misappropriating its assets. And that serious frauds were committed against the company. It was added in the grounds that due consents/resolutions were never obtained/given in the alleged wrongs and that the defendants did not dispute all the above.That indeed these actions were not justified and the defence was not sustainable. It was termed frivolous and vexatious. The plaintiff then swore a 57 – paragraph affidavit in support bearing some fifteen (15) annexed exhibits.

The 2nd defendant then sworn an affidavit in reply, equally long (in fact running into 47 paragraphs) with eight (8) annextures. Down this analysis it will appear that the plaintiff put forth the view that this replying affidavit was of a minimal or next to no value in the light of the main pleadings (the plaint and the defence) or the chamber summons under review. It was submitted by Mr. Oyatsi (for the plaintiff and the 4th defendant company) that that affidavit did not state that its contents were either on information from the 1st and 3rd defendant or that he, the 2nd defendant had authority to depone as he did. It was said that he was not an officer, shareholder or director of the 3rd defendant company and before 1999 when the 1st defendant made him (the 2nd defendant) his nominee in the 4th defendant, the 2nd defendant was not in any way connected with the 4th defendant company and that what he swore either without information from the 1st defendant or authority from the 4th defendant could not be seen to controvert what the plaintiff had deponed to regarding the rest of the defendants. Be that as it may for now.

It seems pertinent to add here that before the subject application was filed, the plaintiff did file a notice of motion on the 22-7-2002, along with the plaint, under S.3A Civil Procedure Act and O.50 r.1 Civil Procedure Rules. It was an ex parte application. Its principal prayers were:

> i) That the plaintiff be granted leave to prosecute this derivative action on behalf of and for the benefit of the 4th defendant and its creditors.
>
> ii) That the plaintiff be indemnified by the 4th defendant company for all costs and expenses reasonably incurred in prosecuting this suit.

It was stated that this derivative action was brought to save the 4th defendant from liquidation. As at the time of filing this cause the 4th defendant was under receivership. But by the close of hearing this application the court was informed that the receivership was lifted last year, 2003. The receivership had been imposed by Imperial Bank Ltd., pursuant to a debenture which it had over the 4th defendants assets, the crystallizing of which, the plaintiff attributed to the defendants' closing down its operations. It was added that the plaintiff could not prosecute the action if he had to expect the 1st and 2nd defendants to sanction the same because the two were labeled as the wrong doers against the company against whom the suit was brought. It was further said that those so-called wrong-doers had misappropriated the money and property of the 4th defendant to their benefit and to the prejudice of the company. That thus this action was imperative or else the 4th defendant company and its creditors faced irreparable loss. And that for bringing this suit for the benefit of the company, it should thus indemnify the plaintiff against all costs and expenses reasonably incurred in the litigation.

Again the plaintiff swore an affidavit to support the prayers in the motion which were expanded upon largely by use of case law and other authorities Mr. Oyatsi relied on.

On the same 22-7-2002 the plaintiff was heard ex parte and he got the orders sought.

On 5-8-2002 the firm of M/s Ochieng Oduol, Onyango & Ohaga Advocates entered appearance for the 1st to the 3rd defendants and filed a joint defence on 19.8.02. The record has in that M/s Theuri Wanjohi & Co. Advocates entered appearance on behalf of the 4th defendant company on 7.10.2002 but nothing

more has been heard of them. But Mr. Oyatsi proceeded as if he was holding that company's brief or having full instructions by the nature of the case.

The record has it that on 16.1.2002, the 1st to the 3rd defendants filed and served a notice of preliminary objection which had these main points:

a) That the court had no jurisdiction to entertain this suit as drawn and filed and

b) That it could for the same reason not deal with the chamber summons dated 26-11-02 (above)

c) That the plaintiff lacked locus standi to bring this cause because he was not the proper plaintiff in law;

d) That he had not brought himself within the exceptions to the rule of Foss vs. Harbottle (see below) and

e) That he was not a minority shareholder as per the Company's Act (Cap 486). It is pleaded in the plaint that him with the 1st defendant (or his nominee) each held 50% share contribution in the 4th defendant.

f) And that because the 4th defendant company had been under receivership (since lifted) the plaintiff could not sue as he did, as it were, ignoring or by- passing the receivers.

The points of objection were however taken along when Mr. Ochieng was heard in the subject application. In the same course were also included the orders sought in the defendants' notice of motion field in court on 14-5- 2003. It was brought under O.50 r.17 Civil Procedure Rules, and S.3A Civil Procedure Act. Its principal prayers were:

1 & 2) That the ex parte orders granting leave to the plaintiff to file derivative suit on behalf of the 4th defendant and that it indemnifies the plaintiff of all expenses, be set aside.

3) That the plaint be struck. This was based on the arguments that either because the claim was filed before leave was granted or that because the plaintiff was not the proper plaintiff in law.

4) That the defendants be at liberty to apply for any further orders.

The grounds put forth were that the plaint was an abuse of the court process and indeed this court had no jurisdiction to entertain it. It will be recalled that the notice of preliminary objection bore such a point and also questioned the locus standi of the plaintiff. It is a ground repeated in his motion. It also added that the ex parte orders of 22-7-02 were obtained through concealment of material facts and then other factors referred to elsewhere above, were repeated e.g. the rule in FOSS VS. HARBOTTLE etc and the receivership issue.

All these interlocutory matters no doubt had/have a base in the main pleadings. There is the plaint and the defence. On 22-7-02 the plaintiff, whom we may refer to simply as Dadani, filed a plaint against his (once) coshareholder, Manji, the 1st defendant. That the two formed the 4th Defendant company on 14-5-93 to trade in musical instruments in premises called Cambrian House along Nairobi's Moi Avenue. It began business in 1995 after the two paid Sh.3.5 m. each thereby being equal shareholders and directors. It is in the pleading and submissions that the plaintiff and the 1st defendant agreed to each actively participate in the operations of the 4th defendant with the 1st defendant doing all the financial and book-keeping work while the plaintiff managed the shop and saw to the day-to-day operations. That although in 1999 the 1st defendant not keen to appear publicly as the 4th defendant's director, brought in the 2nd defendant (Kumar) as a director, but in essence he continued to participate in the 4th defendant's affairs; that the company operated successfully between 1995 and 2000 but the plaintiff did not accept that the books of accounts for those years were a true and accurate financial state of things. He saw them as a fraud on the 4th defendant; that dividends were not paid. It was averred that by April 2001 the 4th

defendant's assets including goodwill were worth Sh.53m.That the 1st defendant then refused to give the plaintiff funds with which to buy new stock and he was forced to quit his management role, while the company owed some creditors including lenders and tax collectors money. That thereafter the 1st defendant caused the 3rd defendant company to be incorporated using the 4th defendant's name and thereby appropriated the latter's premises, equipment etc and has operated the business since then to date. Although it was pleaded that the 1st and 2nd defendants then transferred the 4th defendants assets, equipment, stocks to the 3rd defendant at no cost at, all it transpired that on 20-5-2002 when M/s Gimco Ltd. (instructed by the defendants or the receivers) valued the assets of the 4th defendant they said:

> *"We noted on carrying out physical verification that the following plant and equipment are currently being utilised by Musikland Millenium Ltd., (MML). No formal transfer has b een taken (sic) place."*

That the closure of the 4th defendant's business was for the 1st and 2nd defendants to facilitate the 3rd defendant to defraud the 4th defendant by taking over its business and properties. Further that towards the same end the 1st and 2nd defendants prepared false and fictitious books of accounts for the 4th defendant covering the years 1999 to 2001 understating the company's income, stocks, assets etc. That by such actions the 2nd defendant abused their fiduciary duties to the 4th defendant, misusing and misappropriating its property and allowing strangers to use some without due consent. It was averred in the alternative that the actions of the 1st, 2nd and 3rd defendants were illegal, unlawful and fraudulent of the 4th defendant and what has been alluded to above was reproduced as particulars. The loss suffered by the 4th defendant was particularised to the tune of Sh.75m.

The 26 paragraph plaint was concluded by twelve (12) prayers including declaration that closing the 4th defendant's business and the 3rd defendant acquiring the business premises was unlawful and wrong and that the 3rd defendant be permanently restrained from trading from the said premises. Mandatory injunctions were sought to compel the 3rd defendant to produce and deliver to the 4th defendant its equipment, documents etc it took and for the 1st and 2nd defendants to render an accurate financial statement of affairs over the whole period (since 1995?) and to account and pay up all monies not accounted for.There was a prayer for general damages jointly and severally against the 3 defendants and that they should also personally pay the 4th defendant's creditors. That the 1st and 2nd defendants should jointly and severally pay Sh.75m. to the 4th defendant and that those defendants also pay the costs of the plaintiff and the 4th defendant. This quite wide-ranging plaint was answered by a joint defence of 19-8-02

It began by admitting some formal aspects but struck out quickly to aver that the 4th defendant was under receivership (which has since been lifted). That the 3 defendants held that this court had no jurisdiction to entertain this matter and the plaintiff had no locus standi and thus the suit ought to be struck out in limine. And that this derivative claim was brought with material facts concealed, and thus no leave ought to have been granted ex parte for the plaintiff to continue with this action. That the 4th defendant company was not a partnership but a corporation duly constituted and managed as per the Companies Act. That the 1st defendant was not a director of the 4th defendant and its management was vested in the board of directors according to law. At this point the court, assuming that since 1999, the 1st defendant was no longer a director and/or participating in the management of the company, wonders why he appears to have taken part in the company's meetings e.g. on 30-9-2001 at Serena Hotel when matters relating to the 4th defendant were (also) discussed.Both Manji (1st defendant) as well as his nominee Kumar (2nd defendant) participated! However that his interests were limited to half-shareholding only. The defence added that the plaintiff not only ran the day-to-day operations of the company but also did financial duties e.g. when he with his wife, (Haseena) availed sales receipts, invoices and banking slips. To the 3 defendants, the plaintiff signed the accounts relating to years 1995 to 2001, which were prepared by the company (the 4th defendant) but not the 1st and 2nd defendants.

At this point and at all times the court should remind itself and keep it in mind that it is not deciding the merits or demerits or substance of lack of it of the averments, save to see them side by side (as per the plaint, the defence and affidavits) as to what weighs or not. On this aspect of the accounts between 1995 and 2001, the plaintiff put forth a plea that they were not true or proper. The defendants state in the defence that the plaintiff signed the accounts of 1995 to 1998 or he acknowledged those of 1999 to 2001.

However from a "report" dated 28-1-2000, said but not denied to have been sent to the plaintiff by the 1st defendant from his offices at Mini Bakery, Dandora, Nairobi he said thus of the accounts up to 1998 regarding the 4th defendant (at NRB and MBA):

> "There are no reliable accounts for the period prior to 1998. The statutory accounts are available but these do not provide any reliable detailed information."

In this case what accounts did the plaintiff sign? None were shown to court. Then come the 1999 to 2001 accounts. The plaintiff maintains that they were not acceptable yet the defendants claim that he acknowledged them. Whatever that means, see the plaintiff's letter dated 11-1-2002 directed to the 2nd defendant at the 4th defendant's address:

> *"I refer to your letter of 15 th December 2001. You have produced accounts and returns from the company at the discretion of your employer, the other shareholder (read, Manji, the 1 st defendant) which is totally unacceptable to me as I believe that they are completely inaccurate."*

There was no reponse or clarification from the defendants on this issue. The defendants however put the plaintiff to strict proof over this matter. They also denied understating anything or committing fraud. That the 4th defendant accumulated loss of Sh.1,2 m. as at April 2000 plus a bank overdraft of Sh.18 m. – all which made it impossible to pay dividends.The defence then went over what the 4th defendant owed, was owed or owned in stocks, equipment plus creditors etc and claimed that the plaintiff instead failed to collect Sh.2.59 m. owed by some 2 parties to the 4th defendant, because of being his close acquaintances. That instead the plaintiff mismanaged the 4th defendant and in effect ran it down due to poor investment approach and purchase of stock. The irregular incorporation of the 3rd defendant too was denied or that it was intended to and it took over the 4th defendant's premises assets etc. The quantum of loss as claimed was subject to strict proof by the plaintiff. After forty two paragraphs the court was asked to dismiss the suit.

The hearing of these matters took several days at Milimani Commercial Courts Nairobi and at Mombasa. Arguments were by two very learned counsel noted above, Mr. Oyatsi for the plaintiff and 4th defendant while Mr. Ochieng put up the case of the other defendants. The arguments were long and well researched as per the many authorities each side presented. In essence it is near impossible to claim that the long arguments can be adequately covered by a recap here, let alone authorities. However in doing its best this court endeavors to put as much as is possible from all the above into the following determination based on broad lines and in no particular sequence:

(1) Jurisdiction

(2) Is this a proper derivative suit with the plaintiff competently at the helm?

(3) Is leave (see the motion of 22-7-2002) to be sought before bringing such a suit and is such motion ex parte or ought to be served?

(4) What orders can and do follow the application dated 26-11-2002?

(5) Costs

These broad issues to determine here are not exhaustive and/or exclusive of any relevant aspects touched on during the arguments or other, and it may as well be that all aspects canvassed do not find a place in this determination. Such shall not be as a result of discourtesy to counsel or disregard for the authorities put forth.

(1) Jurisdiction:

After carefully this point as usually the first in all justiciable matters, the court did not find how its

original and unlimited jurisdiction as set out under S.60 of the Constitution of Kenya was lacking

(2) A Derivative Claim:

It is a cardinal principle in company law that it is for the company and not an individual shareholder to enforce rights of action 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 matters **(see Foss vs. 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. **Minority Shareholders: 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 to 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 clai m 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 t he company's rights." (pp. 1)

After hearing submissions at length and going over several of the many authorities placed before this court it is not in doubt that a mere irregularity in internal running of a company cannot be a basis for one to bring a derivative suit for such can be rectified by a vote/resolution at the company's meeting. If a shareholder contemplates using a personal claim of infringement on his rights then a derivative suit will not avail. There are aspects like ultra vires acts, the conduct of the plaintiff shareholder (inequitable or otherwise), if he ratifies the act complained of or not etc all and more which the court looks at to decide whether one should bring such an action or not. The relief sought must be intended for the benefit of the company. That if the suit succeeds the benefit will accrue to the company: itself, all shareholders including even the wrongdoers.

The plaintiff must however place a prima facie case before the court to demonstrate that his move and course is worthy. This brings to the fore the other requirement that the minority shareholder is in a situation where the company is in such control of the wrong-doers that they cannot lend its name to be used as the plaintiff for the wrongs complained of.

In the present case Mr. Ochieng argued this point to the effect that the plaintiff did not fall within the category of those who would competently sue in the manner here. The court considered that position and was satisfied that the plaintiff made out a prima facie case and was thus properly here by way of derivative action and as it should be the company was joined as a defendant. The plaint does not disclose that he was putting up a personal claim disguised as intended for the benefit of the 4th defendant. This is inspite of the depositions in the affidavit in support which spoke of "THE COMPANY'S CREDITORS" and "MY OWN CLAIMS". The plaint confined itself to declarations, injunctions etc for the benefit of the 4th plaintiff as against the various defendants jointly or severally.

It was put forth that the plaintiff's conduct was inequitable in that he participated in illegal acts as to the appointing the 2nd defendant as a nominee and that he signed the company accounts (see above). It has been remarked on earlier that even at this point the defendants did not well counter the position that the plaintiff did not sign or acknowledge the company's accounts between 1995 and 2001. For the first lot the 1st defendant said that there were no reliable accounts as at the end of 1998 and the plaintiff himself wrote in January 2002 to say that the accounts, then in review, were unacceptable and inaccurate. But the court was satisfied that the 3rd defendant was trading in the premises formerly occupied by the 4th defendant along Moi Avenue Nairobi. When receivers were about to move in or were on site they carried out a valuation report (see above M/s Gimco) which observed inter alia that the 3rd defendant was using

the 4th defendant equipment without formal transfer. So by this the plaintiff has shown that not only have its premises been taken over by the 3rd defendant without consent or resolution but that it is similarly using its plant and equipment. The same could be said of the stocks in trade. There was no affidavit evidence from/by the 3rd defendant, to controvert this. The affidavit by the 2nd defendant (in reply to this application) cannot do. The 2nd defendant is neither an officer, a director or a shareholder of the 3rd defendant. He did not even allude to any authority to respond to anything raised here against the 3rd defendant. Thus all matters the plaintiff deponed against that defendant have gone uncontroverted and so admitted.

The court was told that the plaintiff had not exhausted all the internal machinery of the 4th defendant including showing that he could not manage a company meeting to deal with this issue because the majority overwhelmed him. To this the court has this to say: This is a 50-50 shareholding company. The plaintiff held 50% while the 1st defendant with/through the 2nd defendant (Kumar) holds 50%. Now in all fairness would one expect the plaintiff to successfully, by resolution or otherwise, move the other shareholder(s) to allow the company to sue in its name for wrongs against it? Not quite. In this court's view here the proper and equitable way to have the 4th defendant to wage its claims is for the plaintiff to sue on its behalf. A 50-50 situation cannot be described as one where a party is in control and it cannot be such as where the other can move. It remains a stalemate. So in the circumstances we are in, this cannot be a case where the plaintiff has failed to prove that the "majority" shareholders are in control. All he had to demonstrate was that a board resolution was not possible. This suit cannot be struck out. Indeed the defendants have not shown that there are alternative ways or remedies available to the plaintiff or indeed the company.

There was the other issue that the suit was brought when the 4th defendant was under receivership and so it was incompetent. Joffe (above) says this on that subject:

> "When the company is in receivership, a derivative claim will not be available to enable sha reholders to bring proceedings against the receiver in respect of the improper discharge of his duties. This is because there is no reason in principle why the court should not allow the company to sue the receiver in respect of an improper use of his powers. It would also appear that if the debenture pursuant to which the receiver was appointed empowered him to bring proceedings against third parties, no derivative claim would be permitted in relation to those parties."

The same author however adds that where a company is under liquidation a derivative action cannot be brought by minority shareholders because this form of action is only a procedural device which enables proceedings to be brought on behalf of the company notwithstanding that it is under the control of persons who committed or acquiesced in some wrong doing. That cannot be with a company under liquidation.

If Mr. Ochieng meant to impress on the court that being under receivership was a complete defence in such circumstances, or at least when the suit was filed. The court had recourse to the two debentures created in favour of Imperial Bank Ltd., over the 4th defendant's assets. E.g. The one of 15-1-9. It stated at Clause 3 inter alia

> *: "3. The Company as beneficial owner HEREBY CHARGES in favour of the Lender all its undertaking goodwill assets book debts, stocks and property whatsoever …….*"

And that a receiver-manager would exercise all powers given to him under the debenture even generally:

> *"13. (c) To take possession of collect and get in all or any part of the property and assets hereby charged and for that purpose to take proceedings in the name of the company or otherwise as he may deem expedient."*

It was not shown to the court that the debenture(s) allowed the receivers to pursue directors or parties

alleged to have misappropriated or caused the closure of the borrower's (4th defendant's) business including strangers being allowed by a director/shareholder to take over the 4th defendant's premises, stocks, equipment etc. Or for the receivers to insist that those who have to render accounts to the 4th defendant do so. That is what the plaint here is all about and both sides are feuding over these and more. It was not even shown that the receivers when in place followed what the plaint claims. Accordingly this court is unable to accept that the receivership, since lifted, disentitled the plaintiff to bring this suit.

> "In my opinion under the terms of the appointment, the powers conferred upon the receivers and managers did not include the power to take legal proceedings in respect of matters not specifically mentioned, and I am unable to agree with Mr. Binaisa that the com panies could have filed this suit through them."
>
> (See Multi -Holdings ltd. & Another - versus – Uganda Commercial Bank [1971] EA 238)

There was this side issue regarding whether the 4th defendant was run as a partnership and hence to be subjected to the processes used in dissolving such partnerships. While Mr. Oyatsi put up this point to demonstrate how the plaintiff and the 1st defendant had allocated themselves the role to play in the Company's operations, the plaintiff as the manager in charge of sales, purchases and every day operations while the 1st defendant did the accounting, book keeping etc, Mr. Ochieng held a different view. In this court's view nothing much turned on this. It is clear from the documents including notifications, returns etc that the 4th defendant was a limited company and nothing in the circumstances of this case needs make it be treated as if it was a partnership. It is not due for dissolution or other.

We move to the next broad issue.

(3) Leave:

> As seen above on 22-7-2002 the plaintiff filed an application for leave to continue with this cause as a derivative action and for indemnity of costs to be shouldered by the 4th defendant.

Mr. Ochieng argued at length that such leave must precede the instituting of derivative action and that failure to proceed thus made the whole thing invalid. That condition was not complied with by the plaintiff and thus his suit was invalid and had to be dismissed without more, particularly that the plaintiff got the leave after filing the suit

. Mr. Oyatsi held a contrary view. He stressed that the plaintiff's application dated 22-7-2002 was for the court to allow him to continue with the derivative suit and not to file it. That in that application the plaintiff also sought to have the order that the 4th defendant should indemnify him in costs and expenses reasonably incurred in the proceedings. And that the defendants had misconceived this aspect of the proceedings and had neither demonstrated nor shown that in law or by practice the position was as they claimed.

> In approaching this aspect the court again refers to Joffe. Under a subheading "Procedure" before action he says *"There is no approved pre -action protocol in relation to derivatives claims,"*

and that only in cases of extreme urgency is a claimant advised to set out his complaint in a letter before action because of the court's wide discretion as to costs. The learned author then adds that the reason why the plaintiff ought to make the company a defendant in such a claim is that because it is for its (the company) benefit that the cause is brought, the company must be made a defendant (here the 4th defendant). And by that it is bound by a judgment that may follow. There is nonetheless no specific relief sought against it. Then under "Application for permission to continue" with the derivative action Joffe says inter alia:

> *"Before proceeding with a derivative claim a claimant ought to at least be required to*

> *establish a prima facie case (I) t hat the company is entitled to the relief claimed and (ii) that the action falls within the proper boundaries of the exception to the rule o*f **Foss vs. Harbottle** ."

And that also the claimant is entitled to: bring the derivative claim to be determined as a preliminary point at the earliest possible time after commencement of the proceedings. That the process is entirely procedural and no minimum tests or hurdles are set for the claimant to satisfy. All it involves is:

> "….. the onus on the claimant to addu ce 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."

The permission or leave to continue with an action such as this is sought after the suit has been instituted. And substantially all that has been done. Then came the question whether the proceedings in this aspect are ex parte or ought to be after serving the other side. Again we revert to Joffe who continues:

> *"The claim form the application notice and written evidence in support of the application must be served on the defendant within the period within which the claim form is to be served ---------- in any event at least 14 days before the court is to deal with the application."*

In our context the claim form is the plaint and the application is the one to continue the derivative action. May it not be forgotten that Joffe writes specifically for the English courts with their law, procedures and practices. All those may not be applicable here in Kenya. But whether we have the law or procedure covering derivative actions (actually this is an American term – see Gower: **Modern Company Law 3rd Edn. 1969 pp 587)** we are persuaded and inclined to adopt and follow the English courts procedures when derivative actions come calling. So the plaint plus the application for permission to continue with a derivative action must be served before the application is heard. The application has to be heard inter partes because the plaintiff has to demonstrate a prima facie case by the company against the wrong-doing directors and that the plaintiff should bring the case. The service of the plaint and the application affords an opportunity to the defendants in their own pleadings and evidence to try and knock out the intended derivative action. The powers which the court has when hearing the application to continue though not specified, but it can be taken that it can grant the permission all the way up to trial or as it deems fair and just in the matter. And only then can the plaintiff move to the other stages or steps in the cause. Otherwise before the permission, proceedings are virtually stalled.

In our present case, and we are, so far confined to the prayer of the application dated 22-7-2002 (permission to continue) this court is satisfied that the plaintiff ought to have served the defendants with that application for hearing to determine the prayer inter partes. This was not done and so the plaintiff ought not have gotten the ex parte orders to continue with the action on that 22-7-2002. Had that stand been taken up first this court would have been inclined to set that order aside and required the proper process to be put in hand. But here and in the circumstances of the case, all manner of claims, prayers and positions have been heard back and forth. The defendants have argued in full on this and so has the plaintiff. From the stand that the permission should not have been granted ex parte to the fact that a full defence was filed and its merits to traverse the plaint heard, may it be added that the application to strike out the (parts of) the defence was also argued in full as well as the defendants' application to strike out the plaint. No party thus can justifiably claim in the circumstances that the ex parte order to continue with the action is prejudicial and ought to be set aside. The hearing base of a derivative action is cemented in equity. Much as principles, maxims and rules of equity reign it is never in doubt that the ancient basis of discretion underlies them all. So is the case here. Accordingly the ex parte order to continue with this action is not set aside but it is confirmed.

Coming to the next prayer in the application dated 22.7.2002 is the issue of indemnity as to costs. Here again reference is made to Joffe and also the case of **WALLERSTEINER VS. MOIR NO.2 [1975] 1 ALL ER 849.** Joffe says that the court may order the company to indemnify the claimant against any liability in respect of the costs incurred in the claim. And although the time for making an application for such an order is not specified, a claimant can and should obtain such an order at the earliest possible stage. And in Wallersteiner case Lord Denning MR added that the claimant is entitled to get such costs and reasonable expenses paid by the company when acting as an agent of the company, and having relied on reasonable grounds to wage such an action for the benefit of the company, it is only fair and equitable that such a claimant be indemnified by the company accordingly. While in England an application for this order goes to a master, here a judge deals with it. As the case may be, the focus at this point is for the court to decide whether there is a reasonable case for the minority shareholder to bring the suit at the expense of the company. This application is ex parte and Lord Denning said this inste Walleriner case (pp.859 d to f)

> *"In order to be entitled to this indemnity, the minority shareholder soon after issuing his writ should apply for the sanction of the court in somewhat the same way as a trustee does …. In a derivative action I would suggest this procedure: The minority shareholder should apply ex parte to the master for directions, supported by an opinion of counsel, as to whether there is a reasonable case or n ot. The master may then, if he thinks fit, straight away approve the continuance of the proceedings until close of pleadings, or until after discovery or until trial ----. The master need not, however, decide ex parte. He can if he thinks fit, require t o be given one or two of the other minority shareholders – as representatives of the rest – so as to see if there is any reasonable objection. -----. But this preliminary application should be simple and inexpensive. It should not be allowed to escalate into a minor trial."*

So be it. While the plaintiff put two applications in one i.e. for permission to continue with the action and for the sanction of indemnity for costs, the better course appears to have two separate applications, one to be served on the other side while the other is ex parte. In the present case the ex parte order given regarding costs is regular in all ways and need not be made so by this or that explanation.

4.plicatio Orders in the Apn dated 26-11-02

In dealing with this issue i.e. regarding the application under review, it is pertinent from the foregoing to note that prayers (1) and (2) in the defendants notice of motion dated 13-5-2003 and filed here on 14-5-03 have been refused.

As for the first prayer in the plaintiff's chamber summons (dated 26-11- 2002), it sought orders that several paragraphs in the defence be struck out (paras . 5 to 14, 17 to 26, 29 to 41) which would result in judgment being entered for the plaintiffs against the defendants severally and jointly, as the case may be. The court directed attention to the subject paragraphs and the defence responses as both counsel went over them. Then closer focus was put on them when they were set out in this determination. No doubt some strengths as well as weaknesses were noted on either side. The affidavits and annextures relied on were not overlooked either. But at the end of the day this court was satisfied that both main pleadings be left intact and may they form a basis of a trial with evidence (orally) being adduced and the same subjected to the rigours of examination. First, it is not usual that derivative suits feature in litigation in this country. Second, where claims are laid and denials returned, normally proof is better left to the outcome after a trial. Sometimes affidavit evidence may appear extremely attractive as the case was here. But here we even have the added aspect that the replying affidavit by the 2nd defendant to the present application was weak or totally unacceptable in some material aspects. e.g. that deponent did not state or demonstrate sources of his information for instance when he appeared to speak on matters exclusively known to by the 1st defendant.Or indeed the 2nd defendant was not qualified to depone on behalf of the 3rd defendant where he was neither an officer, a shareholder nor director yet Mr. Ochieng sought to impress it on the court that that deponent's single affidavit in reply was competent and good enough. The court was not inclined to accept that. Nonetheless there is a joint defence and the 3 defendants must be accorded an opportunity to argue or testify about what they deny as per the plaint. Affidavit evidence is

good; but oral evidence is better and unless it is in the clearest of cases to strike out a pleading and as it were, shut out a party from being heard on the particular aspect of a case, let him be heard. In any case there were claims by the plaintiff based on estimates or even speculation e.g. Sh.75 m. allegedly lost by the 4th defendant on account of illegal acts of the defendants. Reliance was even placed on documents that could not get near what audited accounts of a company ought to be. Although if liability is given in judgment at this point, proof of loss may follow at the assessment stage (with both sides present) at this point the court is not about to grant the striking out of the parts of the defence to pave way for judgment on liability to the plaintiff followed by assessment of damages. Similarly this court did not accede to the defendants prayer to strike out the plaint as sought.

In sum the main pleadings remain for the basis of a trial, amended or otherwise, and no party gets "summary" judgment at this point.

We move to prayer 2 in the application of 26.11.02: It sought orders against the 3 defendants here in terms of prayers (a) (b) (c) (e) (f) (h) (j) and (k) of the plaint. They were highlighted above and counsel argued why the orders should or should not be granted. This court's views are as follows:

(a) **The closure of the 4th defendant's business and acquisition by the 3rd defendant**: With the material placed before this court against this prayer the court thinks that it came from the 2nd defendant alone who in essence is the 1st defendant's nominee. It had nothing to do with the 3rd defendant. The court is satisfied that the defendants unlawfully closed the 4th defendant's premises and got the 3rd defendant to occupy, and run the premises for its own benefit without the 4th defendant's consent or resolution to sanction the same. Or none was at this point shown to the court. The 4th defendant is entitled to this order.

(b**) The revenue generated by 3rd defendant: No doubt the 3rd defendant** has earned or received revenue during its occupation and use of the 4th defendant's premises on Moi Avenue Nairobi. But proof of this must await trial for it could go one way or the other.

(c) **A Permanent Injunction against the 3rd Defendant**; As at this point this court is satisfied that the 3rd defendant should not be occupying and using the 4th defendant's premises at all. Accordingly only a temporary permanent injunction is granted to the 4th defendant and thus the 3rd defendant is restrained from occupying and using the premises in Cambrian House Moi Avenue Nairobi until the final determination of this suit whereupon it will be said whether to make the injunction permanent or otherwise.

(e) **A Mandatory Injunction for the 1st and 2nd Defendants to produce Accurate books of Accounts:**The defendants told the plaintiff (and here read the 4th defendants) that there were no reliable accounts for the year up to December 1998. And that that plaintiff rejected the rest of the accounts up to 2001 as inaccurate. If these defendants maintain as they do in their case that the books were maintained in accordance with the Companies Act then they should in 30 days be in a position to avail the duly audited and certified accounts over the period to the plaintiff on behalf of the 4th defendant. These should be more complete with tax returns and what was filed with the Registrar of Companies annually.

(f) **All 4th defendants Property, Assets, Stocks**: The court is also minded to order, particularly that the receivership was lifted that all the property, assets, books, records and documents of the company be delivered up to the 4th defendant. That is fair and proper in the circumstances and here 60 days should do.

(h) **Paying the 4th Defendant's Creditors**: May this await the trial. Probably during receivership this was done.

(j) (k): **Costs of the suit plus damages and interest**: These have to await the outcome of the trial.

(5) **Costs**: Both sides were agreed that by the way the hearing of this application has been conducted,

costs be awarded on an allindemnity- basis. Mr. Oyatsi however added that those costs be on a higher scale.

The court appreciates the great energy, research and commitment with which both sides handled this application or applications. However it is of the view that costs will be based on the normal rates but on an all-indemnity-basis. In conclusion it is stated thus:

(a) The plaintiff has made out a case for this derivative claim to be laid and pursued to the end.

(b) The proper way to lay a derivative action is to begin with filing the suit, then following it with an application to be served along with the plaint, followed by the court hearing and determining whether the plaintiff should continue with the action.

(c) At any time, and desirably as soon as the proceedings are instituted, the plaintiff to move the court ex parte for orders of indemnity as to costs.

(d) Prayers (a) (c) (e) (f) in the present application are granted in the terms (see above).

(e) Costs in the normal rates to the plaintiff but on an allindemnity- bases.

Orders accordingly.

Dated and Delivered at Nairobi this 5th day of February, 2004.

J.W. MWERA

JUDGE