



**Muchina & another v Zhigang & another (Commercial Suit E103 of 2022)  
[2023] KEHC 23197 (KLR) (Commercial and Tax) (6 October 2023) (Ruling)**

Neutral citation: [2023] KEHC 23197 (KLR)

**REPUBLIC OF KENYA  
IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)  
COMMERCIAL AND TAX  
COMMERCIAL SUIT E103 OF 2022  
FG MUGAMBI, J  
OCTOBER 6, 2023**

**BETWEEN**

**HARRISON MUCHINA ..... 1<sup>ST</sup> APPLICANT**

**CAREPLUS LIMITED ..... 2<sup>ND</sup> APPLICANT**

**AND**

**LIU ZHIGANG ..... 1<sup>ST</sup> RESPONDENT**

**PHILIP KIMUTAT KIBOR ..... 2<sup>ND</sup> RESPONDENT**

**RULING**

**Background**

1. Before the court is the application dated 29<sup>th</sup> March 2022. It is brought under sections 238 and 239 of the *Companies Act* (the Act), The *Companies (General) Regulations* 2015, order 51 rule 1 of the Civil Procedure Rules and sections 1A, 2B, 3 and 3A of the *Civil Procedure Act* and article 159(2) of the *Constitution* of Kenya. The application seeks leave to continue a derivative claim seeking relief on behalf of Careplus Limited, the 2<sup>nd</sup> applicant.
2. The application was premised on the grounds stated on the face of the application as well as on the annexed affidavit sworn by Harrison Ndugire Muchina, the 1<sup>st</sup> applicant who was a managing director and a minority shareholder of the 2<sup>nd</sup> applicant.
3. The 1<sup>st</sup> applicant takes issue with being unilaterally locked out and barred from accessing the Company premises. He also raised concerns about illegal hoarding of the Company's pharmaceutical products leading to their expiry, failure by the Company to submit financial accounts since 2020 as well as the failure to hold shareholders' meetings since 2018.



4. These actions according to the applicant, pose danger to the Company and are detrimental to the recipients of its supplies noting that the Company deals in pharmaceutical products which directly affect the lives of consumers. He raised concerns that the business of the 2<sup>nd</sup> applicant was being operated without the presence of a qualified pharmacist as required by the Pharmacy and Poisons Board of Kenya.
5. He stated that the respondents do not possess the qualifications necessary for the running of the Company which trades in pharmaceuticals calling for specialized knowledge and skill. For these reasons he sought leave to sustain the derivative suit on behalf of the 2<sup>nd</sup> applicant.
6. The application was opposed by the replying affidavit and supplementary affidavit both sworn by Liu Zhigang. The respondents accused the 1<sup>st</sup> applicant of cover up for illegalities and improprieties propagated by himself while at the helm of the Company between 2017 until his ouster in 2022. The respondents accused the 1<sup>st</sup> applicant of siphoning Company money and engaging in direct business competition with the 2<sup>nd</sup> applicant.
7. The respondents denied any negligent action, default or breach of duty to warrant the prayers sought by the applicant. They acknowledged that they were forced to take over control of the Company to stop the misappropriation of funds.
8. On the injunctive orders sought, the respondents stated that any injunctive orders would be disastrous to the Company and would adversely affect it through exposure to incalculable losses which it may be unable to recover from especially in the prevailing difficult economic conditions.

### Analysis

9. I have carefully considered the pleadings, responses and submissions made by rival parties. Whether the court should grant permission to the applicants to proceed with this suit as a derivative suit is governed by sections 238 and 239 of the Act. By dint of section 238 (1) of the Act, a derivative claim is that which is brought by a member of a Company in respect of a cause of action vested in the Company, seeking relief on behalf of the Company.
10. Of critical importance is that derivative suits are meant to protect the legal interests of the Company by seeking to redress a wrong done to the Company. A derivative action is therefore an exception to the rule established under *Foss v Harbottle*, (1843) 2 Hare 462 that a corporation should sue in its own name and in its corporate character or in the name of the person appointed by the law to be its representative.
11. Under section 238 (1) of the Act, an applicant must establish that he is a member of a Company, that the cause of action is vested in the Company and, the reliefs sought must be on behalf of the Company for its own benefit and not for personal gain or benefit. This Court has previously held that these requirements are not independent of each other.
12. The objective of derivative claims was well explained in *Ghelani Metals Limited & 3 Others v Elesh Ghelani Natwaral & Another*, [2017] eKLR. The Court held that:

“Derivative actions are the pillars of corporate litigation. As I understand it, a derivative action is a mechanism which allows shareholder(s) to litigate on behalf of the corporation often against an insider (whether a director, majority shareholder or other officer) or a third party, whose action has allegedly injured the corporation. The action is designed as a tool of accountability to ensure redress is obtained against all wrongdoers, in the form of a representative suit filed by a shareholder on behalf of a corporation”.



13. Under section 239(1) of the Act, a person intending to sue on behalf of the Company is required to seek leave of the Court. The Court of Appeal held in the case of Amin Akberali Manji & 2 Others v Altaf Abdulrasul Dadani, [2015] eKLR as follows:

“Leave of court shall be obtained before filing a derivative suit, but may be obtained to continue with the suit once filed.... It is our view that at whatever stage leave is sought, the crucial requirement is for the applicant to establish a prima facie case demonstrating that he has *locus standi* to institute such action falls within any of the exceptions to the rule of Foss v Harbottle.”

14. The essence of judicial approval under the Act is to screen out frivolous claims. The court is only to allow meritorious claims as was held in Ghelani Metals Limited. In reaching a determination on leave to proceed with the derivative action, the Court is guided by the considerations stipulated in section 241(2) of the Act. These were articulated by the Court quite comprehensively in Isaiab Waweru Njumi & 2 others Muturi Ndungu, [2016] eKLR. The Court set out the following factors to be considered in such an application:

- i. Whether the plaintiff has pleaded particularized facts which plausibly reveal a cause of action against the proposed defendants;
- ii. If the pleaded cause of action is against the directors, the pleaded facts must be sufficiently particularized to create a reasonable doubt whether the board of directors’ challenged actions or omissions deserve protection under the business judgment rule in determining whether they breached their duty of care or loyalty;
- iii. Whether the plaintiff has made any effort to bring about the action the plaintiff desires from the directors or from the shareholders. Our courts have developed this into a demand or futility requirement where a plaintiff is required to either demonstrate that they made a demand on the board of directors or such a demand is excused;
- iv. Whether the plaintiff fairly and adequately represents the interests of the shareholders similarly situated or the corporation. Hence, a shareholder seeking to bring a derivative suit in order to pursue a personal vendetta or private claim should not be granted leave. In the American case of *Recchion v Kirby* 637 F Supp 1309 (W D Pa 1986), for example, the Court declined to let a derivative lawsuit proceed where there was evidence that it was brought for use as leverage in plaintiff’s personal lawsuit;
- v. Whether the Plaintiff is acting in good faith;
- vi. Whether the action taken by the Plaintiff is consistent with one a faithful director acting in adherence to the duty to promote the success of the Company would take;
- vii. The extent to which the action complained against – if the complaint is one of lack of authority by the shareholders or the Company – is likely to be authorized or ratified by the Company in the future; and
- viii. Whether the cause of action contemplated is one that the Plaintiff could bring as a director as opposed to a derivative action.

15. In Ghelani Metals Limited (*supra*), the Court held that this is a two-stage enquiry process envisaged by the Act. In the first stage, the court must first satisfy itself that there is a *prima facie* case on any of the causes of action noted under section 238(3) of the Act. To surmount the first stage, an applicant



only needs to establish through evidence, that he has a prima facie case without the need to show that it will succeed. (See *Mrao Limited v First American Bank of Kenya Ltd & 2 Others*, [2003] eKLR).

16. Against this background and on the face of it, the applicant has particularized his claim against the respondents in his plaint. I am satisfied that the particulars disclose sufficient cause to demonstrate that a right belonging to one party has been breached and which should be subjected to the rigours of examination. For the avoidance of doubt, the plaint raises the following particularized claims:
- i. Illegal termination of the managing director without following the procedure provided in law and barred him from accessing the Company premises.
  - ii. Illegal operation of the core business of the Company without the presence of a qualified pharmacist / chemist as required by the Pharmacy and Poisons Board of Kenya thus putting consumers at risk.
  - iii. Granting a Power of Attorney to strangers who are subordinates to the 1<sup>st</sup> plaintiff to manage the Company in the 1<sup>st</sup> plaintiff's existence at the expense of the Company and without due procedure.
  - iv. Illegal hoarding of the Company's pharmaceutical products which will lead to their expiry hence putting the public at risk of consuming expired drugs.
  - v. Causing the police to stop the 1<sup>st</sup> plaintiff from accessing the office premises of the Company
  - vi. Threatening to break into the warehouse managed by the 1<sup>st</sup> plaintiff to interfere with the Company's stock which would be detrimental to the Company, its employees and consumers.
17. Having surmounted this first enquiry stage, section 241(2) sets in, to establish whether the 1<sup>st</sup> applicant can sustain the claims raised in the plaint, by a derivative action. I shall now proceed to analyze the facts and evidence before the Court against these well-established principles and the law. It is not disputed that the 1<sup>st</sup> applicant is a member of the 2<sup>nd</sup> applicant by dint of sections 238(6) and 239(1) of the *Act*.
18. A cursory look at the record confirms that the 1<sup>st</sup> applicant served as the 2<sup>nd</sup> applicant's managing director between 2017 and 2022 carrying out general management of the Company. Having been at the helm of the Company, he was therefore aware of the malpractices that he now pleads against the Company. He has not demonstrated in his pleadings that he called out the Directors at that time over the irregularities which he now complains about.
19. In the American decision of *Recchion, Westinghouse Elec. Corp. v Kirby*, 637 F. Supp. 1309, 1313 (W.D. Pa. 1986), the Court was faced with an almost similar situation. It- dismissed an application for leave to institute a derivative suit noting that:
- “Recchion participated in the alleged improper accounting practices at the direction of his supervisor, although he knew that they were in violation of generally accepted accounting principles.”
20. Being a Director, the 1<sup>st</sup> applicant owed the Company fiduciary duties of good faith and loyalty and also owed a duty of care and skill in the discharge of his duties. He failed to exercise these. I am troubled by the fact that the 1<sup>st</sup> applicant waited to leave the employment of the 2<sup>nd</sup> applicant before blowing the whistle about hoarding of pharmaceutical products by the 2<sup>nd</sup> applicant. He was also aware of the violation of the financial reporting requirements by the 2<sup>nd</sup> applicant and did nothing about this. It would therefore seem to me that the 1<sup>st</sup> applicant took part in the irregularities that he complains about.



21. I also note that the applicant seeks injunctive orders against being kept out of the management of the 2<sup>nd</sup> applicant. The Court has already pronounced itself on the question regarding the 1<sup>st</sup> applicant's removal as managing director and shareholder of the 2<sup>nd</sup> respondent. This was in Careplus Limited v Ndugire (Miscellaneous Application E832 of 2021), [2022] KEHC 225 (KLR) (Mwita J).
22. This, together with the dispute regarding the 1<sup>st</sup> applicant's shareholding are matters that the 1<sup>st</sup> applicant ought to pursue in his personal capacity which may be more efficacious than a derivative suit. I state this noting that the Court held that the 2<sup>nd</sup> applicant did not follow the law in the removal of the 1<sup>st</sup> applicant. In reaching this decision the Court further noted that under section 139 of the Act, a Company may by ordinary resolution remove a director before the end of the director's term.
23. In order to do so, the Court advised that a special notice was required for such a resolution. This confirms the fact that the 2<sup>nd</sup> applicant was within its powers to remove the 1<sup>st</sup> applicant so long as the right procedure was followed. This being the case and noting that the Company reserved the right to ratify the 1<sup>st</sup> applicant's removal in the future, meant that the dispute was not fit for derivative action.
24. Finally, and from the totality of all that I have said, I am left doubtful that the suit that the 1<sup>st</sup> applicant seeks to institute will be for the benefit of the Company. It would appear to me that the suit is for the 1<sup>st</sup> applicant's own benefit, possibly for purposes of settling scores, having been ousted from his position at the Company. In my view, while the reliefs will benefit the Company nominally, the true beneficiary will be the 1<sup>st</sup> applicant. I find that the suit is therefore brought in bad faith.

#### **Determination**

25. For all the reasons that I have stated, I decline to grant leave to the plaintiff to continue with this suit as a derivative action. I find and hold that the applicant has failed to substantiate his claim under sections 238, 239 and 241 of the Companies Act. I dismiss the application dated 29<sup>th</sup> March 2022 with costs to the respondents.

**DATED, SIGNED AND DELIVERED IN NAIROBI THIS 6<sup>TH</sup> DAY OF OCTOBER 2023**

**F. MUGAMBI**

**JUDGE**

