REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

COMMERCIAL AND ADMIRALTY COURTS

CIVIL SUIT NO. 107 OF 2014

ASTERISK LIMITED.....PLAINTIFF

VERSUS

HUMMING HEALTHCARE LIMITED.....DEFENDANT

R U L I N G

1. This is a ruling on the Motion on Notice dated 20/2/2018. It was brought ***under Order 51 Rule 1 of the Civil Procedure Rules, 2010 and section 3A Civil Procedure Act, Cap 21 of the Laws of Kenya.***

2. The application sought leave to execute the decree herein against **Nazmina Popat, Nawaz Popat, Nadeem Popat and Narina Popat,** the directors of the defendant.

3. The grounds upon which the application was predicated upon were that; on 14/9/2015, the plaintiff obtained judgment against the defendant for Kshs. 984,758/=, USD 123,281.00 and USD 25,000, respectively. A decree issued thereon could not be executed because the defendant was put into liquidation by its receiver manager shortly thereafter.

4. The plaintiff contended that the directors of the defendant had perpetrated several acts of fraud which resulted in the debt the subject of the decree. These included; entering into a contract with the plaintiff for the supply of medical equipment with full knowledge that the defendant was unable to pay the purchase price for the goods; entering into a settlement agreement for payment of the plaintiff's claim with knowledge of the defendant's inability to pay and failure to disclose to the plaintiff that the defendant was at a risk of being put under receivership.

5. Others included the defendant's withdrawal of the offer to transfer 10% shares in the defendant to the plaintiff on 11/4/2013, entering into a Buy-Back Agreement with the plaintiff on 8/9/2012 with knowledge of the defendant's inability to fulfil its obligations therein, obtaining a loan from KCB with knowledge of the defendant's inability to pay and the filing of a petition dated 17/5/2013 by one of the defendant's shareholders, **Rohit Reddy,** to wind up the defendant.

6. The application was opposed vide a lengthy replying affidavit of **Nazmina Popat** sworn on 24/7/2018 on her own behalf and on behalf of the other directors. She contended that **Narina Popat** was only a shareholder with 150 shares which had already been paid up to the defendant with no further liability to it. That she was never a director and was not involved in the daily running of the defendant.

7. On the allegation of fraud, it was contended that at the time the defendant entered into contractual relationship with the plaintiff, it was able to pay the purchase price. That it paid the purchase price for the supplied goods and subsequent maintenance of the medical equipment.

8. That the debt which resulted in the decree arose out of the USD 100,000 owed to the plaintiff for the purchase of 10% equity shareholding in the defendant, which never materialized. That it was therefore not for the contract for the supply of goods.

9. That the directors had not signed any settlement agreement for the claim. That the letter dated 23/11/2012 sent to the plaintiff by one of the directors was just an assurance that the debt owed would be settled.

10. It was further contended that at the time of taking out the loan with KCB, the defendant had been in business for three years and diligently serviced the loan for one year. That the Buy-Back Agreement between the bank and the parties was a condition for granting the loan. That the financial difficulties that the defendant faced later on were unforeseen. These are the ones that prompted the bank to put the defendant under receivership for default.

11. That the defendant was a limited company and the plaintiff could not therefore seek execution against its members. That the defendant legitimately carried out business without any intent to defraud its creditors.

12. The application was also opposed vide a replying affidavit of **Rohit Reddy** sworn on 5/2/2019 on his own behalf and on behalf of **Dropa Sandhu**. He averred that he was a non-executive director. That he and **Dropa Sandhu** were shareholders holding a mere 15% shareholding in the form of 150 paid up shares each.

13. That he had resigned from the directorship of the defendant on 31/12/2012, whereas Dropa resigned from her position in the company as a Manager on the same date. That the agreement leading to the judgment debt was entered into by the plaintiff and defendant on 3/10/2014 by which time both he and **Dropa** had resigned. That they did not participate in the agreement and that they did not commit any fraud complained of.

14. The parties filed their respective submissions which the Court has carefully considered. It was submitted for the plaintiff that; a case for the lifting of the defendant's corporate veil had been made to allow recovery of the judgment debt against the defendant's directors.

15. That the defendant's assets were liquidated and sold on 31/3/2015. That the receiver manager's report on the statement of affairs of the defendant confirmed that the defendant had not traded profitably from the date it commenced operations resulting in the appointment of a receiver.

16. It was further submitted that the directors carried out operations of the defendant whilst passing it off as able to incur and pay debts to the plaintiff. But for the presentation, the plaintiff would not have conducted business with the defendant. It was clear from the defendant's accounts that the medical equipment were the defendant's most valuable assets.

17. That the act of carrying on a loss making business whilst incurring liability from innocent parties was unjust. The case of **Multichoice Kenya Limited vs Mainkam Limited & Anor (2013) Eklr** was relied on for that submission**.** That the plaintiff was unlikely to recover from the defendant after its liquidation and sale of assets.

18. On behalf of the directors, it was submitted that **Narina Popat** was a shareholder of the defendant and not a director. That the nominal value of her 150 shares had been paid off and she was not liable to any further payments and was not liable for the defendant's debts. That **Nawaz Popat** was a non-executive director and not involved in the running and decision making of the company. That **Nadeem Popat** joined the company in March, 2013 and was not a member of the company in 2012.

19. It was further submitted that the plaintiff had not made a case for the lifting the corporate veil. That the allegation of fraud was general and non-specific to assign any guilt on the directors. That the fact that a company made losses *perse* was not an indicator of fraud.

20. **Rohit Reddy and Dopra Sandhu** similarly filed their submissions dated 28/5/2020. They submitted that the plaintiff's case was inadequate to warrant the lifting of the corporate veil. That they had voluntarily resigned as directors before the events leading up to the suit took place.

21. The sole issue for determination is *whether the plaintiff made a case for lifting the corporate veil.* It is trite law and as established in **Salomon & Co Ltd vs Salomon (1897) AC, 22. HL** that a company is a separate legal entity from its members. However, from time to time, courts have moved away from this position and held the directors and members of a company liable for a company's actions/debts.

22. At paragraph 10 of **Halsbury's law of England 4th edition,** the learned writers observe: -

> ***"Notwithstanding the effect of a Company's Incorporation, in some cases, the court will 'pierce the corporate veil' in order to enable it to do justice by treating a particular company for the purpose of the litigation before it, as identical with the persons who control that company. This will be done not only where there is fraud or improper conduct but in all cases where the character of the company, or the nature of the persons who control it, is a relevant feature. In such cases the court will go behind the mere status of the company as a separate legal entity distinct from its shareholders and will consider who are the persons as shareholders or even as agents directing and controlling the activities of the company"***

23. In **Mugenyi & Company Advocates vs. The Attorney General [1999] 2 EA 199,** the Court quoted **Palmers Company Law** with approval on the 10 instances in which the veil of corporate personality may be lifted as follows: -

> ***1. Where companies are in the relationship of holding and subsidiary companies'***
>
> ***2. Where a shareholder has lost the privilege of limited liability and has become directly liable to certain creditors on the ground that business continued after the membership had dropped below the legal minimum, to the knowledge of the shareholder;***
>
> ***3. In certain matters relating to taxation;***
>
> ***4. In the law relating to exchange control;***
>
> ***5. In the law relating to trading with the enemy;***
>
> ***6. In the law of merger control in the United Kingdom;***

7. In competition of the European Economic Community;

8. In abuse of law in certain circumstances;

9. Where the device of incorporation is used for some illegal or improper purpose; and

10. Where the private company is founded on personal relationship between the members.

24. In **Kolaba Enterprises Ltd vs. Shamsudin Hussein Varvani & Ano (2014) Eklr,** the court held: -

> ***"It should be appreciated that the separate corporate personality is the best legal innovation ever in company law. See the famous case of SALOMON & CO LTD v SALOMON [1897] A.C. 22 H.L that a company is different person altogether from its subscribers and directors. Although it is a fiction of the law, it still is as important for all purposes and intents in any proceedings where a company is involved. Needless to say, that separate legal personality of a company can never be departed from except in instances where the statute or the law provides for the lifting or piercing of the corporate veil, say when the directors or members of the company are using the company as a vehicle to commit fraud or other criminal activities".***

25. And in **Multichoice Kenya Ltd v Mainkam Ltd & Anor. (2013) Eklr,** it was held: -

> ***"I agree that directors are generally not personally liable on contracts purporting to bind their company. If the directors have authority to make a contract, then only the company is liable on it. To my mind, there is no doubt that ever since the famous case of Salomon v Salomon (1897) A.C. 22, Courts have applied the principle of corporate personality strictly. But exceptions to the principle have also been made where it is too flagrantly opposed to justice or convenience. Other instances include when a fraudulent and improper design by scheming directors or shareholders is imputed. In such exceptional cases, the law either goes behind the corporate personality to the individual members or regards the subsidiary and its holding company as one entity."***

26. In this regard, that fundamental principle of incorporation may be disregarded, lifted, or pierced in exceptional circumstances both under express statutory provisions and under judicial interpretation or intervention. As regards the latter, case law has established the broad principle that the corporate veil will be lifted by the courts if, among other situations, corporate personality is being used as a mask for fraud or improper conduct.

27. In this case, it was the plaintiff's case that the defendant's directors, despite knowing that the company was operating at a loss, entered into a contract for the supply of medical equipment. It further contended that the director's entered into a settlement agreement with knowledge that the defendant was unable to pay off the debt.

28. It is not in dispute that after the company was liquidated and its assets sold off, there was no surplus to pay the plaintiff's unsecured claim. The directors contended that, the plaintiff was aware that the defendant had taken a secured loan with KCB, which, as a secured creditor, had a right to place the defendant under receivership without the director's approval.

29. It cannot be the case that the plaintiff could envision that the defendant would take loans, default and be subsequently liquidated. Quite the opposite, the plaintiff's expectation could only be that the defendant would be run in a prudent manner that would enable it to repay its debts.

30. The circumstances of this case point towards improper conduct on the part of the defendant's director's. It is not just a simple case where the company made abrupt losses that led to its winding up. This is a case where the defendant's directors entered into financial obligations with knowledge of the struggling financial status of the defendant. I note the receiver manager's report concluded that the company registered losses right from incorporation.

31. The defendant's ability to dutifully pay loan facilities or settle creditor's debts was doubtful from the very beginning. This is borne by the report of the receiver manager. This is a fact that must have been at all times within the knowledge of the directors who still proceeded to make financial commitments with unsuspecting parties the plaintiff included. This must be but improper conduct on the part of the said directors.

32. I take note of the director's exhibit produced as **"NP6"** in the replying affidavit of 24/7/2019. It is a letter dated 3/5/2013 from KCB to the defendant's directors. It raised concerns that the directors had failed to perform one of the conditions upon which the loan facility by KCB was granted. The directors had undertaken to settle the issue of the impending change in the directorship of the defendant within 45 days from the date of disbarment. The directors failed to do so despite having benefited from the loan facility. This again raises doubt on the conduct of the directors. It demonstrates improper conduct on their part.

33. In view of the foregoing, I find that this is a proper case that calls for the lifting of the corporate veil. In so doing, this court will treat the defendant as being identical with its directors who controlled its operations. This is on the ground of the improper conduct by the directors as established above.

34. Rohit Reddy and Dropa Sandhu submitted that they had already resigned from their positions in the defendant as at 31/12/2012. I have seen the resignation notices of 19/12/2012, and the bundle of correspondence marked as "**RR-5"** between the directors of the company, and **Rohit** and **Dropa,** where their resignation was discussed in detail. I also note that **Rohit Reddy** instituted winding up proceedings as against the defendant for non-payment of their respective shares.

35. The contractual agreement leading to the judgment in this case was entered on 3/10/2014. As at that time, **Rohit Reddy and Dropa Sandhu** were not in control of the defendant. They cannot therefore, in the circumstances, be liable for any debts incurred subsequent to their resignation.

36. It is not in dispute that the plaintiff obtained judgment as against the defendant on 14/9/2015. The events leading to the same were orchestrated by the directors of the defendant. They very well knew what they were doing.

37. In this regard, I am convinced that the application is well founded. I allow the same as prayed save that **Rohit Reddy** and **Dropa Sandhu** are excluded therefrom.

38. The plaintiff shall have costs of the application.

It is so ordered.

DATED and **DELIVERED** at Nairobi this 1st day of July, 2021.

A. MABEYA, FCI Arb

JUDGE