



**Dande v Capital Markets Authority; Cytonn Asset Managers Limited & another (Interested Parties) (Petition E283 of 2020) [2021] KEHC 297 (KLR) (Commercial and Tax) (17 November 2021) (Ruling)**

Neutral citation: [2021] KEHC 297 (KLR)

**REPUBLIC OF KENYA  
IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)  
COMMERCIAL AND TAX  
PETITION E283 OF 2020**

**F TUIYOTT, J**

**NOVEMBER 17, 2021**

**IN THE MATTER OF: ALLEGED VIOLATION AND INFRINGEMENT OF THE RIGHTS AND FREEDOMS IN ARTICLES 2, 3, 10, 19, 20, 21, 22(1), 23, 27, 28, 40, 47 48, 50 (1) &(2), 73, 75, 258 (1) & 259 (1) OF THE CONSTITUTION OF KENYA;**

**AND**

**IN THE MATTER OF: ALLEGED VIOLATION OF THE CAPITAL MARKETS ACT;**

**AND**

**IN THE MATTER OF: ALLEGED VIOLATION OF THE CAPITAL MARKETS (COLLECTIVE INVESTMENT SCHEMES) REGULATIONS, 2001;**

**AND**

**IN THE MATTER OF: THE FAIR ADMINISTRATION ACTION ACT, 2015.**

**BETWEEN**

**EDWIN H DANDE ..... PETITIONER**

**AND**

**CAPITAL MARKETS AUTHORITY ..... RESPONDENT**

**AND**



CYTONN ASSET MANAGERS LIMITED ..... INTERESTED PARTY

CYTONN HIGH YIELD FUND ..... INTERESTED PARTY

**The burden of proof in demonstrating non-breach of investment limitations alleged by the CMA is on the petitioner**

*The CMA directed Cytonn High Yield Fund to limit related-party investments to 10%, citing regulatory compliance and investor protection. Cytonn challenged that as illegal, arguing it violated their fund's structure. The court ruled that Cytonn failed to prove it was not in breach of regulations or that CMA violated statute/constitution. Consequently, the court dismissed Cytonn's application, affirming that courts should not interfere with regulatory mandates without a prima facie case of clear breach.*

Reported by John Ribia

**Capital Markets Law** - Collective Investment Schemes – investment limitations - whether the Cytonn High Yield Fund's investment structure and activities fell within the purview of the Capital Markets (Collective Investment Schemes) Regulations 2001, particularly concerning related-party investment limitations - whether the High Court could interfere with Capital Market Authority's body exercise of its statutory mandate concerning the enforcement of the Capital Markets (Collective Investment Schemes) Regulations, where a Fund Manager had not demonstrated a prima facie case of clear breach of statute or constitutional provisions by the regulatory authority - Capital Markets Act (Cap 485 A) section 11; Capital Markets (Collective Investment Schemes) Regulations 2001 (Cap 485A Sub Leg) regulation 16(2)

**Law of Evidence** – burden of proof – burden of proof in specialized administrative proceedings – Capital Markets Authority – Collective Investment Schemes – investment limitations – burden of proof in claims of violation of investment limitations - which party bore the burden of demonstrating compliance with statutory investment limitations, specifically concerning the proportion of funds invested in related entities, when the Capital Markets Authority issues a directive based on alleged non-compliance – Capital Markets Act (Cap 485 A) section 11; Capital Markets (Collective Investment Schemes) Regulations 2001 (Cap 485A Sub Leg) regulation 16(2)

**Brief facts**

Cytonn High Yield Fund (CHYF), a unit fund regulated by the Capital Markets Authority (CMA), faced a dispute regarding CMA directives. On June 3, 2020, the CMA instructed Cytonn Asset Managers Limited (Fund Manager) to limit its investments in Cytonn-related projects to 10% of its portfolio, citing regulation 16(2) of the Collective Investment Schemes Regulations. The directive, reinforced by an email from the fund's trustee, froze investments in SBM Bank and Cytonn affiliated notes.

The Fund Manager criticized the directive as malicious and illegal, arguing it contradicted the fund's Trust Deed and initial CMA consents, which permitted up to 80% investment in Cytonn-related projects. They claimed the directive was commercially impractical, prejudiced investors' property rights, and was issued without adequate notice or stakeholder consultation.

The CMA responded that the directive stemmed from the Fund Manager's February 2020 application for an exemption to investment limits, which was denied due to high concentration risk if further waivers were granted. CMA asserted its mandate to protect investor interests and ensure compliance with regulations, arguing the Fund Manager was investing in related entities and thus subject to the 10% limit.

**Issues**

- i. Whether the Cytonn High Yield Fund's investment structure and activities fell within the purview of regulation 16(2) of the Capital Markets (Collective Investment Schemes) Regulations 2001, particularly concerning related-party investment limitations



- ii. Whether the High Court could interfere with Capital Market Authority's body exercise of its statutory mandate concerning the enforcement of the Capital Markets (Collective Investment Schemes) Regulations, where a Fund Manager had not demonstrated a *prima facie* case of clear breach of statute or constitutional provisions by the regulatory authority.
- iii. Which party bore the burden of demonstrating compliance with statutory investment limitations, specifically concerning the proportion of funds invested in related entities, when the Capital Markets Authority issues a directive based on alleged non-compliance.

### **Held**

1. The onus was on the petitioner to show that the investments from the fund had not been made in a related company and if they were, then the investments were limited to 10% of the total funds managed by the Fund Manager.
2. In a letter of August 4, 2020, Cytonn Investment Management PLC referring itself as the principal partner confirmed that Cytonn High Yield Fund had investments in Cytonn Money Market Fund. The court had not seen sufficient effort by the petitioner to demonstrate that the investments did not breach the provisions of regulation 16(2) of the CIS regulation 2001.
3. A principal objective of the Capital Markets Authority was to protect investor interests. It had power to license, approve and regulate private equity and venture capital companies that had access to public funds. In the letter of June 3, 2020 CMA simply reminded the Fund Manager to comply with regulation 16(2) of the CIS regulation.
4. In so far as the petitioner had not established that the Fund Manager was not in breach of that regulation, the court was unable to hold that the petitioner had made out a *prima facie* case with a likelihood of success. Courts should not interfere with the manner in which public bodies discharge or carry out their mandate unless they did so in clear breach of statute or the constitution.

*Application dismissed with costs.*

### **Citations**

#### **Statutes**

1. Capital Markets Act (Cap. 485A) — section 11(1)(a); 11(3)(9a) — Interpreted
2. Capital Markets (Collective Investment Scheme) Regulation 2001 (cap 485A) — regulation 16(2); 78(2)(c) — Interpreted
3. Companies Act Repealed (Cap 486) — section 154, 152 — Interpreted

#### **Advocates**

None mentioned

## **RULING**

1. Cytonn High Yield Fund (CHYF) is a unit fund established and regulated by the [\*Capital Markets \(Collective Investment Scheme\) Regulation 2001\*](#). This petition is in respect to certain directives issued by the regulator, The Capital Markets Authority (CMA) regarding the fund.
2. What is now before court is the notice of motion dated August 10, 2020 for the following orders:-
  1. ....
  2. This Honourable Court be pleased and do hereby suspend the purported malicious directive dated 3<sup>rd</sup> June 2020 and the subsequent email dated Mon June 15, 2020 limiting the 1<sup>st</sup> Interested Party, to invest not more than 10% of funds in its portfolio and subsequently freezing any investment of the funds held in SBM Bank awaiting a further directive from the Respondent, pending the hearing and determination of this application.



3. This Honourable Court be pleased and do hereby suspend the purported malicious directive dated June 3, 2020 and the subsequent email dated Mon June 15, 2020 limiting the 1<sup>st</sup> Interested Party, to invest not more than 10% of funds in its portfolio and subsequently freezing any investment of the funds held in SBM Bank awaiting a further directive from the respondent, pending the hearing and determination of the Petition.
  4. A conservatory order do issue staying the respondent's decision to limit the investment of the 2<sup>nd</sup> interested party's portfolio funds to 10% and its further directive through the Trustee not to allow the 1<sup>st</sup> Interested Party to invest any further funds held at SBM Bank and in Cytonn affiliated notes pending the hearing and determination of this application.
  5. A conservatory order do issue staying the respondent's decision to limit the investment of the 2<sup>nd</sup> interested party's portfolio funds to 10% and its further directive through the Trustee not to allow the 1<sup>st</sup> interested party to invest any further funds held at SBM Bank and in Cytonn affiliated notes pending the hearing and determination of this petition.
  6. The costs of this application be provided for.
3. The case by the petitioner is that vide a letter dated June 3, 2020, CMA wrote to Cytonn Asset Managers Limited (the Fund Manager) directing that the Fund Manager should align its investment products and activities of the fund with the provisions of regulation 16(2) of the *Capital Markets (Collective Investment Schemes) Regulations 2001* as read together with regulation 78. The effect of the directive was that the Fund Manager was to only invest 10% of funds in its portfolio in Cytonn related projects.
  4. Pursuant to that directive, the Fund Manager received an email sent on June 15, 2020 from Natbank who are the trustees of the fund making reference to the letter dated June 3, 2020 in which it ordered the Fund Manager not to invest any funds in SBM Bank and in Cytonn affiliate loans notes until the Trustee receives a go ahead from CMA. Cytonn complains that the effect of the directive is that its investment capabilities are negatively impacted as it will be unable to invest up to 80% in Cytonn related projects as initially consented to by CMA.
  5. The directive is criticized as being malicious, unreasonable, irregular and illegal because:-
    - a. The fund was formed on the basis of the Trust Deed and rules formulated and agreed to by the Fund Manager and scrutinized by CMA.
    - b. it conflicts with the objects of the Trust as set out in the information memorandum dated May 7, 2019.
    - c. The variation destroys the substratum of the Trust.
    - d. That the requirement only applies where both the Trustee Fund Manager and the custodian are related in terms of regulation 16(2) as applies to a Fund Manager, regulation 26(2) as applies to the Trustee and regulation 34(2) as applies to the custodian.
    - e. It is commercially impractical for the Fund Manager to withdraw funds it has already invested in its real estate projects.
  6. The petitioner also states that the directive is manifestly unreasonable and malicious because the Fund Manager was not given a chance to inform its investors of the directive; the investors were not given an opportunity to have a say in the decision which was fundamentally and economically altered, interfered and even jeopardized their right to property and CMA did not give practical reasons on how the Fund



- Manager will mitigate and manage the prejudice and expectations of the unit holders already in the fund.
7. The response by CMA is that on or about the February 20, 2020, the Fund Manager made an application to it for exemption of regulation 78(2)(c) of the *CIS Regulation 2001* which restricts investments into single issue real estate to 25%. That following subsequent meetings and discussions by all parties, CMA wrote to the Fund Manager on June 3, 2020 indicating that the request for waiver will not be progressed on account of the fund being a collective investment scheme with exposure of upto 80% in real estate in diversified and non-related entities. CMA explains that if a further waiver was granted, the concentration risk will be high and consequently the investors will be exposed to noting a single asset class, that is real estate, but also real estate assets of a related entity.
  8. CMA asserts that the funds have been invested in Cytonn Investment Management PLC real estate by the Fund Manager which is a regulated affiliate of Cytonn Investment Management PLC and the key beneficiary of the real estate is Cytonn Investment Management PLC.
  9. The application before court is a plea for a conservatory order. The principles for grant of such an order are well settled. As correctly pointed out by counsel for CMA, they are that:-
    - a. The applicant must demonstrate that he has a prima facie case with a likelihood of success.
    - b. That there is a real danger that the petitioner will suffer prejudice as a result of a violation or a threat of violation of the constitution if the order is not granted.
    - c. The court has to decide whether a grant or denial of the relief will enhance the constitutional values and objects of the specific right or freedom in the Bill of Rights.
    - d. The court must ensure that the conservatory orders fulfills the public interest dogma.
  10. At this interlocutory session, the court must be careful not to make findings that posture as final as that will embarrass the trial Court.
  11. It seems to this court that the substantial issue in question is whether the fund, as arranged, organized and managed, is subject to regulation 16(2) of the CIS regulations. A related question is whether CMA has dealt with the petitioner in a manner that abridges his rights to fair administrative action.
  12. Regulation 16(2) reads as follows:-
    - (2) A fund manager of a collective investment scheme may in relation to the custodian or trustee of such collective investment scheme, be a holding company or a subsidiary company within the meaning of the terms as defined in section 154 of the *Companies Act* (cap 486) or be deemed by the Authority to be otherwise under control of substantially the same persons or consist substantially of the same shareholders, provided that the investment in a related company shall be limited to ten per cent of the total funds managed by the fund manager.
  13. The key argument by the petitioner is that the Fund Manager is not related or even co-owned by the other key players of the Fund (by dint of the incorporation documents) either at subsidiary or a holding company within the meaning of section 152 of the *Companies Act*. CMA insists that they are related and contends that the Fund manager is an affiliate of Cytonn Investment Management PLC in whose real estate the funds are been invested.



14. The Trial Court will have to make that call after receiving evidence and unravelling the entities involved. Yet for now, the court is unable to downplay the contents of the letter of the Fund Manager dated February 20, 2020. It reads in part:-

February 20, 2020

Mr Wycliffe Shamiah

Ag Chief Executive Officer

Capital Markets Authority

Embankment Plaza, Upper Hill

PO Box 74800 – 00200

Nairobi

Dear Sir,

RE: Cytonn High Yield Fund

We refer to the above subject matter, your letter dated January 14, 2020(ref CMA/CMD/004) and the various discussions held.

The Authority did cite that it has noted fund manager's concerns regarding the 25% single issuer investment limit for the Cytonn High Yield Fund ("CHYF") in accordance with regulation 78(2)(c) of the Capital Markets (Collective Investment Schemes) Regulations, 2001 taking into consideration the ongoing transition exercise geared towards seamless migration of the existing investors in the Cytonn High Yield Solutions ("CHYS") into the regulated CHYF.

In an effort to ensure that CHYF provides a competitive and compelling interest rate comparative to similar rates that CHYS investors are accustomed to, the fund manager is seeking an exemption to regulation 78(2)(c) for a period of three (3) months to allow for investment in the Alma Loan Note instrument to the maximum permissible limit at this nascent stage of the transition process pending the securitization of the outstanding four (4) additional projects identified for purposes of investment by CHYF as had been communicated in earlier correspondence. The fund manager remains of the opinion that the above exemption will serve to encourage uptake of CHYF considering existing investors remain wary that the fund is not delivering similar rate of return albeit the fact that it is a regulated collective investment vehicle.

We wish to reiterate our commitment to work closely with the Authority and the Principal Partner, Cytonn Investment Management Plc to ensure the transition realizes the desired results. We appreciate the Authority's continued guidance and cooperation during this process and look forward to your favorable response.

Yours faithfully,

For and on behalf of: Cytonn Asset Managers Limited

Victor Odendo

Principal Officer

cc: Timothy Wambui

Principal Officer



Natbank Trustee and Investment Services Limited  
PO Box 72866 – 00200  
NAIROBI

15. It is the response to this letter that triggered the filing of the Petition. In the letter CMA raises concern that investors will be exposed not only to real estate asset class but also because they are real assets of a related entity.

16. The onus is on the Petitioner to show that the investments from the fund have not been made in a related company and if they are, then the investments are limited to 10% of the total funds managed by the Fund Manager. In another letter of August 4, 2020, Cytonn Investment Management PLC referring itself as the principal partner does confirm that Cytonn High Yield Fund has investments in Cytonn Money Market Fund. It further states that:-

“...we maintain that CMMF can invest upto 25% in CHYF according to CIS regulation 78(l) (d), the EGM resolutions dated November 15, 2018, the Trust Deed and Rules and the no objection from the authority dated 24<sup>th</sup> December 2018.”

17. Given this disclosure, the Court has not seen sufficient effort by the Petitioner to demonstrate that the investments do not breach the provisions of regulation 16(2) of the CIS regulation 2001.

18. A principal objection of the CMA is to protect investor interests (section 11(1)(a) of the *Capital Markets Authority Act*). It has power to license, approve and regulate private equity and venture capital companies that have access to public funds ( section 11(3)(9a).In the letter of June 3, 2020 CMA simply reminds the Fund Manager to comply with regulation 16(2) of the CIS regulation. This is what it states:-

“ Further, in line with our letter dated March 24, 2020, also ensure compliance with the 10% limit provided for in regulation 16(2) of the *Capital Markets (Collective Investment Schemes) regulation 2001.*”

In so far as the petitioner has not established that the Fund Manager is not in breach of this regulation, the court is unable to say that the Petitioner has made out a prima facie case with a likelihood of success. Courts should not interfere with the manner in which public bodies discharge or carry out their mandate unless they do so in clear breach of statute or the constitution.

19. The notice of motion dated August 10, 2020 is hereby dismissed with costs.

**DATED AND SIGNED THIS 11<sup>TH</sup> DAY OF NOVEMBER 2021**

**F. TUIYOTT**

**JUDGE**

**DATED AND DELIVERED AT NAIROBI THIS 17<sup>TH</sup> DAY OF NOVEMBER 2021**

**A. MABEYA, FCI Arb**

**JUDGE**

Present

