



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT MACHAKOS

MISC CIVIL APPLICATION NO. 314 OF 2019

SAMSON MUKEKU MUTUKU.....APPLICANT

VERSUS

DAVID KIOKO MUSAU..... RESPONDENT

RULING

1. The applicant approached this court by way of Chamber Summons dated 16.7.2019, brought under Section 238,239 of the Companies Act No. 17 of 2015 Laws of Kenya, Order 40 of the Civil Procedure Rules 2010 and other enabling provisions of the Law. He sought the following reliefs.

a) Spent

b) That the applicant be granted permission to continue the Derivative Claim seeking relief on behalf of Davisum Limited in respect of the acts and omissions by the Respondent, involving negligence, default, breach of duty and breach of trust in his capacity as director of Davisum Limited on such terms as the Honourable Court considers fit.

c) That pending the hearing and determination of the derivative claim, the Respondent be compelled to surrender to the applicant the Certificate of Incorporation, Memorandum and Articles of Association, KRA Pin Certificate, ETR Machine, the books of records, and any other property of Davisum Limited in his custody.

d) The costs of the application be provided for.

2. The grounds of the application are set out in the chamber summons as follows:

a) The property belonging to Davisum Limited is in danger of being wasted by the respondent affording reasonable probability that the company and the applicant may be delayed in execution of any decree that may be passed against the respondent in the derivative claim;

b) The applicant is a director and shareholder of Davisum Limited acting in good faith and in the interest of the company;

c) The proceedings are in respect of a cause of action vested in the company seeking relief on behalf of the company for protection of its members against unfair prejudice arising from actions of the respondent in his capacity as director of the company;

d) That the actions of the respondent are inconsistent with the articles of association of the company and lack authority of its shareholders;

e) The board of directors of the company are at a stalemate and the company is incapacitated to decide on whether to pursue the claim on its own behalf;

f) The applicant has made attempts to exhaust available alternative remedies and in more particular by referring the matter to arbitration and the respondent refuses to acknowledge the terms of the arbitral award.

3. Also in support of the application is the affidavit of **Samson Mukeku Mutuku** deponed on 15.7.2019 reiterating the foregoing grounds. Annexed to the affidavit is a copy of the Certificate of Incorporation, Memorandum of Association and Articles of Association for Davisum Limited marked SMM1 to 3; a copy of the company status report marked SMM6 and a copy of the arbitration proceedings and award marked SMM 8. The deponent averred further that from the incorporation of the company till 2016 the shareholders never received calls to receive

their dividend payments as the same was ploughed back into the company and in 2017 when it was agreed that dividends be paid out, the respondent was unreachable only to resurface in January 2018 and allege that there was no money. It was averred that unknown to the applicant, the respondent had registered another company under the name Davesafe Limited and issued letters to their customers that the company had changed name to Davesafe Ltd as evidenced by letter marked SMM4. The deponent averred that the respondent transferred funds from the company account to his account, Regina and Smiller Muthoki's account and account belonging to Davesafe Ltd as evidenced by the bank statement marked SMM5. It was averred that the respondent in the course of the arbitration proceedings intimated intentions as resigning as director of Davisum Ltd and that he claimed an outstanding salary of Kshs10m/- which claim was never resolved by the Board of Directors as required by the Articles of Association of Davisum Ltd. It was averred that litigation will not disrupt the company business and that the company is likely to suffer if the claim fails.

4. In reply to the application is a replying affidavit deposed by David Kioko Musau on 11.9.2019. He denied the averments of the applicant and averred that he and two principal shareholders were in charge of running the company. He denied refusing to acknowledge the arbitral award and that the success of the company is attributed to his hard work and diligence as managing director of the company. It was averred that in 2017 the company decided to relocate from Athi River to a new location and that the board of directors decided that he was to buy out the applicant. It was averred that on 26.2.2018 in the presence of auditors, the Board of directors agreed to a parting formula where the applicant would be paid Kshs 2.5m/- as goodwill and that the board of directors authorized him on 26.2.2018 to have the sole mandate to operate the bank account opened in the names of Davisum Ltd. It was averred that on 28.2.2018 the applicant changed his mind on the goodwill offer when he realized that the buy-out deal would not be attainable hence a stock taking exercise was conducted on 1.3.2018 of the company's stocks wherein the stock was split into two. He averred that he was prevented from taking his half of the stocks to the new premises at Mavoko Business Park and feeling frustrated he incorporated Davesafe Limited as evidenced by annexure DKM4, its certificate of incorporation. It was averred that from the time Davesafe was incorporated, communication broke down and attempts to reconcile the directors of Davisum reached a stalemate. It was averred that on 27.11.2018 the arbitrator convened a meeting and did not find any evidence of misappropriation of funds as alleged by the applicant. It was also averred that there is no demonstration that the respondent was negligent in performance of his duties; or that he engaged in acts of omission or that he was in default or breach and that he was fair at all material times. The deponent took the view that the application was bereft of merit, an abuse of the court process and that litigation would adversely affect the image and reputation of the company.

5. By way of rejoinder, the applicant deposed vide an affidavit dated 23.11.2019 where he averred that there were irreconcilable differences between him and the respondent and as the remaining director of Davisum Limited he sought to file the suit so that the company could get back on its feet.

6. The court directed that the application be canvassed vide written submissions and it is only the applicant's submissions that are on record. Vide submissions filed on 24.10.2019 by counsel for the applicant, four issues were framed for determination. Firstly whether the suit was wrongly before the court on grounds of there being no case, a frivolous and vexatious case that will burden the judicial process and waste courts time; Secondly whether the applicant by himself is not entitled to the prayers to continue with a derivative claim on behalf of Davisum Limited and or the respondent unequally and secretly paid himself large sums of money which he has not been able to clarify when queries were put to him by the auditor and / or arbitrator and the same remained unsolved; Thirdly whether the applicant had proved his case on a balance of probabilities and if so, whether he is entitled to the orders sought against the respondent and finally, whether the Respondent had proved his case on a balance of probabilities and if so, whether he is entitled to the orders sought in his replying affidavit.

7. On the 1st issue, it was submitted, while placing reliance on section 238, 239 of the Companies Act No. 17 of 2015, Order 40 and Order 3 Rule 1(1) of the Civil Procedure Rules that a director may institute an application on behalf of the company. Reliance was placed on the cases of **Wilmot Mwadilo, Edwin Mwakaya, Amos Nyatta & Patrick Mbinga v Eliud Timothy Mwamunga and Sagalla Ranchers Ltd as affected party (2017) eKLR** that required that leave be sought before a derivative action is filed and **Udali Group Ltd v Umberto Riccardo Dellavale & 3 Others (2017) eKLR** where it was held that a derivative action is an accountability tool in the form of a representative action filed by a shareholder on behalf of a corporation. Counsel submitted that the instant action was not a waste of court's time. On the 2nd issue, it was submitted that the application is one of the steps towards pursuing a derivative claim, which steps were listed in **Akberali Manji, Hemanth Kumar & Musikland Millenium Ltd v Altaf Abdulrasul Dadani & Musikland Ltd (under receivership) (2015) eKLR**. On the 3rd issue, learned counsel submitted in placing reliance on the case of **Nobert Ouma Njoga v Benjamin Osano Ondoro (2016) eKLR** and **Section 108 and 112 of the Evidence Act** that the applicant had proved his case in tandem with his supporting affidavit that is to the effect that the queries put to the respondent remained unanswered. On the 4th issue, counsel submitted that the respondent's replying affidavit be dismissed and in the alternative the applicant be awarded the un-pleaded prayer of general damages and the pleaded remedy of return of the company documents and papers.

8. The gist of the application is that the applicant seeks to continue with a derivative claim because he considered the actions of the respondent in breach of trust, breach of duty. It is undisputed that the applicant is a member of the company and therefore the issues that are for determination are whether the applicant may be granted leave to continue the derivative claim and, if so, on what terms? Secondly, is the applicant (on behalf of the other members and the company) entitled to an interim measure of surrender of the Certificate of Incorporation, Memorandum and Articles of Association, KRA Pin Certificate, ETR Machine, the books of records, and any other property of Davisum Limited to him?

9. A derivative action is an action commenced by a shareholder and is an exception to the general rule laid out in **Foss vs. Harbottle (1843) 2 Hare 461** that a company is the only proper plaintiff to sue for wrongs done to it. The Court will not ordinarily intervene in a matter which the company can settle through its internal mechanism i.e. in case of an irregularity it can ratify or condone the matter through its internal mechanism. Where it is alleged that a wrong has been done to a company, prima facie the only proper plaintiff is the company itself. Members/shareholders of a company have a limited right to bring a derivative action on the Plaintiffs own behalf and on behalf of the company. (See **Ghelani Metals Limited & 3 others v Elesh Ghelani Natwarlal & another [2017] eKLR**)

10. According to L.C.B Gower in Gower's Principles of Modern Company Law Fourth Edition at page 647, there is confusion generated by a failure to draw a distinction between two kinds of rights in which a minority shareholder's action is possible. The first right arises in a situation where a wrong is done to the company and action is brought to restrain its continuance, or to recover the company's property or claim damages or compensation due to it. In such an action the company is the only true plaintiff. In such cases the dispute is not internal and

is a dispute between the company and third parties even if the third parties are directors who are majority shareholders. The minority shareholder sues on behalf of the company and other members. The action is brought by a member where it is impracticable for the company to do so. The wrong complained about must be in the form of a fraud which cannot be waived by a majority vote of members. It may involve expropriation of company property or that of members. Secondly it may involve director's breach of duty. It must be shown that the wrongdoers control the company. It must further be shown that the directors were asked to commence an action but refused to do so, and that they have controlling votes. This one is covered under Section 239 of the Companies Act, 2015. The other kind of action is covered under Section 780 to 782 of the Companies Act where the member's rights have been prejudiced by the wrongdoers. In **Rai and Others v Rai and Others [2002] 2 EA page 537** Shah J.A. held that shareholders have a limited right to bring an action for wrongs done to the company and at page 551 set out the rule in *Foss vs. Harbottle* which rule is expounded in **Edwards v Halliwell [1950] 2 ALL ER 1064 – 1067** that firstly the proper plaintiff in an action in respect of a wrong alleged to be done to the company is the company itself. Secondly where the alleged wrong is a transaction which might be made binding on the corporation and on its' members by a simple majority of the members, no individual member of the corporation is allowed to bring an action in respect of that matter, because, if the majority challenge the transaction, there is no reason why the company should not sue:

“(3) There is no room for the operation of the rule if the alleged wrong complained of is ultra vires the corporation, because the majority members cannot confirm the transaction (4) There is also no room for the operation of the rule if the transaction complained of could be validly sanctioned only by a special resolution or the like because a simple majority cannot confront a transaction which requires the concurrence of a greater majority (5) There is an exception to the rule where what has been done amounts to fraud and the wrong doers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrong doers themselves, being in control, would not allow the company to sue.”

11. The basis for the doctrine is seemingly the principle of democracy in the company that advances the principle that the person or persons with majority shareholding have a proportionate voting power by which they can outvote any minority on any issue subjected to a vote and therefore have control over the company. Where the majority have made a decision the minority should not challenge it except under grounds which are exceptions to the general rule. A derivative action is essentially an action of the minority. It is a rule that gives remedies to minorities against the oppression of the majority on exceptional grounds.

12. In a derivative action envisaged by this application, the conduct complained about must be one that arises from an act or omission involving negligence, breach of duty or breach of trust by a director of the company, and the plaintiff ordinarily would be the company save that the name of the company could not be used because the company is unwilling through its directors to enforce the action against the company.

13. Section 238 of the Kenyan Companies Act 2015 provides:

A derivative claim under this Part may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.

14. A derivative claim should aver the steps taken to bring the action in the name of the company and which steps failed on account of majority action. It was held by Harman J in **Birch v Sullivan and Another [1958] 1 All ER 56** at page 58 - 59 that:

“It would be necessary to allege, as well as thereafter to prove, that the plaintiff could not, by reason of the first Defendant's opposition, obtain the name of the company to issue proceedings: that he was in the position in which the minority shareholders were in the comparatively rare cases where such actions have been allowed.”

15. In other words, the grounds making it impossible to sue in the names of the company should be averred. Coming to the facts of this case, the applicant as shareholder and director of the company has sought to continue the derivative claim. However, it is clear that firstly it seems there is a power struggle between the applicant and the respondent who are directors of the company and secondly the application has not shown how the applicant could not issue proceedings in the name of the company, neither am I satisfied that the applicant took steps to institute an action in the name of the company and has been frustrated by the company and/ or the respondent. I equally am not convinced that there are actions of *negligence, default, breach of duty or breach of trust* and what is apparent is shadow boxing between the two directors. I however note that there was an attempt at arbitration that handled the issues between the parties in this application and there has been a commendable job and formidable conclusions that have been made as reflected by the arbitral award. For all intents and purposes the application does not fit the definition of a derivative claim within the provisions of Section 238 of the Companies Act, 2015. I therefore do not agree that the applicant can continue a derivative claim and what he can do is institute an action against the company in case he has a cause of action for acts which are alleged to be negligent or in breach of duty as per Section 241(2)(f) of the Companies Act, 2015.

16. In **Ghelani Metals Limited & 3 others v Elesh Ghelani Natwarlal & another [2017] eKLR**, Justice Onguto observed that ***“The essence of judicial approval under the Act is to screen out frivolous claims. The court is only to allow meritorious claims. All that the applicant needs to establish, through evidence, is a prima facie case without the need to show that it will succeed. The factors to be considered are infinite. There will however be compulsory refusal of permission where the suit is not in the interest of or of benefit to the company. Permission will also be denied where the proposed act has been authorized by the company or the impugned act has been ratified by the company. The court, in my view, must however not be reluctant to intervene in the company's decision making process as wrong doing on the part of directors must be checked if only to promote corporate governance.”***

17. In the premises, I find the applicant has not convinced me that the orders sought are merited. It is worth noting that the dispute between the parties herein has since been aptly referred to arbitration and that there is already an arbitral award for enforcement. The applicant has not shown evidence that he has engaged his energies on the said award. He should proceed to enforce the award and if he is dissatisfied by its outcome then he can always appeal against the same.

18. In the result it is my finding that the applicant's application dated 16.7.2019 lacks merit. The same is dismissed. As parties are directors of the same company I find an order that each bears their own costs to be appropriate in the circumstances.

It is so ordered.

Dated and delivered at Machakos this 6th day of May, 2020.

D. K. Kemei

Judge