REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

COMMERCIAL AND ADMIRALTY DIVISION

CIVIL SUIT NUMBER 100 OF 2016

YUSUF ABDI ADAN..PLAINTIFF

VERSUS

HUSSEIN AHMED FARAH..1ST DEFENDANT

HUSSEIN UNSHUR MOHAMED..2ND DEFENDANT

MOHAMED ABDIKADIR ADAN..3RD DEFENDANT

BLUE BIRD AVIATION LIMITED.......................4TH NOMINAL DEFENDANT

RULING

1. By a plaint dated 30th March 2016 filed in court on 31st March 2016, alongside a notice of motion of the even date, the Plaintiff herein sought for orders as stated under paragraphs 4 (a) to (j) and 5 (2) to (11) of the plaint and/or application. It is supported by an affidavit sworn by the Applicant.

2. To place this matter in perspective, it suffices to lay the factual background thereof. In that regard, it is noteworthy that, upon filing of the application, it was heard ex parte and prayer 2 thereof granted. The prayer was seeking for orders as here below reproduced;

a) *The Honourable court do record, order and grant leave to the 1st Plaintiff/Applicant that the suit filed herein, do proceed, be heard and determined as a derivative suit brought by the 1st Plaintiff/Applicant on behalf of the 2nd Plaintiff Company, and further give the 1st Plaintiff/Applicant authority to continue prosecuting the suit herein as a derivative suit for and on behalf of the 2nd Plaintiff;*

b) *The fees and legal cost incurred by the 1st Plaintiff/Applicant herein in filing, prosecuting, handling and continuing with the suit herein be authorized by the Honourable court to be charged to, be indemnified by and paid by the 2nd Plaintiff Company.*

3. Subsequently, the Defendants challenged the issuance of those orders ex parte. The parties were then heard inter parties on the subsistence and/or extension of the same. The court delivered its ruling on the issue on 18th May 2016 and granted prayer 3 of the application, in the terms stated under paragraph 24 of the ruling.

4. Of great significance is the fact that, on 14th June 2017, the parties entered into a consent, whereby it was agreed that the ex parte leave granted by the court on 31st March 2016, be deemed as stage one (1) of the application pursuant to provisions of section 239 (1) of the Companies Act (herein "the Act") and be deemed construed as permission to the Applicant to continue the claim.

5. The parties to the consent expressed themselves in the following terms;

a) The leave granted herein on 31st March 2016 by the Hon. Lady Justice F. Amin be and is hereby set aside;

b) The said leave be construed as stage one (1) of the permission to continue the claim pursuant to Section 239 (1) of the Companies Act, Act No. 17 of 2015;

c) The parties to argue stage two (2) pursuant to Section 239 (4) of the Companies Act No. 17 of 2015;

d) The Defendants to file and serve their Replying Affidavits and/or grounds of opposition, if any, within 21 days from today in response to the Plaintiff's application dated 30th March 2016;

e) The Plaintiff to file and serve his further affidavit within 14 days of service of the last Defendant's Replying Affidavit mentioned in four above;

f) The matter to be mentioned on 27thJuly 2017 with a view to obtain further direction and hearing date to the Application.

6. On 3rd December 2018, the parties appeared before court in accordance with their consent agreement to argue stage two (2) of the application as stated in the consent order. However, learned senior counsel, Mr. Ahmednassir Abdullahi, appearing for the Plaintiff argued that the Defendants have no right of audience, to be heard on whether the court should grant the Plaintiff permission to continue the suit as a derivative suit.

7. He argued that, the ruling delivered by the court delivered on 16th February 2017, whereby the company was struck out as the 2nd Plaintiff has great trajectory and bears critical and consequential impact on the entire matter. It means the company is sitting outside the dispute and has no opportunity to be heard on the application under consideration. It has elected not to oppose the application, yet under Sections 238-240 of the Companies Act, (herein "the Act"), it is only the evidence of the company and the directors who are not challenging the leave to continue the claim as a derivative action who should be heard.

8. The learned senior counsel further argued that, there are two categories of directors who the court should consider; first, those who are not prospective defendants and/or party to the proceedings and/or those who are not accused of anything with regard to the derivative suit and second, those who stand accused and against whom the leave is sought. Therefore the Defendants herein being party to the suit cannot be heard.

9. He submitted that the affidavits the defendants have sworn and filed mean nothing and should not be considered pursuant to the provisions of Section 241 of the Act. The court was referred to the cases of *Lesini Vs. Westrip Holdings Limited [2009] EWHC 2526 (Ch), Wishart Vs. Castlecroft Securities Limited (2010) BCC 161* and the text on "*Practice on the Minority Shareholders"*, by Lowe, to argue that the Defendants should not be heard at the leave stage, as they will use the opportunity to rehearse the full action and scuttle and/or contaminate the proceedings. That the hearing the Defendants at stage 2 of the application, will give them veto power to consider whether the company can pursue them or not.

10. However, the Defendants opposed the arguments by the Plaintiff that they have no right of audience at this stage 2 of the hearing of the application. The learned counsel for the 1st Defendant, Ms Jan Mohamed argued that, the Plaintiff is estopped from denying the 1st Defendant an opportunity to be heard and/or file an affidavit in response to the application, as the parties have filed several affidavits and the Plaintiff responded thereto.

11. She argued that, there is no requirement under Section 239 of the Act, for leave to be granted and all that the court is required to do is to determine whether, on the documents filed, the action is a derivative one. If it so finds, then it grants permission for the suit to continue as such. If the court grants permission, it has to give direction on the evidence to be provided by the company. However, the court cannot order the company to give evidence herein; as it is not a party to the suit and neither could it, when it was named as the 2nd Plaintiff.

12. The 1st Defendant argued that, the allegations herein are leveled against individual Defendants; therefore it is not for the company to answer for them but the Defendants themselves. That the company has shareholders and directors, it has no independent directors. That section 241(3) of the Act, does not bar any of the directors from being heard; either on the basis of having direct interest in the matter or company or otherwise. That, even suspects have a right to give statements therefore the Defendants should not just be shut out, as Article 50 of the Constitution entitles them to be heard. The court should be allowed to evaluate the matter on its own merit.

13. The 2nd Defendant was represented by the learned counsels, Mr. Biriq, and Mr Sagana. Mr Biriq, in response to the Plaintiff's submission argued that, it is not an issue of the company opting to stay out. The company must be a Defendant and in the absence of the company being Defendant, then there is no suit, as the suit is anchored on Section 238 (1) of the Act and based on the company. As such this is a personal suit. Reference was made to the case of; *Roberts FC Vs. Gille Co. Solicitors[2010] UKSC 22.* Further Section 238 of the Act, requires that the company must give evidence; and will be contrary to the statutory provisions for the court to proceed without the company.

14. On the issue of indirect defendants, the learned counsel submitted that, under Section 241 (3) of the Act, there are no independent members of the company. That is not a misnomer. That Section 263 (4) of the Company's Act in UK is the same as Section 263 (4) of the Kenyan Act. He referred to the landmark case of; *Mission Capital PLC Vs. Sinclair & Another[2008] EWHC 1339 (Ch)* and argued that stage 2, the court has to hear both parties, that is why it is referred to as inter parties hearing.

15. Mr. Sagan argued in further submission that, it is the court to determine who has interest whether direct or indirectly in the suit and that a party not sued has an indirect benefit if the company succeeds in the suit. That, in all the authorities cited, the company is named as a Defendant; and in the absence of the company herein being a Defendant, the Plaintiff must suffer the consequences.

16. The Counsel distinguished the procedure for instituting a derivative suit in the courts in Scotland, with that in Kenya, UK and Wales. He observed that in Scotland, the Applicant has to file a separate Originating Summons to determine whether or not to get leave to file a derivative suit. The Originating Summons is purely between the Applicant and the Company and is an independent suit. In Kenya, there is no requirement to seek for leave before filing the suit. The leave to continue with the suit as a derivative is a matter where the Defendant is already a party. Reference was made to the case of; Re Gen2 Partners Inc. (2012) 4 HKLRD which stipulated the same procedure as that in

Scotland.

17. The 3rd Defendant submissions were advanced by the learned Counsel Mr Daud who submitted that, there are two (2) stages in the proceedings seeking for a suit to be heard as a derivative suit. The 1st stage is intended to throw away frivolous suits. However, it is unfortunate that it was not complied with in this case. He relied on the case of; *Seven Holdings LimitedVs. Trevor & Another (2011) EWHC 1893 (Ch)*. He distinguished the Scotland authority cited by the Plaintiff and submitted that it dealt with the proprietary value of the evidence and the people who should participate. That in the case of; *Wishart (supra)* confirms that all the parties have an interest in the matter and should be heard.

18. The learned counsel Mr Gacha, submitted further on behalf of the 3rd Defendants and concurred with the submissions of the other learned counsels. However, he argued that, the Plaintiff has no authority from the company to file the claim and can only draw authority from the leave granted to continue with the claim. That it is a requirement that the company must be made a Defendant as a mandatory party and having made the company a Plaintiff, the Plaintiff lost sight of the nature of derivative action. Therefore, it is up to the Plaintiff to make a choice and if agreeable, the company must be made a party. If so, the Plaintiff ought to move the court for the appropriate orders or proceed as herein. It is not for the Defendants to tell the Plaintiff what to do. They cannot be forced to remedy the situation.

19. The Learned Counsel argued that there is no court system that stands for the rule of law, which can deny a party an opportunity to be heard. That, if the Plaintiff wants to bar the Defendants from addressing the court, he should make a formal application. The counsel submitted that the position propounded by the Plaintiff that the Defendants should not be heard at this stage has been rejected in the U.K and Scotland where the court applies Rules distinct from the Kenyan position, under the Kenyan system, the statutory provisions apply and the Kenyan jurisprudence is that the court should not bar a party from being heard. If there is doubt in the court's mind, it should be given to the benefit of the Defendants.

20. The learned senior counsel Mr. Fred Ojiambo, for the Interested Party, opted to remain as a by-stander at this stage of proceedings. However, the learned senior counsel Mr. Ahmednassir, in final reply to the Defendants submissions stated that, there is no dispute that the Defendants are parties to the suit. All the Plaintiff pleads is that, at stage 2 of these proceedings, the matter be heard ex arte, because the court may not even grant the leave. That the Plaintiff has no objection to the Defendants being heard thereafter on the issue of injunction.

21. The Defendants having failed to admit liability from being served with a demand letter, the Plaintiff choose to file the claim herein. On the authorities cited, the learned senior counsel argued that, the only difference between Scottish and Kenyan law, is purely procedural; as the substantive law is the same. However, the Hong Kong statute is completely different. Further, in the case of; *Kleanthous Vs Paphitis& Others (2011) EWHC 287 (Ch)* the Defendants were allowed to participate due to the issue of costs; as they were seeking for indemnity of costs.

22. At the conclusion of the arguments and/or submissions by the parties, I find that the only issue to determine is whether the Defendants should be heard at this stage 2 of the proceedings or not. To appreciate the answer to that question, it is important to consider the relevant law on the matter. The plaintiff has moved the court to be allowed to institute the claim herein as a derivative suit. In that regard, Section 238 (1) of the Companies Act No. 17 of 2015, defines "a derivative claim" as follows;

> "*In this Part, "derivative claim" means proceedings by a member of a company—*
>
> *(a) in respect of a cause of action vested in the company; and*
>
> *(b) seeking relief on behalf of the company.*

23. The provisions of; Section 238 (2) to (5) further provides as follows;

> "*(2) A derivative claim may be brought only—*
>
> > *(a) under this Part; or*
> >
> > *(b) in accordance with an order of the Court in proceedings for protection of members against unfair prejudice brought under this Act.*
>
> *(3) 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.*
>
> *(4) A derivative claim may be brought against the director or another person, or both.*
>
> *(5) It is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company.*
>
> *(6) For the purposes of this Part—*
>
> > *(a)"director" includes a former director;*
> >
> > *(b)a reference to a member of a company includes a person who is not a member but to whom shares in the company have*

been transferred or transmitted by operation of law."

24. However before a derivative suit is instituted the procedure laid down must be followed. In that regard the provisions of; Section 239 of the Act provides as follows;

(1) In order to continue a derivative claim brought under this Part by a member, the member has to apply to the Court for permission to continue it.

(2) If satisfied that the application and the evidence adduced by the applicant in support of it do not disclose a case for giving permission, the Court—

(a) shall dismiss the application; and

(b) may make any consequential order it considers appropriate.

(3) If the application is not dismissed under subsection (2), the Court—

(a) may give directions as to the evidence to be provided by the company; and may adjourn the proceedings to enable the evidence to be obtained.

(4) On hearing the application, the Court may—

(a) give permission to continue the claim on such terms as it considers appropriate;

(b) refuse permission and dismiss the claim; or

(c) adjourn the proceedings on the application and give such directions as it considers appropriate.

25. These provisions empower a member of the company to institute a derivative suit. Prior to the enactment of these provisions the law on derivatives suits was based on the legal principles in the case of: *Foss –v- Harbottle [1843] 2 Hare 461* where it was held that "a company is a separate legal personality and the company alone is the proper Plaintiff to sue on a wrong suffered by it". That a member of a Company can only institute a suit on behalf of the company under the exceptions to the rule in that case. The Court of Appeal in the case of; *Rai & Others V. Rai and others [2002] 2 EA 537* upheld the application of the rule in *Foss V. Harbottle* (supra), in Kenya and recognized four (4) exceptions to thereto ass follows:-

a) Firstly, where the directors or a shareholding majority use their control of the company to take actions which would be ultra vires the constitution of the company or are illegal.

b) Secondly, if some special voting procedure would be necessary under the company's constitution or under the Companies Act, it would defeat both if they were to be sidestepped by ordinary resolutions of a simple majority, and no redress for aggrieved minorities were to be allowed (Edwards V. Halliwell [1950] 2 ALL ER 1064.

c) Thirdly, where there is invasion of individual rights of the shareholder, such as voting rights (Pender V. Lushington [1877] 6 Ch D 70)

d) Fourthly, where a fraud on the minority is being committed.

26. Therefore subsequent to the enactment of the Act, derivatives suits are guided by the statutory provisions as observed in the case of; *Ghelani Metals Limited & 3 others v Elesh Ghelani Natwarlal & another [2017] eKLR* held that; statutory procedure is now the exclusive method of pursuing derivative claims. The Act, sets out the sorts of company claims that may be pursued and explicitly provide that derivative claims may only be pursued under the Act.

27. To revert back to the issues herein, there are two stages involved in this process. The first stage requires the court to satisfy itself that based on the evidence provided by the Applicant, there is a prima facie case. The Applicant need not show that the claim will succeed. The parties herein, by the consent entered into and referred to above agreed that the leave granted herein on 31st March 2016 by the Hon. Lady Justice F. Amin be and is hereby set aside and the said leave be construed as stage one (1) of the permission to continue the claim pursuant to Section 239 (1) of the Companies Act, Act No. 17 of 2015.

28. As such the parties are at stage 2 of the application. This is supported by the submissions filed by the Plaintiff where reference is made to the consent order recorded by all parties on 14th June 2017, dispensing off with stage one (1) and clearing the parties to proceed to stage 2, pursuant to Section 239(4) of the Act. This stage entails a consideration of statutory provisions and factors which ordinarily guide judicial discretion albeit in the realm of derivative action.

29. The provisions of Section 239(4) of the Act simply states that on hearing the application it does not say who should be heard, however, it is clear that in making a decision as to whether to give permission or refuse, the court will be guided by the provisions set out under Section 241. Most significantly is the provision of Section 241(4) which provides that;-

"In deciding whether to give permission, the Court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest (direct or indirect) in the matter."

30. The question that arises therefore is; who is this member and whether it includes Defendants who have been alleged to be wrong doers. The arguments advanced by the parties in this issue are already summarized herein, and before I answer these questions, analysis of comparison jurisdiction may be guide full. In that regard, it suffices to note that, the provisions of Section 238 to 242 of the Kenyan Companies Act 2015, are similar to provisions of Section 260 to 264 of the United Kingdom Companies Act 2006 which provides the framework for derivative claims applicable in England and Wales and Northern Ireland. The English provisions are similar to the Scottish provisions, which are set out in sections 265 to 269 of the same Act.

31. However, it is noteworthy that, Section 261(1) of the United Kingdom Act, which provides that "a member of a company who brings a derivative claim must apply to the court for permission to continue it", can be contrasted with the corresponding provision under Section 266(1), of Scotland Act which provides that, "derivative proceedings may be raised by a member of a company only with the leave of the court".

32. This contrast was a subject of discussion in the case of; *Wishart Vs. Castelecroft (2010) BCC 161* which dealt with the provisions of; Sections 239 of the Companies Act 2015, Section 261 of the United Kingdom Companies Act 2006 and 266(1) of the Companies Act of Scotland. The court observed as follows;-

"Section 266(1) imposes the requirement that leave be obtained. It creates a two-stage procedure: a first stage, prior to service of the application, when the court considers the application and the evidence produced by the applicant in support of it, and must refuse the application if those materials do not disclose a prima facie case for granting it; and, if the application is not so refused, a second stage, after service, when the court considers the application at a hearing in which the company is entitled to take part. The relevant provisions for England and Wales (in section 261) creates a similar two-stage procedure, although there are some technical differences which it is convenient to note at this point.

33. The court further stated as follows;

"Under Rule 19.9A of the Civil Procedure Rules applicable in England, the application is commenced by the issue of a claim form in respect of the derivative claim, accompanied by a separate application for permission to continue the claim. In the normal course, the application and the evidence filed in support of it are considered by the court without the company's being made a respondent. If the application is not dismissed at that stage as failing to disclose a prima facie case for granting it, the court orders that the company and any other appropriate party be made a respondent to the application, and directs service on them of the application notice and claim form. A hearing is then held on the application. In practice, the parties may agree to telescope this procedure by dealing with the application in its entirety at a single hearing (as, for example, in Mission Capital plc v Sinclair [2008] BCC 866 and Franbar Holdings Ltd v Patel [2008] BCC 885)."

34. In a nutshell, the case of *Wishart vs. Castelecroft (supra)* held that;

"There are thus three significant differences between the first stage and the second stage: at the first stage, the material before the court is confined to the application and the supporting evidence produced by the applicant, whereas at the second stage the court may also have material placed before it by the company; at the first stage any hearing will normally be ex parte, whereas at the second stage the company is entitled to be heard; and at the first stage the court need only consider whether there is a prima facie case for granting the application, whereas at the second stage the court must decide whether the application should actually be granted. The matters which are in principle relevant to the court's decision are however the same at each stage: in particular, it is necessary at both stages to consider the requirements of section 265 and the factors listed in section 268, together with any other relevant circumstances."

35. Similarly in the case of; *Franbar Holdings Limited vs. Patel & Others (2008) EWHC 1534 (Ch)* the court observed;

"I now turn to the application for permission to continue the derivative claim under section 267 (1) of the Companies Act 2006. In the normal course this application would have come before the court without Medicentres being made a respondent (CPR 19.9A(3)) and on that application, the court would have been required to consider whether the application and the evidence filed in support of it disclosed a prima facie case. If they had not, the court would have been required to dismiss the application but if they had the court would have ordered that Medicentres and any other appropriate party be made a respondent to the application and would have given directions for service on them of the application notice and claim form. In the present case the procedure has been telescoped. Franbar has not so far sought to establish a prima facie case for permission to continue its derivative claim, but Mr. Sisley accepts that it would be appropriate for me to deal with the entirety of the application for permission to continue at a single hearing. That is what I propose to do."

36. From the statutory and legal authorities cited herein, the following issues are clear; that at stage one of the hearing of the application to continue derivative suit, the application is heard ex parte. At stage two, the application is heard inter parties. The party that has a right to be at this stage is the company. However it is noteworthy from the cases cited herein and the provisions of Section 241(4), that the company is entitled to be heard at stage 2, but the court has the power to order any other appropriate party be made a Respondent to the application, and direct service on them of the application notice and claim form.

37. At the hearing of the application, the company was not a party to the suit having been struck out as stated herein, and most of the arguments advanced by the parties were to the effect that in the absence of the company, there is no suit and the application seeking for permission to continue the claim as a derivative suit must fail. However, it suffices to note that as at the time this ruling is being delivered,

the company has applied and been granted leave to come on record as an interested party. It has prosecuted an application dated 4th February 2019 and therefore as much as it was not on record; it has subsequently been accorded an opportunity to be heard and has actually filed its wish list.

38. In my understanding, the Respondents whom the court will invite to the hearing at stage 2 will be parties who are not already on record. In that case, the Defendants would not qualify as such. Similarly it does appear that from the provisions of Section 239(3), the court will only consider the material placed before it by the Applicant that would have been considered at stage 1 to arrive at a decision that there is a prima facie case in addition to the evidence to be provided by the company. There does not seem to be any express provisions allowing the Plaintiff to be heard further at stage 2.

39. Be that as it were, the parties herein seem to have agreed through a consent recorded in court on 14th June 2017 and which I have referred to herein that they will argue the application inter parties at stage 2 pursuant to the provisions of Section 239(4) (see clause (c) to (f) of the consent).

40. In that regard, unless the consent is set aside, the Defendants will have a right to be heard based on that consent, and in the same vein then, the Plaintiff will have a right to be heard. Whatever the case may be, the parameters to be considered by the court in making a decision still remain to be the provisions of Section 241. The court does not intend to canvass or delve further into the issues raised in the submissions that may go to the merit of the matter in view of the fact that, the parties are still arguing their application dated 30th March 2016.

41. Those are the orders of the court.

Dated, delivered and signed in an open court this 3rd day of October 2019.

G.L. NZIOKA

JUDGE

In the presence of;

Mr. Ahmednassir SC & Ms. Ngugi for the Plaintiff

Ms. Jan Mohamed for the 1st Defendant

Mr. Biriq for the 2nd Defendant

Mr. Wanjogu & Mr. Mohamed for the 3rd Defendant

Ms Okonji for the 4th Defendant

Ms. Onyango for the Interested part

Dennis -------------------------Court Assistant