REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI LAW COURTS

COMMERCIAL & ADMIRALTY DIVISION

CIVIL SUIT NO.68 OF 2014

PETER KURIA.....PLAINTIFF /APPLICANT

VERSUS

EUNICE MUTHONI.....1STDEFENDANT/RESPONDENT

HOTSTAR INVESTMENTS LTD.....2ND DEFENDANT/RESPONDENT

HOTEL STAREHE LTD.....3RD DEFENDANT/RESPONDENT

RULING

[1] This Ruling is in respect of the two applications dated **29 January 2015** and **11 November 2015**. The first application, dated **29 January 2015** is the Defendant's application that was filed by way of Chamber Summons pursuant to **Section 6 of the Arbitration Act** as read with **Rules 6** and **7 of the Arbitration Rules 1997**, for orders that this Court be pleased to stay the proceedings herein and refer the parties to arbitration; while the second application, which was filed by the Plaintiff, is by way of Notice of Motion for orders restraining the Directors of the 2ndand 3rd Defendants from appointing any other real estate agency apart from **Muigai Commercial Agencies Ltd**, to collect rent from the tenants occupying the premises on **LR 209/2788/17**; and from banking the companies' income in any other account than at the companies' bona fide accounts at **Family Bank**. The parties agreed that the latter application be heard first and hence, I propose to deal with it first.

The Plaintiff's Application dated 11 November 2015

[2] That Notice of Motion, which was supported by the Supporting Affidavit sworn by the Plaintiff, **Peter Kuria**, was filed pursuant to Sections **1A, 1B and 3A of the Civil Procedure Act, Chapter 21 of the Laws of Kenya, Order 40 Rules 1, 2 and 3(3) of the Civil Procedure Rules, 2010** as well as **Sections 28, 147, 148** and **149 of the Companies Act, Chapter 486 of the Laws of Kenya and Sections 92, 628, 629, 635 and 636 of the Companies Act, 2015.**

Thespecific orders prayed for are:

> a) An order restraining the directors of the 2nd Respondent from appointing any other real estate agency apart from **Muigai Commercial Agencies Ltd** and **Mamuka Valuers (Management) Ltd** from collecting rent from tenants in the building located at **LR. 209/2788/17**.

b) An order restraining the directors of the 2nd Respondent from banking its income in any other bank account apart from its bank account **No. 059000009866** at **Family Bank Limited**.

c) An order restraining the directors of the 3rd Respondent from banking its income in any other bank account apart from its bank account **No. 059000009865** at **Family Bank Limited**.

d) An order for Costs.

[3] The application was based on the grounds that **Muigai Commercial Agencies** was issued with an agency notice **by Kenya Revenue Authority (KRA)** requiring it to remit all monies collected on behalf of the 2nd Respondent directly to **KRA** , and that to circumvent this, the directors appointed **Mumuka Valuers (Management) Ltd** to collect rent without the knowledge of **KRA**, and therefore endangering the survival of the 2nd Respondent as its property could be auctioned by **KRA** in recovery of outstanding taxes. It was further contended that Family Bank Limited where account numbers **No. 059000009865** and **No. 059000009866** are domiciled was also similarly served with agency notices by **KRA** to remit all funds deposited in the account directly to **KRA**, and that to defeat and frustrate those instructions, the directors arranged for the funds to be banked in their joint account **No. 0120264010944** at **Equity Bank Ltd** without the knowledge of **KRA**. Finally, it was the contention of the Applicant that one of the Directors, **Margaret Wanjiru,** signed falsified books of accounts for the year 2013 that were submitted to **KRA**, an indication that the financial statements of the 2nd and 3rd Respondents were being manipulated for fraudulent purposes.

[4] In his supporting affidavit, the Plaintiff deponed that the 2nd and 3rd Defendants are limited liability companies that were founded by his late father, **Eliud Njoroge Kuria**, and that he is one of the four administrators of the estate of his deceased father, the others being: **Bernard Njoroge, Simon Muhia, Phyllis Wangari Njoroge**. The Plaintiff further deponed that his late father had appointed **Muigai Commercial Agency Ltd** to collect rent from tenants occupying the suit premises, which is owned by the 2ndDefendant; and that after **KRA** issued a tax demand of **Kshs. 17,298,826** and **Kshs. 5,596,756** to the 2nd and 3rd Defendants, respectively, on **16 June 2014**, which notices were served on **Muigai Commercial Agency Ltd** and **Family Bank Ltd**, the 1st Defendant and **Margaret Wanjiru** who are directors of the two companies, entered into property management agreement with **Mamuka Valuers (Management) Ltd,** authorizing them to collect rents in place of **Muigai Commercial Agency Ltd**and to deposit the same in a joint account opened in the names of the deceased's two widows at **Equity Bank Ltd**. It is the Plaintiff's contention that these changes were made behind the back of **KRA** with a view of tax evasion and fraud, and in proof thereof he posited that that the companies' directors submitted false returns to **KRA** for the year 2013 per the documents marked **PK15** and **PK16**.

[5] In addition to the foregoing, the Plaintiff averred that, after receiving the initial tax demands from **KRA,** the directors of the 3rd Defendant terminated the services of virtually all its employees and then closed down the operations of the bar and restaurant. That on account of the 3rd Defendant's insolvency, he (the Plaintiff) had been financing the operations of the 2nd and 3rd Defendants from time to time. He relied on the documents marked **PK12** and **PK13**in proof thereof. It is therefore the Plaintiff's case that he is apprehensive that if the current state of affairs continues, the two companies risk being wound up altogether, to the detriment of the deceased's beneficiaries.

[6] The Defendants opposed the Plaintiff's application and relied on the Replying Affidavit sworn on their behalf by the 1st Defendant, **Eunice Muthoni**. In that affidavit, the 1st Defendant denied the allegations of fraud levelled against her and **Margaret Wanjiru** and contended that, to the contrary, it was the Plaintiff who fraudulently acquired company shares; and that, on account thereof, she filed a complaint with the Registrar of Companies, which complaint was still pending with the Registrar of Companies.

[7] The 1st Defendant further drew attention to the discord between the Plaintiff on the one hand and the other administrators and dependants of the estate of the deceased, **Eliud Njoroge Kuria,** on the other hand, as well as the numerous applications that have been filed by the Plaintiff herein and in other related suits in other courts. Her contention was that the nexus in all the suits and applications is the succession dispute that is pending before the Family Division of the High Court at Milimani Law Courts being

Succession Cause No. 2423 of 2010. She explained in detail the circumstances under which

Mamuka Valuers (Management) Ltd was engaged and the **Equity Bank Ltd** Account in the name of the deceased's two widows opened, and that the situation has since changed in that all monies are currently being deposited in the companies' Family Bank accounts, and the tax arrears being reduced accordingly.

[8] It was the 1st Defendant's contention that the Plaintiff's ultimate objective, in filing this suit and the instant application, was to have himself entered as a creditor in the companies' books of accounts so that once he manages to plunge the companies into insolvency, he would emerge as the single beneficiary of an inevitable liquidation process. She thus posited that, as a non-director of the two family companies, the Plaintiff lacks the capacity to transact any business on behalf of the companies, including the *locus standi* to file this suit; and that what the Plaintiff has done amounts to abuse of the court process. She therefore urged for the dismissal of this application with costs.

[9] The application was canvassed by way of written submissions, which I have carefully perused and considered. A brief background would be in order to place the instant application in perspective. The Plaintiff and the 1st Defendant are siblings, the son and daughter of the deceased with **Margaret Wanjiru**, who is one of the directors of the family companies alongside the 1st Defendant. The Plaintiff, on the other hand, is one of the four administrators of the estate of the deceased, **Eliud Njoroge Kuria.** At some point in time, the Plaintiff was also a director of the 2nd and 3rd Defendant companies, but was removed on **2 November 2014**, pursuant to the then **section 185 of the Companies Act, Chapter 486 of the Laws of Kenya**.

[9] As pointed out by the 1st Defendant herein, this case has a close bearing with **Nairobi High Court Succession Cause No. 2423 of 2010**pending before the Family Division at Milimani Law Courts. It is evident that the Plaintiff had filed an application therein seeking more or less the same relief that he has prayed for herein, whereupon **Musyoka J**, in his Ruling dated **25 September 2014** had this to say:

> **"Regarding the two companies and their tax burden, I do note that these matters relate to limited liability companies which are separate legal entities from the estate. The companies should be able to take care of their own affairs, without allowing the same to spill on to the succession matter. I note that there are certain suits pending elsewhere in this court between the companies and the estate or certain individuals who are survivors of the deceased. Venturing into the affairs of the business would only complicate the matters. Suffice it to say that a firm of accountants has been appointed to address the dispute with the Kenya Revenue Authority. Let the said matter be handled vide the legal framework governing tax matters."**

[10] There appears to be no dispute therefore, that **KRA** served agency notices on **Muigai Commercial Agencies Ltd** and **Family Bank Ltd** in respect of taxes owed to it by the 2nd and 3rd Defendants. It is in the light of the foregoing that the Plaintiff moved the court to restrain the Defendants from evading their responsibility to pay taxes to **KRA**, to avert what he considered to be a real existential threat to the companies.

[11] According to **Mr. Gaita**, Learned Counsel for the Defendants, the instant application does not conform to any known law of procedure, in the sense that the main suit is designed to challenge the Plaintiff's removal as a director, yet the application seeks to ameliorate what the Plaintiff sees as the mismanagement of the companies. **Mr. Gaita** further argued that the application is misconceived in that, while it purports to be an interlocutory one, the prayers sought are not in the nature of interlocutory relief. **Mr. Gaita** also stressed the principle that parties are bound by their pleadings and therefore posited that interlocutory relief, if any, should be in tandem with the relief sought in the Plaint. The final point raised by **Mr. Gaita** was that, having been removed as a director, the Plaintiff had no *locus standi* to raise the issues he had raised in the instant application.

Given the foregoing scenario, the issues to consider are:

(a) Whether the Plaintiff has the requisite *locus standi* to file this suit and the instant application; and if so,

(b) Whether the prayers sought by the Plaintiff in the Notice of Motion dated 11 November 2015 are tenable.

[12] Ordinarily, companies transact business through resolutions passed either at the meetings of the Board of Directors, or of shareholders at Annual or Special General Meetings. This practice is firmly grounded on the principle laid down in the case of **Salomon vs. Salomon Co. Ltd [1895-99] All ER 33** that a company is a legal personality in its own right, with its own corporate identity, separate and distinct from the Directors or Shareholders, including the capacity to sue or be sued in its own name. In the premises, the proper Plaintiffs, in a case like the instant one, where a wrong is alleged against the Directors of the two companies, ought to have been the companies themselves, in accord with the principle laid down in the case of **Foss vs. Harbottle [1843] 67 ER 189.** The rule was restated by **Jenkins LJ** in the case of **Edwards vs. Halliwell [1950] All ER 1064** thus**:**

> **"The rule in Foss-v-Harbottle, as I understand it, comes to no more than this. First, the proper Plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is prima facie the company or the association itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quaestio*; or if the simple majority challenges the transaction, there is no valid reason why the company should not sue."**

[13] Needless to say that the Rule in **Foss vs. Harbottle** is applicable in Kenya. For instance, a discussion of the rule and its applicability to the Kenyan situation was done in the case of **Dadani vs. Manji & 3 Others [2004] eKLR** by **Mwera, J** (as he then was) and some of his observations, which were upheld on appeal in **Amin Akberali Manji & 2 Others vs. Altaf Abdulrasul Dadani [2015] eKLR,**were thus:

> **"It is a cardinal principle in company law that it is for the company and not an individual shareholder to enforce rights of actions vested in the company and to sue for wrongs done to it. It is also cardinal that in absence of illegality a shareholder cannot bring proceedings in respect of irregularities in the conduct of the company's internal affairs in circumstances where the majority are entitled to prevent the bringing of an action in relation to such matters...All this is in deference to the self-regulation the law allows corporations and thus limits the interference by courts in the running of such bodies on their own. However, if due to an illegality a shareholder perceives that the company is put to loss and damage but cannot bring an action for relief in its own name, such shareholder can bring an action by way of a derivative suit."**

[14] In the light of the foregoing, and going by the age-old principle that to every rule there is an exception, the Court of Appeal in the case of **Manji vs Dadani** (supra) acknowledged the following five exceptions:

a) if the alleged wrong is *ultra vires* the corporation because the majority shareholders cannot confirm the transaction;

b) if the transaction complained of could be validly sanctioned only by special resolution because a simple majority cannot confront a transaction which requires the concurrence of a greater majority;

c) where what has been done amounts to fraud and the wrongdoers are themselves in control of the company;

d) where it is alleged that the personal rights (including right to attend meetings and to insist on strict observance of the legal rules; statutory provisions in the Memorandum and Articles) of the plaintiff shareholder have been or are about to be infringed; and,

(e) any other case where the interests of justice require that the general rule, requiring suit by the company, should be disregarded.

The question, then, is whether the facts of the instant case fall within the foregoing exceptions.

[15] It is not in dispute herein that the Plaintiff is a shareholder of the 2nd and 3rd Defendants. There is however a disputation as to the Plaintiff's directorship of the two companies, in that, according to the Defendants, the Plaintiff was, by a resolution passed on **2 November 2014**, removed from the companies' directorship. The Plaintiff, on the other hand, contends that he is still a Director of the companies on the strength of letters from the Registrar of Companies (copies attached to his supporting affidavit as **PK1** and **PK2**). Whereas it is not altogether clear whether the Plaintiff sought to use the companies' internal mechanisms for dispute resolution and failed, it is evident that he found himself in the group of minority shareholders whose collective voice appears to have been drowned by the majority. He has alleged **fraud** against the Directors of the two companies, and while his allegations were denied by the 1st Respondent, those allegations bring the case within the exceptions to the **Foss vs. Harbottle Rule**. Moreover, the Plaintiff has demonstrated that his **personal interests** are in jeopardy, in that a resolution has been made by the other directors for his removal from the Board of Directors. As such, he cannot attend board meetings or otherwise participate in the day to day running of the companies.

[16] It is for the foregoing reasons that the court is satisfied that the option the Plaintiff had was to institute a **derivative suit** as he did herein, and therefore that he had the *locus standi* not only to file the suit, but also to bring the instant application. It therefore matters not that the orders prayed for in the instant application are not a replication of the prayers in the Plaint, so long as what is sought it to protect the interests of the companies in the interim. As to whether those allegations are credible is a matter for determination at the trial.

[17] Having found that the Plaintiff had the *locus standi* to file this suit as a minority shareholder, the next issue for determination is the competence of the application itself and whether the orders sought are tenable. This is because a party filing a derivative suit is expected, first and foremost, to adhere to the applicable threshold requirements before proceeding any further. In the case of **Manji vs. Dadani**, the Court of Appeal was of the view that leave to file or progress a derivative suit is a pre-requisite. It observed that:

> **"Leave of court shall be obtained before filing a derivative suit, but may also 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, the company is entitled to the intended relief and that the action falls within any of the exceptions to the rule in Foss vs. Harbottle."**

[18] The court thus approved the pre-action procedural guidelines set out in **Dadani vs Manji** (supra) that the proper way to bring a derivative action is to begin with the filing of the suit, then following it with an application to be served along with the Plaint, followed by the court hearing and determining whether the plaintiff should continue with the action. The court further observed thus:

> **"...the plaint plus the application for permission to continue with a derivative action must be served before the application is heard. The application has to be heard *inter partes* because the plaintiff has to demonstrate a prima facie case by the company against the wrong-doing directors and that the plaintiff should bring the case. The service of the plaint and the application affords an opportunity to the defendants in their own pleadings and evidence to try to knock out the intended derivative action. The powers which the court has when hearing the application to continue though not specified, but it can be taken that it can grant the permission all the way up to trial or as it deems fair and just in the matter. And only then can**

the plaintiff move to the other stages or steps in the cause. Otherwise before the permission, proceedings are virtually stalled..."

[19] There is no indication herein that the Plaintiff complied with these procedural requirements. To the extent therefore that the court has not been appropriately moved to grant and has not, thus far, granted leave for the continuation of this suit as a derivative suit, the instant application appears to be premature and I so hold. In the premises, I find it superfluous to get into a consideration of whether or not the orders sought in the Plaintiff's Notice of Motion dated 11 November 2015 are warranted. I would accordingly strike out that application for being incompetent and award costs thereof to the Defendants.

Orders accordingly.

The Defendants' Application Dated 29 January 2015

[20] The application, dated **29 January 2015** is the Defendants' application. It was filed by way of Chamber Summons pursuant to **Section 6 of the Arbitration Act** as read with **Rules 6** and **7 of the Arbitration Rules 1997**, for orders that the Court be pleased to stay the proceedings herein and refer the parties to arbitration, and that the costs of the application be in the cause. The application was predicated on the grounds that:

(a) The Memorandum and Articles of Association of the 2nd and 3rd Defendants provides for arbitration as the mechanism for solving any dispute between the members of the company or between a member and the company;

(b) It is in the interests of justice that the matter be referred to arbitration in order to attain an expeditious determination.

The application was supported by the affidavit of **Eunice Muthoni**, the 1st Defendant herein, to which were annexed the Articles of Association of the 2nd and 3rd Defendants.

[21] The Plaintiff opposed the application on the grounds that under **Section 6(1) of the Arbitration Act, Chapter 49 of the Laws of Kenya**, an application for stay of proceedings pending arbitration must be brought at the time when an appearance is filed or acknowledgment of the suit is otherwise made by a Defendant, and that this was not done by the 1st Defendant/Applicant. He further argued that there being no arbitration agreement between him and the 1st Defendant, the dispute herein does not lend itself to arbitration, more so because one of the issues in controversy is the allegation of fraud. Finally, it was the Plaintiff's contention that arbitral proceedings have become quite expensive, with some arbitrators charging **Kshs. 25,000** per hour. He thus opposed the application and urged for its dismissal with costs.

[22] The court has carefully considered the instant application in the light of the supporting and replying affidavits and the annexure thereto, as well as the written submissions filed by the parties. It is the law under **Section 6 of the Arbitration Act** that:

"A court before which proceedings are brought in a matter which is the subject of an arbitration agreement shall, if a party so applies not later than the time when that party enters appearance or otherwise acknowledges the claim against which the stay proceedings is sought, stay the proceedings and refer the parties to arbitration unless it finds--

(a) that the arbitration agreement is null and void, inoperative or incapable of being performed; or

(b) that there is not in fact any dispute between the parties with regard to the matters agreed to be referred to arbitration..."

[23] The **Articles of Association** annexed to the supporting affidavit of the 1st Defendant do confirm that, in **Clause 31** in each case, arbitration was provided for as the preferred dispute resolution

mechanism in all disputes involving the two companies. Accordingly, the Plaintiff's argument that he had no arbitration agreement with the Defendants is clearly untenable, he being a member of the Defendant companies. In any event, an arbitration agreement for the purposes of the **Arbitration Act** is defined in **section 3(1)** thereof to be:

> **"...an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not..."**

[24] Clause 31 of the Articles of Association of the 2nd and 3rd Defendants would no doubt qualify as arbitration agreements for the intended purposes. I entirely agree with the view taken by **Njagi, J** on this point in **Abdirahaman Affi Abdalla vs. Osupuko Service Station Ltd & Another [2012] eKLR**, in which he stated thus in respect of a similar clause:

> **"With respect, Mr. Chelanga's contention overlooks one fundamental principle of company law. That principle ordains that a company's articles of Association give rise to a contract not only between every member and the company, but also among the members of the company *inter se*. The logical conclusion to be drawn from that principle is that members of the 1st Plaintiff company are bound by that company's Articles among themselves, and therefore Article 31 becomes an arbitrating agreement among all the members."**

[25] The issues in contest herein relate to the removal of the Plaintiff as a Director, alleged fraudulent transfer of shares, and the management of the companies' bank accounts. All these are issues within the purview of the **Articles of Association**, and therefore amenable to arbitration. Accordingly, the only issue to determine is whether, given the strictures of **Section 6(1) of the Arbitration Act**, the application for referral to arbitration is **time-barred**.

[26] Section **6(1) of the Arbitration Act**, which is couched in peremptory terms, explicitly requires that an application such as the instant one be filed contemporaneously with the filing of the Memorandum of Appearance, for it reads "... **not later than the time when that party enters appearance or otherwise acknowledges the claim..."** (Emphasis added). It is noted that whereas Mr. Gaita came on record for the Defendants on **23 September 2014**, the instant application was not filed until some **four** months later, on **30 January 2015.** It is clearly time-barred from the stand-point of the enabling procedural provision, namely **Section 6(1) of the Arbitration Act**. In the case of **Charles Njogu Lofty vs. Bedowin Enterprises Limited [2005] eKLR,** the Court of Appeal had the following to say in a similar situation:

> **"...even if the conditions set out in paragraphs (a) and (b) of Section 6(1) are satisfied, the court would still be entitled to reject an application for stay of proceedings and referral thereof to arbitration, if the application to do so is not made at the time of entering an appearance, or if no appearance is entered, at the time of filing any pleadings or at the time of taking any step in the proceeding."**

[27] Clearly therefore, the Chamber Summons application dated **29 January 2015** is untenable and is hereby dismissed with costs.

Orders accordingly.

DATED, SIGNED AND DELIVERED AT NAIROBI THIS 13th DAY OF MAY, 2016

OLGA SEWE

JUDGE