



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI
COMMERCIAL & ADMIRALTY DIVISION
CIVIL SUIT NO 281 OF 2014 (FAST TRACK)

VERY REVEREND FATHER

SILOUANOS SAMUEL MWANGI GICHANGA.....PLAINTIFF

V ersus

ARCHBISHOP MAKARIOS TILLYRIDES.....1ST
DEFENDANT

POPE THEODOROS II NIKOLAOS CHOREFTAKIS.....2ND DEFENDANT

ATHINODOROS PAPAEVRIPIADES.....3RD
DEFENDANT

KONGAI DAVID KIPLANGAT.....4TH DEFENDANT

ORTHODOX TOWERS MANAGEMENT

COMPANY LIMITED.....5TH DEFENDANT.

ORTHODOX ARCHBISHOPRIC OF KENYA LIMITED.....6TH DEFENDANT

RULING

Derivative suit

[1] The Plaintiff says this suit is a derivative suit. He has filed it on behalf of and for the benefit of the 6th Defendant-a registered company. He, therefore, seeks for leave to proceed with the suit as a derivative suit for the 6th Defendant. Two issues arise from the pleadings and submissions of the parties; 1) Are the grievances expressed by the Plaintiff in the nature of derivative suit; and 2) Is leave merited?

[2] Much judicial as well as literally ink has been spilt over the subject of derivative suit; its nature, when and how it should commence and proceeded with by an aggrieved minority shareholder of a company. Counsels in this case have also submitted in ex tenso on this subject. I will not, therefore, try to re-invent the wheel but to cite some clear past decisions and literally works on the matter. Derivative suit has its origin as an exception to the famous rule in **Foss V Harbottle [1843] 67 ER 189/2 Hare 461**. The Rule as formulated in this case is:

“In any action in which a wrong is alleged to have been done to a company, the proper claimant is the company itself.”

However, a shareholder or minority members of a company may sue on behalf of the company in instances where a company has been wronged by some third person, usually, although not invariably, a corporate officer or Board of Directors, but the company has failed or are not willing to take action to remedy a wrong done to the company. Most of the time, the wrongdoers are the majority in the Board of Directors who use their majoritarian control to perpetuate the wrong against the company. But not all wrongs will found a derivative suit. The wrongs which will found a derivative suit are those wrongs which amount to *ultra vires* the company- as such acts, cannot in law be confirmed even by unanimous or majority resolution of the Board; or amounts to fraud on the company. It must be noted also that derivative suit should be for the benefit of the company and its shareholders as opposed to individual benefit to the person suing. And, again, the person commencing a derivative suit should not be part of the wrong being remedied by a derivative suit. Also see literally work in ***COMPANY DIRECTORS - Duties, Liabilities and Remedies***, Ed. SIMON MORTIMORE QC) that:

“The rationale of derivative claims is not difficult to explain. Where the company has suffered a wrong by reason of the conduct of a director, leaving the decision of whether to bring an action or not to the board would create room for a conflict of interest. The derivative claim is best viewed as an action commenced by a minority shareholder seeking relief on behalf of the company in respect of a wrong done to the company: his rights are “derived” from the company.”

I have set out the threshold. I now proceed to examine the facts of the case and the submissions of the parties against this legal threshold.

The nature of suit and plaintiff’s submissions

[3] The Plaintiff filed an amended plaint on 21st July 2014 and added the Orthodox Archbishopric of Kenya Limited as the 6th Defendant. The Plaintiff also added a prayer for a mandatory injunction seeking restitution. The Plaintiff also filed a notice of motion dated 21st July 2014 seeking leave to proceed with the suit herein as a derivative suit. He did not forget to ask for indemnity to the 6th Defendant by way of costs of the suit. According to the Plaintiff, this court should determine whether the Plaintiff has **locus standi** and whether this suit is a derivative action.

[4] The Plaintiff is of the view that he has locus standi to file this suit on behalf of and for the benefit of the 6th Defendant. In his Supporting Affidavit sworn on 21st July 2014, the Plaintiff avers that he is a director of the 6th Defendant and he annexed an extract from the Registrar of Companies as proof thereof. As such director, he found himself in the minority in the face of actions perpetrated by his co-directors, which actions were undertaken behind his back and which could not be corrected or remedied by internal controls. The Plaintiff did not expect the other directors, the very perpetrators of the acts complained of, to authorize proceedings to be taken in the name of the 6th Defendant. The law and practice relating to derivative actions is settled both under the common law and subsequent codifications in England and in our own jurisprudence. He relied on the literally work in ***COMPANY DIRECTORS - Duties, Liabilities and Remedies***, Ed. SIMON MORTIMORE QC).

[5] The Plaintiff in the Plaint outlined several wrongs perpetrated against the 6th Defendant and especially the movement of over six hundred million shillings from the 6th Defendant’s bank account at Prime Bank, Riverside drive, to the 5th Defendant’s bank account with the same bank. He is concerned that the movement of these funds was done during the pendency of this suit. To the Plaintiff this is a demonstration, *prima facie*, that wrongs have been committed against the 6th

Defendant which require intervention of this Honourable court. *A fortiori* the Plaintiff has *locus standi* to bring this action and he urged this Honourable court to so find.

[6] He continued with submissions. That being a director in the minority faced with wrongs visited and or intended to be visited upon the 6th Defendant, so he filed these proceedings to protect the 6th Defendant. He asserted that none of the prayers in the Plaint seek any particular benefit for the Plaintiff. The beneficiaries of the suit would be the 6th Defendant and, of course, its members including the Plaintiff's co-directors. The 1st, 2nd, 3rd, 4th, and 5th Respondents have planned a takeover of the assets of the 6th Defendant, a limited liability company, which is absolutely illegal being not authorized by the board and being an appropriation by one entity of the assets of another without any consideration. And if these plans by the 1st, 2nd, 3rd, 4th, and 5th Respondents succeed, the 6th Defendant will be rendered moribund – an empty shell. The Plaintiff's objective is, therefore, to promote the interests of the company and its members as a whole. He is also not involved in the wrongs being perpetrated by the co-directors. The Plaintiff believes that the claim herein is not based on mere procedural faults that can be remedied by internal mechanisms; it is a suit which satisfies all the conditions of a derivative suit and should be allowed. The 6th Defendant is in the full control of the other Defendants and it can only be saved by the Plaintiff through this derivative action. The Plaintiff found support in the case of **Dadani - vs- Manji and 3 others [2004] 1KLR 95**, where Honourable justice Mwera (as he then was) had this to say:

“So this basically is intended to be what is called a derivative action. By such actions in company law, minority shareholder(s) feeling that wrongs have been done to the company which cannot be rectified by internal company mechanisms like meetings and resolutions, because the majority shareholders are in control of the company, come to court as agents of the “wronged” company to seek reliefs or relief for the company itself, all the shareholders including the wrongdoers, and not for the personal benefit of the suing minority shareholder(s)” (page 97)

And having considered rival submissions, the learned judge held that:

“Now in all fairness would one expect the Plaintiff to successfully by resolution or otherwise, move the other shareholder(s) to allow the company to sue in its name for wrongs against it? Not quite. In this court's view here the proper and equitable way to have the 4th Defendant to wage its claims is for the Plaintiff to sue on its behalf..... All he had to demonstrate was that a board resolution was not possible. This suit cannot be struck out.”

The Defendants returned fire

1. [7] The Defendants filed a Replying Affidavit dated 15th July 2014 sworn by David Kiplagat Kongai, Grounds of Opposition dated 28th July 2014 Notice of Preliminary Objection dated 23rd July 2014. They contended that the 1st, 2nd, 3rd and 4th Defendants are members of the 6th Defendant which is a company limited by guarantee. The Plaintiff, until recently, was also a member of the 6th Defendant. Pursuant to Article 37F of the Memorandum and Articles of Association, the 2nd Defendant is empowered to remove any member by an instrument in writing. On 15th September 2014, the Plaintiff was removed as a member of the 6th Defendant and the 6th Defendant is currently in the process of obtaining a revised List of Shareholders and Directors (Form CR12) from the Companies Registry. The 5th Defendant was incorporated with a sole view of managing the assets of the 6th Defendant. The 6th Defendant had previously invested in shares through Standard Investment Bank, out of which substantial profits/returns were realized. The 6th Defendant through consultations with auditors and attorneys, opted to have the 5th Defendant incorporated as a company limited by shares, for purposes of making further investments of the

returns afore stated, *to wit*, the construction of a commercial building (hereinafter referred to as “the proposed project”) which will give the 6th Defendant regular income. The incorporation of the 5th Defendant is necessary in investment because; the proposed project will be undertaken with the help of financial partners who are expected to enter in to a joint venture agreement with the 5th Defendant; and such investment for the 6th Defendant has tax implications since the 6th Defendant is exempt from paying taxes. With investment to derive income, it will be mandatory for tax to be paid after the construction of the proposed project. The 5th Defendant is wholly owned by the 6th Defendant as is set out in the Memorandum and Articles of Association of the 5th Defendant. The shareholders of the 5th Defendant hold shares in trust for the 6th Defendant. The transfer of the funds held by the 6th Defendant in Prime Bank Limited was done in accordance with the law, through a board resolution passed by majority members, and in furtherance of the cause to secure the funds for the benefit of the 6th Defendant. It is not in dispute that the said funds are held in an interest earning account, and the purpose of these funds is for the proposed project. The 6th Defendant holds other accounts with various banks, which accounts hold money used for the daily operation of the Church, the 6th Defendant. These funds remain in the accounts held by the 6th Defendant.

[8] According to the Defendants, in 2011, the Memorandum and Articles of the 6th Defendant were amended to vest all powers in the Pope, the 2nd Defendant herein, and the Plaintiff has therefore perjured himself in claiming to be the financial controller of the 6th Defendant. Indeed the 2nd Defendant exercised his powers under the Memorandum and Articles of the 6th Defendant and removed the Plaintiff from being a member of the 6th Defendant, and in his place, appointed Georgios Vladimirov. Therefore, the Plaintiff’s Application dated 2nd July 2014 has been overtaken by events and perhaps that is the reason why the Plaintiff has not submitted on that aspect in his written submissions. For reasons afore stated, the Defendants prayed for the said application to be dismissed with costs.

[9] The Defendants also submitted that the Plaintiff has not *locus standi*, to file representative suits and derivative suits. They cited Order 1 Rule 13 (1) and (2) of the Civil Procedure Rules 2010 to support their submission that the Plaintiff is not authorized by others to appear, plead or act on their behalf and is not the holder of authority in writing and signed by the party or parties giving it. This suit is also not a derivative suit and it offends the rule in **Foss vs. Harbottle** which requires that the proper party in any suit by the company should be the company. They emphasized the rationale for this rule and the courts’ historical reluctance to become involved in disputes over the internal management of companies. They submitted that it is only where the wrong complained of is *ultra vires* the company or is fraud and the wrongdoers themselves are in control of the company. when a derivative suit may be filed. But not on transactions which can be validly done or sanctioned by a special resolution or the like. Fraud, according to the Defendants in this context essentially encompasses situations such as where the majority are endeavouring to appropriate themselves money or property which belong to the company which is not the case here. Fraud does not cover the situation where the alleged wrong-doers do not themselves benefit. The law is very clear that fraud does not involve mere negligence on the part of the members or directors so that a derivative action cannot be brought against directors who, say, mismanage a company and cause it loss, even if they have control. Such is Company Law. As the 5th Defendant is wholly owned by the 6th Defendant, the decision of the majority members of the 6th Defendant to transfer money to the 5th Defendant cannot be faulted and it certainly cannot and does not constitute fraud. They quoted the case of **Parlides vs. Jensen [1956] Ch 565** where the plaintiff, a minority shareholder, brought an action against the defendant directors alleging that they had negligently sold a mine at a gross undervalue, Danckwerts J held that negligence did not fall within “fraud on minority” exception to the rule in **Foss –v- Harbottle** so that the plaintiff could not sue. Also, the case of **Prudential Assurance Co. Ltd vs. Newman Industries Limited [1982] Ch. 204**, the Court of Appeal held:

“In our view, whatever may be properly defined boundaries of the exception to the rule, the plaintiff ought to at least be required before proceeding with his action to establish a prima facie case (i) that the company is entitled to the relief claimed and (ii) that the action falls within the proper boundaries to the rule in Foss –v- Harbottle.”

[10] The Plaintiff has not established a *prima facie* case against the Defendants or that the company is entitled to the intended relief and that the action falls within the exceptions to the rule in Foss –v- Harbottle. For those reasons, the Defendants prayed that the Plaintiff’s suit ought to be struck out in its entirety. Likewise, the Plaintiff’s applications dated 2nd July 2014 and 21st July 2014 should be dismissed with costs.

THE DETERMINATION

[11] I have already set out the law on derivative suit as well as the issues for determination. Has the Plaintiff established a prima facie case; i) that the company is entitled to the relief claimed in this case; and ii) that the action falls within the proper boundaries to the rule in Foss vs. Harbottle? For me to answer these first questions, I must examine the nature of the wrongs complained of. The Plaintiff claims to be a member and director of the 6th Defendant and according to him there is fraud being committed on the company by the 1st, 2nd, 3rd, 4th, and 5th Respondents. These Defendants are in control of the company as they are the majority. The fraud, as per the Plaintiff is in the fact that these Defendants have planned a takeover of the assets of the 6th Defendant, a limited liability company, which is absolutely illegal being not authorized by the board and being an appropriation by one entity of the assets of another without any consideration. He stated that the Defendants have moved a sum of Kshs. 600,000,000 to another account within Prime Bank belonging to the 5th Defendant. And if these plans by the 1st, 2nd, 3rd, 4th, and 5th Respondents succeed, the 6th Defendant will be rendered moribund – an empty shell. The Plaintiff claims that he has no personal benefit in filing this suit, and that the suit will accrue benefit to the company and its members including the Plaintiff. Therefore, he claims that his objective is, therefore, to promote the interests of the company and its members as a whole. Further, the Plaintiff contends that he is not involved in the wrongs being perpetrated by the co-directors. These wrongs, according to the Plaintiff are not based on mere procedural faults that can be remedied by internal mechanisms; the 1st, 2nd, 3rd, 4th, and 5th Respondents are the wrongdoers and cannot be expected to right their wrongs through ordinary company internal processes. Are these wrongs which would entitle the company any relief in law within the exception to the rule in Foss vs. Harbottle?

[12] The wrongs which would entitle a minority shareholder to file suit on behalf of the company are mainly acts which are ultra vires the company or which amount to fraud. Ultra vires decisions are those decisions which are made without any authority under the Memorandum and Articles of Association or the law. Such decisions cannot even be ratified by the Board or the shareholders in a General or Special Meeting of the company. This test is straight forward and easy to apply on the wrong complained of. I will determine eventually whether the wrongs complained of are matter ultra vires the company once I analyse the entire case as well as the arguments by the Defendants. For now let me say something about fraud especially because the Plaintiff seems to rely on fraud. Fraud, within the exception to the rule in Foss vs. Harbottle consists in wilful acts or omission by the directors of a company to defraud the company of its assets. The fraud may manifest itself in various forms including conspiracies and other stealth schemes calculated at inducing the company to enter into bargains which will result into deprivation of the company asset. It may also take an overt stature of outright mis-use or unfair misuse of power arising out of the authority under the Memorandum and Articles of association of the company.

[13] There is no doubt that Article 37F of the Memorandum and Articles of Association, empowers the 2nd Defendant to remove any member by an instrument in writing. On 15th September 2014, the Plaintiff was removed as a member of the 6th Defendant and the 6th Defendant is currently in the process of obtaining a revised List of Shareholders and Directors

(Form CR12) from the Companies Registry. There nothing to make me doubt that 5th Defendant was incorporated with a sole view of managing the assets of the 6th Defendant. There is also nothing which controverts that the 5th Defendant is wholly owned by the 6th Defendant. Its' Memorandum and Article of Association attests to that fact. The other averment by the Defendants which has not been controverted is that the 6th Defendant had previously invested in shares through Standard Investment Bank, out of which substantial profits/returns were realized. Is the resolution to incorporate a company wholly owned by the 6th Defendant for purposes of investment ultra vires the company, or a fraud on the company? The Memorandum of the 6th Defendant does not preclude such incorporation of wholly owned subsidiary company for purposes of investment. And advice such as the one the 6th Defendant received in its consultations with auditors and attorneys makes economic sense and complies with the countries tax regime; because the 6th Defendant, which enjoys tax relief by way of exemption, cannot invest for income without paying taxes. An investment which will require funding by other investors would certainly pose a challenge to the 6th Defendant as incorporated. And I agree with counsel for the Defendants that, in those circumstances there was need under law to incorporate the 5th Defendant, a company limited by shares, for purposes of making further investments of the capital in the hands of the 6th Defendant in order to comply with tax laws. Although I must state that I believe the previous returns on investment by the 6th Defendant met the thresholds of the income tax. I note also that the 5th Defendant is wholly owned by the 6th Defendant. These things make it is difficult to call this arrangement a "take-over" of the assets of the 6th Defendant or an act which will make the 6th Defendant moribund as the Plaintiff wants the court to believe. It is not disputed that the 6th Defendant holds other accounts with various banks, which accounts hold money used for the daily operation of the Church, the 6th Defendant. These funds remain in the accounts held by the 6th Defendant. It is difficult to read fraud in the stated facts and circumstances. The resolutions to invest company assets are not fraudulent or ultra vires the company as they do not offend the law; were passed in accordance with the Memorandum and Articles of Association of and in furtherance of a cause of the company.

[14] There is nothing which the Plaintiff intends to save the company from through a derivative suit. In sum, the circumstances of this case do not bring themselves within the boundaries to the exception to the rule in **Foss vs. Harbottle**. The Plaintiff has not established a prima facie case; i) that the company is entitled to the relief claimed in this case; and ii) that the action falls within the proper boundaries to the rule in Foss vs. Harbottle. But before I make the final order, the following statement by Defendants in their submissions requires some commentary:

Fraud does not cover the situation where the alleged wrong-doers do not themselves benefit.

Fraud covers even those wrongs which the directors commit for the benefit of other people. Any fraudulent transaction by the board which is calculated to benefit others or one or more of the board members, and on which the company has failed or the directors have deliberately refused to take action, entitles a minority shareholder to file a derivative suit on behalf of the company.

[15] The upshot is that the court declines to give leave to the Plaintiff to continue with a derivative suit. The application for leave is hereby dismissed and as the suit saddles upon the application for leave, it also meets judicial death. As at the time of filing this suit, the company was in the process of formalizing the removal of Plaintiff as a member of the 6th Defendant and I am not able to read any malice on the part of the Plaintiff in instituting this suit. I will not, therefore, condemn the Plaintiff to costs. Each party shall bear own costs of the applications as well as the suit. It is so ordered.

Dated, signed and delivered in court at Nairobi this 2nd day of February 2015

F.GIKONYO

JUDGE