REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

Civil Case 1417 of 1998

EPHANTUS M. KAGOMO & 6 OTHERS…….....……....PLAINTIFF

VERSUS

INDUSTRIAL & COMMERCIAL DEVELOPMENT CORPORATION.
…….DEFENDANT

JUDGEMENT

The plaintiffs, **EphantusMwangiKagomo, Joseph MburuMuturi, Wilson NjomoKamau, Damian Maganga, Joseph KamauKamenwa, James Chiigwado and Nelson NkuguaKaranja**by their amended plaint filed in Court on 22nd September 2008 seeks from the defendantdamages for wrongful dismissal and/or loss of employment, loss of income and other terminal benefits, Costs of the suit as well as interests. Their cause of action is premised on the fact that while being employees of Kenya Engineering Industries Limited (hereinafter referred to as the Company) the defendant which was an equal and joint equity/share holder and manager the affairs of the said company as well as a debenture holder over all the assets of the said company, placed the company under receivership jointly with Kenya Commercial Bank Limited (hereinafter referred to as the Bank). This action, according to the plaint, was in the exercise of the powers conferred upon the defendant by the said debenture. Consequently, the plaintiff's employment was unlawfully terminated. It is the plaintiffs, position that the Defendant as the joint owner of the said company was by extension their employer and owed them the duty to ensure that the company was not run down or bankrupted and is obliged to compensate them for the loss of employment which losses were to be particularised at the hearing of the case. The plaintiffs' losses therefore stem from what, according to them, is the Defendant's unlawful act of closing down the subsidiary company. They therefore claim loss of income as well as their share of statutory deductions in respect of NSSF and NHIF and an account thereof.

The defendant filed a defence on 15th September 1998 in which while averring that the said company was a subsidiary Company, denied managing the affairs of the company. It, however, admitted having placed the said companyunder receivership but contends it was within its rights as debenture holder to take such lawful action. According to the defendant it was not the Receiver of the company but a debenture holder. According to the defendant the said company has since been placed on liquidation and rights to sue therefore extinguished.

It is important to note that on 2nd June 2010, the 1st, 2nd and 5th plaintiffs' suits were marked as withdrawn with costs to the defendant. However, on 12th June 2012, the plaintiff's advocate applied that the 1st, 2nd and 7th plaintiff's suit be withdrawn and according to him that would have left intact the claims by the 3rd, 4th, 5th and 6th plaintiffs. An order was recorded to that effect. However, the result of the order made on 12th June 2012 had the effect of only leaving the suits by the 3rd, 4th and 6th plaintiffs

since the 5th plaintiff's suit had been withdrawn and there was no order reinstating the same.

The plaintiffs called **Wilson JomoKamau**, as PW-1. According to him he was also giving evidenceon behalf of his co-plaintiffs. According to him they worked for the company for a very long time and at the time of leaving the employment they were not paid. The witness was employed as a Machine Operator, the 5th plaintiff was in the Assembly Section, the 4th Plaintiff was a Machine Operator while the 6th Plaintiff was a welder. He served the company for 23 years, the 5th plaintiff served for 10 years, the 4th Plaintiff served for 10 years while the 6th Plaintiff served for 16 years. The Company according to him was owned by the defendant. The Company according to the documents of incorporation was incorporated on 29th July 1969 with the shareholders as the Defendantand**Polcpmex SA (**the Polish Company) in the ratio of 49:51. In 1980 the Defendant bought the whole shares. According to the witness, in March 1994 they were not paid due to computer breakdown. When they resumed work on 7th April 1994, they were paid and told to go on leave for 7 days. However, when they resumed work the unpaid leave was extended for another period of 3 months after which they were informed that the company had been placed under receivership. The receiver, **G. Silcock**of **Price Waterhouse**, was appointed by the Defendant and Kenya Commercial Bank Limited. Although the said receiver promised that they would be paid, they were never paid and never resumed their work under the said receiver. They are therefore suing for their benefits, damages and court expenses. According to the witness the Company was owned by the Defendant which was their employer by extension. In support of their claim the witness produced the documents comprised in their list and supplementary list of documents as exhibits.

In cross-examination by **Mr. Matheka**, learned counsel for the Defendant, PW-1 confirmed that his employer was the company and that he sued the defendant because it owned the Company. According to him he is not aware that the company is separate from the shareholders. At the time the receivers were appointed the witness said they were at home and that he never met them there. He confirmed that the whole shares of the company were bought by the Defendant and that the receiver informed them that once he sold the Company he would pay them their dues. He confirmed that their services were being rendered to the company and so their dues should have been paid in accordance with the schedule.

The second witness was **Joseph KamauKamenwa** who gave evidence as PW-2. His evidence in chief was limited to confirming that he had authorised the 3rd plaintiff to give evidence on his behalf and that what PW-1 had testified on was the truth. In cross-examination by **Mr. Matheka**, said that the reason for suing the Defendant was because the Defendant owned and managed the Company. According to him the company was not managed by the receiver who came when they were out of the Company. He confirmed that **Mr. G. Silcock** was appointed by the Defendant and derived authority from the Defendant. He, however, confirmed that his employer was the Company.

PW-3, was **Damien Nganga**, the 4th plaintiff. His evidence in chief was similarly limited to confirming that he had authorised PW-1 to give evidence on his behalf and the evidence adduced by PW-1 was true. He was not cross-examined.

PW-4, **James Chigwadu** is the 6th plaintiff. He similarly confirmed having authorised PW-1 to testify on his behalf. In cross-examination, he reiterated that he was adopting what PW-1 had stated. He was however unaware that a shareholder is separate from the company. While being aware of the appointment of **G. Silcock** as a receiver, he was not aware that he was not an agent of the Defendant. While confirming that the receiver was appointed by the Defendant he was unaware of the circumstances under which the Defendant and the Bank came together in the said appointment. According to him, the receiver was not appointed because he came in when everything was over.

At the end of PW-4's evidence the plaintiffs' case was closed.

The defendant called one witness **Peter MugaKaruga**, the Defendant's Deputy Debt Recovery Manager. According to him the plaintiffs' claims are wrongly addressed since they were employees of the Company and not the Defendant. He testified that the Company wasthe Defendant's client to whom they had lent Kshs. 2,000,000.00 vide a loan agreement dated 8th May 1986. In support of his claim he

produced the said agreement as exhibit. The securities for the said facility were a charge over LR No. 209/7406 Nairobi area and a debenture over all the assets of the Company. The charge and debenture were similarly produced as exhibits. Following the inability of the Company to service the loan, the two debenture holders, the Defendant and the Bank decided to place the Company under receivership since the Bank also held a debenture which ranked in *parupassu* with that of the Defendant. Both these entities, according to the witness placed the Company under receivership and appointed a receiver manager on 1st July 1994. At the time of the appointment of the receiver, the sum due had accumulated to Kshs. 5,135,000.00. According to the witness the plaintiffs' suit ought to be dismissed because the plaintiffs were employed by the Company and it is the receiver manager who terminated the plaintiffs' employment and who should account for the sum recovered. According to the witness the sum due to the Defendant was not recovered in full.

In cross-examination by **Mr. Meenye**, learned counsel for the plaintiffs the witness admitted that from the documents shown to him the company was formed on 29th July 1969. Although he was not aware of the shareholding of the Company he confirmed that the Defendant was a shareholder thereof. He confirmed that the Company was owned jointly with the Polish Company though he was unaware of the directorship. On being shown the Articles of Association of the Company he confirmed that the directors were the Defendants and the said Polish Company whichwere also its shareholders. He was however, unaware that the said Polish Company withdrew from the Company. While conceding that the Company was placed into receivership by the Defendant and the Bank, he stated that the plaintiffs were not employees of the Defendant by extension or operation of the law.

At the close of the case the parties filed written submissions.

According to the plaintiffs, each plaintiff claims 3 months unpaid salary; 3 months' pay in lieu of notice, severance pay i.e. 15 days for each completed year of service; and statutory deductions for both NSSF and NHIF (sic) contributions as tabulated in exhibit P2. It is submitted by the plaintiffs that although they were all employees of the defunct company, and their services were terminated by the receiver appointed by the debenture holders, namely the Defendant and the Bank, they were all, by extension, employees of the defendant since the defendant was the joint promoter and equity holder of the defunct company; the defendant wasthe beneficiary, by way of profits earned, of labour and sweat of the Plaintiffs; the defendant was a Director of the defunct company and if one lifts the veil of incorporation the Defendant and the defunct company are one and the same entity. Accordingly the court is urged to see the defendant through the eyes who were recruited by its agent, the company for their both benefits. Accordingly, it is submitted the defendant should not be allowed to hide under the guise of incorporation to escape its legal and contractual obligations as the owner of the company since the company was a wholly owned subsidiary of the Defendant. The Court is urged to find that the magic of corporate personality enabled the defendant to be master and servant at the same time and to get all the advantages of both. For support **C B Grower – The Principles of Modern Company Law at pages 194-205** is cited for the submission that the company and the defendant are one and the same person hence the plaintiffs were employees of the defendant. On so finding the court, in line with **Gitau vs. East African Power & Lighting Co. Ltd [1986] KLR 365** is urged to award compensation for loss of wages and salaries for the periods worked without pay, notice period pay and redundancy pay, the unremitted statutory deductions for both NSSF and NHIF and employers' share of those contributions and obligations plus costs of the suit.

On its part the defendant submitted that the plaintiffs were employees of the company and there was no employment contract between the defendant and the plaintiffs hence the plaintiffs' claim for damages lacks merit. It is further submitted that there is no basis why the Plaintiffs have lifted the corporate veil of incorporation since it is settled law that a company is a separate and distinct entity from the shareholders. As the debt was not fully satisfied and is still outstanding, the plaintiffs who were unsecured creditors rank after the secured creditors. Accordingly the receiver did not owe any duty of care to the plaintiffs but only owed a duty of care to the company and a statutory duty of care to the preferential creditors and in support of this submission the defendant cites **Michael Oyugi& 181 Others vs. Industrial Plant (EA) Limited (in receivership) & Another [2006] eKLR**. According to the debenture, it is submitted that the receiver was the agent of the Company and the Company was solely liable for his acts. It is further noted in the said submissions that both the Company and the receiver were not joined in the suit. Accordingly,

the defendant prays that the suit be dismissed with costs.

In my view the following issues fall for determination:

1. Whether the defendant managed the affairs of the Company.

2. Whether the defendant by its actions should be considered as the same entity as the company and whether the company's corporate veil should be lifted.

3. Whether the defendant was within its rights to place the company under receivership.

4. Whether the defendant is liable to the plaintiffs and if so in what sum

5. Whether there is a cause of action disclosed against the defendant.

6. Whether the rights to sue still exist.

7. Who should bear the costs of the suit.

The first issue for determination is whether the defendant managed the affairs of the Company. Acorporation is an artificial legal entity. Accordingly it must of necessity act through agents, usually the Board of Directors. In other words the corporation's brain is the Board of Directors who make decisions on behalf of the company. A company may in many ways be likened to a human body; it also has hands which hold the tools and act in accordance with the directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by law as such. The day to day management of the company may, however, be handled by specific officers tasked to do so on behalf of the Board. However, the ultimate responsibility rests with the directors. It therefore follows that the management of the corporation must be deemed to be carried by or on behalf of the Board save in cases where the ultra vires principle applies. In this case, although the subscribers to the Company's Articles and Memorandum of Association are indicated to be the Defendant and the said Polish Company, the directors are indicated to be **D Masika, H M Adolwa, J Myszka** as well as the Defendant. This was admitted by DW-1 in cross examination. It follows that the Defendant was one of the managers of the Company and the answer to the first issue must be in the affirmative.

The second issue is whether the defendant by its actions should be considered as the same entity as the company and whether the company's corporate veil should be lifted. The legal position as regards incorporated entities is well settled. In **Standard Chartered Bank Kenya Limited Vs. Intercom Services Limited & 4 Others Civil Appeal No. 37 of 2003 [2004] 2 KLR 183**, the Court of Appeal citing**Salomon vs. A. Salomon & Company Ltd [1897] AC 22** and **Adams vs. Cape Industries Plc [1990] 1 Ch 433** held that it is a principle of company law of long antiquity that a limited company has a legal existence independent of its members and that a company is not an agent of its members. The Court further said that the principle of *alter ego* attributes the mental state of company's directors or other officers to the company itself in order to fix the company with either criminal or civil liability.

In the present case it is not in doubt that the plaintiffs were employed by the Company and not by the Defendant. From the documents on record it is clear that the Defendant was a principal shareholder and a Director of the Company. That does not, per se, make the Defendant liable for the actions or omissions of the Company unless the circumstances are such that the corporate veil of the Company can be lifted. The case of **Mugenyi& Company Advocates vs. The Attorney General [1999] 2 EA 199**following**Palmers Company Law Vol. 1 (22 ed)**lists 10 instances in which the veil of corporate personality may be lifted or as they put it looking behind the company as a *legal persona*and these are:-

1. Where companies are in the relationship of holding and subsidiary companies;

2. Where a shareholder has lost the privilege of limited liability and has become directly liable to certain creditors on the ground that business continued after the membership had dropped below the legal minimum, to the knowledge of the shareholder;

3. In certain matters relating to taxation;

4. In the law relating to exchange control;

5. In the law relating to trading with the enemy;

6. In the law of merger control in the United Kingdom;

7. In competition of the European Economic Community;

8. In abuse of law in certain circumstances;

9. Where the device of incorporation is used for some illegal or improper purpose; and

10. Where the private company is founded on personal relationship between the members.

In **Salomon vs. Salomon** (supra) and **Jones & Another vs. Lipman& Another [1962] 1 WLR 833**it was held that whereas a registered company is a legal person separate from its members this veil of incorporationmay, however, be lifted in certain cases for instance, where it is shown that the company was incorporated with or was carrying on business as no more than a mask or device for enabling the directors to hide themselves from the eyes of equity.Therefore if a company is thought to be a mere cloak or sham, a device or a mask which the defendant holds to his face, in an attempt to avoid recognition by the eye of equity, the court will grant summary judgement even against the person behind the said company.

However, the decision to lift the corporate veil will not be lightly undertaken. In the present case the plaintiffs rely on the fact that the Company was a subsidiary of the Defendant and therefore the veil ought to be lifted. Whereas that may be a ground upon which the veil may be lifted, in my view, it does not necessarily follow that in all cases where the relationship between two companies is that of a holding and subsidiary company the veil must be lifted. The circumstances ought to exist as would justify the conclusion that to permit the holding company to invoke corporate status of the subsidiary company would be inequitable. In this case the Company was placed in receivership due to its failure to settle its debts to the Defendant and to the Bank. From the evidence on record, it is not possible to attribute the receivership solely to the Defendant in order to conclude that the corporate status of the Company was meant to defraud the plaintiffs. In other words I am not satisfied there exist circumstances that would justify the lifting of the corporate veil of the Company in order to find the Defendant liable. To make matters worse, from the evidence on record, it is clear that the Defendant was not the sole shareholder of the Company. Whereas the plaintiff's evidence was that the Defendant bought out the other shareholder and became the sole shareholder there was no such evidence on record. Without joining all the shareholders to the suit, it would not be possible even if it was so minded for the Court to lift the veil of incorporation and find only one shareholder liable in these circumstances. The other issue that caused me concern is the fact that the plaintiff never specifically pleaded and sought the orders for the lifting of the corporate veil. In my view, in cases where it is sought that the corporate veil of a company be lifted, there ought to be a specific prayer for the same and the company if in existence ought to be made a party to the suit. I associate myself with **Visram, J** (as he then was) in **John Njengavs. Bata Shoe Company Limited Nairobi HCCC No. 2332 of 1993**that a point that is not pleaded even if canvassed at the hearing cannot be a basis of a determination.

That leads me to the issue whether the defendant was within its rights to place the company under receivership. In the absence of the Company itself to these proceedings, it is not possible to make a finding on this issue. The only evidence on record as to the circumstances under which the Company was placed under receivership is from the Defendant. No attempt was made at all by the plaintiffs to challenge

the Defendant's right to place the Company under receivership. In any case, since the receivership was jointly between the Defendant and the Bank, it would not be appropriate in these proceedings to which the Bank is not a party to find that the said receivership was unlawful.

The next issue is whether the defendant is liable to the plaintiffs and if so in what sum. Having found that the circumstances of this case do not justify the lifting of the Company's corporate veil, there is no basis upon which I can find the defendant liable for the actions of the Company. However, even if I were to find the Defendant liable, from the pleadings as filed, it is not possible to determine the sum due. In their application for leave to amend the plaint the plaintiffs correctly particularised their claim. However, in the amended plaint that was filed, the same particulars were curiously omitted though the amended plaint at the relevant paragraph indicated that the same were to be proved at the hearing. The law on claims forspecial damages such as loss of earnings is now trite that the same must be pleaded with as much particularity as circumstances permit and it is not enough to simply aver in the plaint that the particulars of special damages are to be supplied or proved at the time of trial. If at the time of filing the suit the particulars of special damages are not known with certainty, then those particulars can only be supplied at the time of the trial by amending the plaint to include the particulars which were previously missing. It is only when the particulars of the special damages are pleaded in the plaint that a claimant will be allowed to proceed to the strict proof of those particulars.Where, therefore, a party intends to provide the omitted particulars of special damages at the hearing the procedure is that an application oral or otherwise ought to be made to amend the pleadings. Where no such application is made, the claim cannot be allowed since to do so would amount to trial by ambush without according the other side adequate opportunity to prepare and defend the claims which is a breach of the rules of natural justice. If any authority is required the Court of Appeal cases of **Central Bank of Kenya vs. Martin King'ori Civil Appeal No. 334 of 2002**and **Coast Bus Service Ltd vs. SiscoMurungaNdanyi& 2 Others Civil Appeal No. 192 of 1992**are on the point.

It follows that the issue whether there is a cause of action disclosed against the defendant must be answered in the negative in light of the circumstances hereinabove. As to whether the rights to sue still exist, in light of the inadequate material on the current status of the Company I am unable to make a finding whether the right to sue the Company has been extinguished.

In the foregoing circumstances, the plaintiffs' suit against the defendant fails. However, taking into account the fact that the Defendant was admittedly a shareholder and manager of the company and contributed to the company being placed into receivership, there will be no order as to costs.

Dated at Nairobi this 2nddday of October 2012

G V ODUNGA

JUDGE

Delivered in the presence of

Plaintiffs in person

Mr.Mathekafor the Defendant