



REPUBLIC OF KENYA

IN THE ENVIRONMENT & LAND COURT AT NAIROBI

ELC 1400 OF 2013

PRUDENZIO NICHOLAS GAITARA.....PLAINTIFF

VERSUS

PATRICK KARIUKI MUIRURI.....1ST DEFENDANT

THIKA DAIRIES LIMITED.....2ND DEFENDANT

MAPEMA HOLDINGS LIMITED.....3RD DEFENDANT

RULING

The plaintiff brought this suit against the defendants on 19th November, 2013 seeking the following reliefs:

1. Orders directing the cancellation of the transfer issued in favour of the 3rd defendant in respect of all that parcel of land known as L.R No. 4953/2414 (hereinafter referred to as “the suit property”).
2. Orders that all the changes done on the particulars of the 2nd defendant illegally/fraudulently be cancelled and the 2nd defendant be restored to its initial state as at 4th December, 1992.
3. An order of a permanent injunction restraining the 3rd defendant from engaging in any further dealing/transaction involving the suit property.
4. An order of a permanent injunction restraining the 1st defendant from engaging in further dealing/transaction on behalf of the 2nd defendant.
5. Costs of the suit.

In his plaint dated 14th November, 2013, the plaintiff averred that at all material times he was a director and a shareholder of the 2nd defendant which is a limited liability company incorporated on 4th August, 1992. The plaintiff averred further that the 2nd defendant was at all material times registered as the proprietor of the suit property. The plaintiff averred that between 13th October, 1993 and 14th December, 2005 the 1st defendant illegally and fraudulently altered the share capital, shareholding and directorship of the 2nd defendant. The plaintiff averred that on 10th February, 2006 he lodged a complaint with the Registrar of Companies regarding the said illegal and fraudulent dealings.

The plaintiff averred that the aforesaid changes and alterations in the 2nd defendant were carried out without meetings of the 2nd defendant being held and resolutions passed authorising the same. The plaintiff averred that following the illegal and irregular alterations in the shareholding and directorship of the 2nd defendant, the 1st defendant was able to fraudulently deal with the suit property which belonged to the 2nd defendant. The plaintiff averred that on 14th March, 2012, the 1st defendant without the authority or consent of the shareholders and other directors of the 2nd defendant transferred the suit property to the 3rd defendant. The plaintiff averred that the 1st defendant had not accounted for the purchase price for the suit property which amounted to Kshs.9,000,000/-.

The 1st and 2nd defendants filed a statement of defence and counter-claim on 20th December, 2013. The 1st and 2nd defendants averred that the plaintiff was a minority shareholder in the 2nd defendant and was later removed as a shareholder. The 1st and 2nd defendants averred that the plaintiff was no longer a shareholder in the 2nd defendant. The 1st and 2nd defendants admitted that the suit property was registered in the name of the 2nd defendant as the proprietor thereof. They contended however that the property was transferred to the 3rd defendant fraudulently. The 1st and 2nd defendants admitted that there were alterations and changes in the share-capital, shareholding and directorship

of the 2nd defendant but contended that the same were carried out in accordance with the Memorandum and Articles of Association of the 2nd defendant and following valid resolutions passed for that purpose.

The 1st and 2nd defendants denied that the said alterations and changes were carried out illegally and fraudulently as alleged by the plaintiff. The 1st and 2nd defendants averred that the 3rd defendant caused the suit property to be transferred and registered in its name fraudulently. The 1st and 2nd defendants averred that the instrument of transfer through which the suit property was conveyed to the 3rd defendant was not executed by the 2nd defendant's directors and that save for the deposit, the 3rd defendant did not pay the purchase price for the property.

In their counter-claim against the 3rd defendant, the 1st and 2nd defendants sought an order cancelling the registration of the 3rd defendant as the owner of the suit property and a declaration that the suit property belonged to the 2nd defendant.

The 3rd defendant filed its defence to the plaintiff's claim and the 1st and 2nd defendants' counter-claim on 19th March, 2014. With regard to the plaintiff's claim, the 3rd defendant averred that it acquired the suit property from the 2nd defendant at a consideration of Kshs.9,000,000/- following an agreement for sale between it and the 2nd defendant dated 10th March, 2008. The 3rd defendant averred further that since the suit property belonged to the 2nd defendant prior to the transfer of the same to the 3rd defendant, the plaintiff had no *locus standi* to initiate proceedings in respect thereof as the proper plaintiff should have been the 2nd defendant. The 3rd defendant averred that since the plaintiff had not obtained leave of the court to proceed with the suit as a derivative action, the plaintiff's suit was not maintainable in law. The 3rd defendant denied that the suit property was sold and transferred to it fraudulently and illegally.

The 3rd defendant averred that although the purchase price for the suit property was paid to the 1st defendant, the parties had agreed that the payment would be deemed to have been made to and acknowledged by the 2nd defendant. The 3rd defendant averred that it acquired the suit property lawfully and as such the plaintiff's suit disclosed no reasonable cause of action against it.

With regard to the 1st and 2nd defendants' counter-claim, the 3rd defendant denied that it fraudulently procured the transfer of the suit property in its favour. The 3rd defendant averred that it paid to the 1st defendant the full purchase price for the suit property in the sum of Kshs.9,000,000/- in accordance with the terms of the agreement for sale dated 10th March, 2008. The 3rd defendant averred that following the said payment, the 2nd defendant's directors voluntarily executed the instrument of transfer in its favour. The 3rd defendant denied the particulars of fraud pleaded in the 1st and 2nd defendants' defence and counter-claim. Without prejudice to its defence, the 3rd defendant averred that if there were any irregularities or mistakes in the said instrument of transfer, the said mistakes and irregularities were attributable to Mr. Patrick Ngunjiri Maina advocate who acted for both the 2nd defendant and the 3rd defendant in the sale transaction. The 3rd defendant averred further that the clerical mistakes in the instrument of transfer did not affect its interest in the suit property since the said instrument could be rectified. The 3rd defendant averred that having acquired the suit property for valuable consideration from the 2nd defendant, it was the absolute and indefeasible owner thereof.

What is now before the court is the plaintiff's application brought by way of Notice of Motion dated 14th January, 2016 seeking leave to proceed with this suit as a derivative action and to amend the plaint to add another party, Eveready Agricultural Services Limited as a second plaintiff in the suit. The plaintiff's application was brought on the grounds that the plaintiff, the 1st defendant and three (3) other persons who are not parties to the suit incorporated the 2nd defendant on 4th August, 1992 for the purposes of manufacturing dairy products. The plaintiff averred that pursuant to this objective, they applied to the Director of Investments to be allocated the suit property. The plaintiff averred that through fraudulent activities, the shareholding in the 2nd defendant was changed without any regard to the procedures laid down in the defendant's Memorandum and Articles of Association and the Companies Act, Chapter 486 Laws of Kenya (now repealed).

The plaintiff averred that the said fraudulent changes in the 2nd defendant were orchestrated by the 1st defendant who through them became a majority shareholder in the 2nd defendant and caused the suit property to be transferred to the 3rd defendant through forgery. The plaintiff averred that the other directors of the 2nd defendant colluded with the 1st defendant in the fraudulent activities complained of. The plaintiff averred that being a minority shareholder, he could not direct or influence the board of directors of the 2nd defendant to protect the interest of the 2nd defendant. The plaintiff averred that it was in the interest of justice that he be granted leave to continue with this suit as a derivative suit in order to protect the interest of the 2nd defendant by maintaining the suit against the directors of the 2nd defendant and the 3rd defendant who have deprived the 2nd defendant of the suit property.

The plaintiff averred that the proposed 2nd plaintiff that he intended to add to the suit was equally a minority shareholder in the 2nd defendant company and was interested in the suit. The plaintiff averred that the defendants would not be prejudiced if the application was allowed.

The plaintiff's application was opposed by the defendants. The 1st and 2nd defendants opposed the application through a replying affidavit sworn by the 1st defendant on 24th June, 2016. The 1st and 2nd defendants termed the plaintiff's application as frivolous, vexatious and an abuse of the process of the court. The 1st and 2nd defendants contended that the plaintiff did not contribute towards the purchase of the suit property and as such he had no proprietary right over the same. The 1st and 2nd defendants averred that the nominal share capital of the 2nd defendant was increased pursuant to its Memorandum and Articles of Association following resolutions that were passed at the 2nd defendant's Special General Meetings. The 1st and 2nd defendants averred that the plaintiff did not pay for the one (1) share in the 2nd defendant that was allotted to him and did not also make any contribution towards the acquisition of the suit property.

The 1st and 2nd defendants admitted that on 10th March, 2008, the 2nd defendant entered into an agreement with the 3rd defendant to sell to the 3rd defendant the suit property at a consideration of Kshs.9,000,000/-. The 1st and 2nd defendants averred that although the 3rd defendant defaulted in the payment of the balance of the purchase price after paying the initial deposit of Kshs.2,000,000/-, the 3rd defendant

fraudulently caused the suit property to be registered in its name. The 1st and 2nd defendants averred that since the transfer of the suit property in favour of the 3rd defendant was procured through fraud and misrepresentation, the 3rd defendant was not the proprietor of the suit property.

The 1st and 2nd defendants averred that the plaintiff's application if allowed would prejudice them in that the plaintiff would have been granted permission to interfere with the suit property in respect of which he had no legitimate interest. The 1st and 2nd defendants averred further that the plaintiff's application was not brought in good faith the same having been filed two (2) years after the plaintiff lost the injunction application. The 1st and 2nd defendants urged the court to dismiss the application as misconceived and unmeritorious.

The 3rd defendant opposed the application through grounds of opposition dated 21st June, 2016. The 3rd defendant contended that the plaintiff had not satisfied the threshold outlined in the Companies Act, 2015 for leave to continue suit as a derivative action. The 3rd defendant contended that the plaintiff had not established a prima facie case for the remedy sought against the 3rd defendant or that the 2nd defendant was entitled to the relief. The 3rd defendant averred further that the plaintiff had not established that his claim falls within the exceptions to the rule in *Foss v. Harbottle*.

The 3rd defendant contended that the plaintiff was not acting bona fide for the benefit of the 2nd defendant. The 3rd defendant averred further that the 3rd defendant had by its own defence and counter-claim sought to enforce its purported rights in the suit property and as such it would be inappropriate for the plaintiff to continue with its claim as a derivative action. The 3rd defendant contended that the plaintiff's application lacked merit and was an abuse of the court process.

The plaintiff's application was heard on 27th June, 2018. In his submission in support of the application, Mr. Wakwaya who appeared for the plaintiff relied entirely on the grounds on the face of the application and the supporting affidavit. He also relied on the authorities in the plaintiff's list of authorities filed in court on 11th June, 2016. Mr. Wakwaya submitted that the authorities the plaintiff relied on outlined the principles upon which the court exercises its discretion in applications for leave to institute or continue with a derivative suit. He submitted that the plaintiff had satisfied the conditions for bringing a derivative suit. He submitted further that the plaintiff had established that his claim fell within the exceptions to the rule in *Foss v. Harbottle*.

Mr. Wakwaya submitted further that the court has power to grant leave to a party to continue with a suit that has already been instituted as a derivative suit. He submitted that leave to institute a suit as a derivative suit can be sought before or after the filing of the suit.

In his submission in reply, the advocate for the 1st and 2nd defendants, Mr. Onyanha submitted that for the court to grant leave to institute a derivative action, the applicant must demonstrate that the company is entitled to the relief sought and that the action falls within the proper boundaries of the exceptions to the rule in *Foss v. Harbottle*. Mr. Onyanha submitted that the plaintiff's claim was based on two (2) grounds namely, that the share structure in the 2nd defendant had been altered fraudulently and secondly, that the property belonging to the 2nd defendant had similarly been sold fraudulently. With regard to the claim based on the sale and transfer of the suit property to the 3rd defendant, Mr. Onyanha submitted that the transfer had been cancelled by the Land Registrar administratively. He submitted that nothing remained to be pursued with regard to that transaction. With regard to the dispute over shareholding in the 2nd defendant, Mr. Onyanha submitted that the dispute did not fall within the jurisdiction of the court. On the limb of the application that sought leave to amend the plaint, Mr. Onyanha submitted that the plaintiff had no right to join the proposed 2nd plaintiff in the suit. Mr. Onyanha submitted that since the plaintiff's principal complaint had been dealt with administratively, there was nothing left to be pursued by the plaintiff in this suit and urged the court to dismiss the application.

For the 3rd defendant, Mr. Odera relied on the 3rd defendant's grounds of opposition dated 21st June, 2016 and its list of authorities dated 24th June, 2016. Mr. Odera submitted that the reliefs sought by the plaintiff were not sought on behalf of the 2nd defendant company and that the same did not fall within the exceptions to the rule in *Foss v. Harbottle*. Mr. Odera agreed with Mr. Onyanha for the 1st and 2nd defendants that the only issue that was left for determination in the plaintiff's claim concerned the shareholding in the 2nd defendant company and that the issue was not within the jurisdiction of the court.

In a rejoinder to the defendants' submissions, Mr. Wakwaya submitted that the transfer of the suit property to the 3rd defendant was cancelled after the plaintiff had brought this suit. Mr. Wakwaya reiterated that the reliefs sought by the plaintiff are for the benefit of the 2nd defendant company.

I have considered the plaintiff's application together with the affidavit filed in support thereof. I have also considered the grounds of opposition and replying affidavit filed by the defendants in opposition to the application. Finally, I have considered the respective submissions by the advocates for the parties and the authorities cited in support thereof. What the court has been called upon to determine in the plaintiff's application is whether the plaintiff has satisfied the conditions for instituting a derivative suit. The concept of derivative action has its origin in common law and equity. In the case of *Altaf Abdulrasul Dadani v Amin Akberali Manji & 3 Others*[2004]eKLR, Mwera J. (as he then was) stated as follows:

“It is a cardinal principle in company law that it is for the company and not an individual shareholder to enforce rights of action 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 (see *Foss vs. Harbottle (1843) 2 Hare 461*). 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 a shareholder can bring an action by way of a derivative suit. Minority Shareholders: Law, Practice and Procedure by Joffe (Butterworths 2000) defines such cause as

“... Where the shareholder seeks to enforce a right not invested in himself but the company of which he is a member, for example a claim to the company’s property fraudulently misappropriated by the directors, he can only do so (if at all) by means of a derivative claim. The derivative claim is a claim brought by an individual shareholder in his own name but on behalf of the company. The reason the claim takes this form is that the minority shareholder is not in a position to see that the claim is brought in the name of the company itself to enforce the company’s rights.”

In the case of Edwards v. Halliwell (1950) ALL ER 1064 Jenkins L. J. expounded on the rule of *Foss v. Harbottle* as follows:

“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 of persons 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.”

In the case of David Langat v St. Lukes Orthopedic Trauma Hospital Ltd. & 2 Others (2013) eKLR, Munyao J. stated as follows:

“In essence the Rule in *Foss v. Harbottle* established two principles. The first is the “proper plaintiff principle” and the second is “the majority principle.” Through the former, a wrong done to the company may be vindicated by the company alone. On the second principle, if the alleged wrong can be confirmed or ratified by a simple majority then a shareholder is barred from bringing an action. The principle effect in the Rule in *Foss v. Harbottle* is to bar actions by minority shareholders.”

As pointed out in Altaf Abdulrasul Dadani v Amin Akberali Manji & 3 Others (supra), there are exceptions to the rule in *Foss v. Harbottle*. In the text, The Principles of Modern Company Law, 3rd Edition by L.C.B Gower, the exceptions to the rule in *Foss v. Harbottle* are set out as follows:

1. When it is complained that the company is acting or proposing to act ultravires;
2. When the act complained of though not ultravires the company could be effective only if resolved upon by more than a simple majority vote, i.e where a special or extra ordinary resolution is required and (it is alleged) has not been validly passed;
3. Where it is alleged that the personal rights of the plaintiff shareholder have been or are about to be infringed;
4. Where those who control the company are perpetrating a fraud on the minority; and
5. Any other case where the interest of justice requires that the general rule requiring suit by the company, should be disregarded.

In the case of Amin Akberali Manji & 2 Others v Altaf Abdulrasul Dadani & Another (2015) eKLR that was decided by the Court of Appeal I believe before the enactment of the Companies Act, 2015 the Court of Appeal stated as follows regarding the procedure for instituting a derivative suit:

“The procedure therefore remains the English Common Law, and it matters not whether it is the common law extant as at 1987, as submitted by Mr. Ochieng or before 2006, as contended by Mr. Oyatsi. Leave of court shall be obtained before filing a derivative suit but may also be obtained to continue with the suit once filed.”

Derivative claims are now provided for in Part XI of the Companies Act, 2015. Section 239 of the Companies Act, 2015 provides that leave of the court is required to continue a derivative claim. Since this suit was instituted in 2013 prior to the enactment of the Companies Act, 2015, the applicable law when considering whether leave should be granted to continue with the same as a derivative suit is the English Common Law in accordance with the decision of the Court of Appeal in the case of Amin Akberali Manji & 2 Others v Altaf Abdulrasul Dadani & Another (Supra).

In the said case of Amin Akberali Manji & 2 Others v Altaf Abdulrasul Dadani & Another (Supra) the court stated that:

“It’s is our considered opinion 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*.”

From the material placed before the court, I am of the view that if the plaintiff had brought the present application earlier, the court would not have hesitated to grant him leave to continue with the suit as a derivative action. The evidence placed before the court shows that the plaintiff was a minority shareholder in the 2nd defendant and that the 2nd defendant owned the suit property. The evidence also shows that the directors of the 2nd defendant entered into an agreement for sale with the 3rd defendant on 10th March, 2008 in respect of the suit property under which the said directors sold the suit property to the 3rd defendant at a consideration of Kshs.9,000,000/-. A copy of the agreement for sale placed before the court shows that a deposit on account of the purchase price in the sum of Kshs.2,000,000/- was paid by cheques drawn in favour of 1st defendant who is one of the directors of the 2nd defendant and not to the 2nd defendant. A copy of the instrument of transfer

placed before the court also shows that the entire purchase price in the sum of Kshs.9, 000,000/- was paid to the 1st defendant directly. In view of the foregoing, it is clear that the 2nd defendant did not receive the proceeds of sale of its property and that the 2nd defendant had a right to sue the 1st defendant and the 3rd defendant to account for the proceeds of sale of the said property and the manner in which the sale was conducted.

I am of the view that by selling the suit property and diverting the proceeds of sale to the 1st defendant's personal account, those in control of the 2nd defendant were perpetrating fraud against the minority shareholders. The plaintiff had also claimed that the shareholding in the 2nd defendant had been altered fraudulently to his disadvantage contrary to the Memorandum and Articles of Association of the 2nd defendant. The plaintiff's claim in this regard concerns the infringement of his personal rights. The plaintiff has demonstrated on a prima facie that the 2nd defendant was entitled to the relief that he has sought herein relating to the suit property. The plaintiff has also demonstrated that his claim is within the exceptions to the rule in *Foss v. Harbottle*. The plaintiff has made out a case for leave to continue with this suit as a derivative suit.

As was pointed out by the defendants in their response to the application, the plaintiff's application for leave was filed more than two (2) years after the filing of the suit. While the suit was pending, some developments took place which had direct effect on the plaintiff's claim. It was common ground that the Land Registrar cancelled the transfer of the suit property to the 3rd defendant on 4th October, 2016. With the cancellation of the transfer of the suit property by the 2nd defendant to the 3rd defendant, the plaintiff's claim against the defendants in respect of the property falls by the way. This court cannot grant to the plaintiff leave to continue with a claim which is spent. I am in agreement with the defendants that the only claim which is pending and which can be pursued by the plaintiff is that relating to the alleged illegal and fraudulent alteration of the shareholding in the 2nd defendant. I am of the view that this is a claim which the plaintiff can pursue as of right as it relates to the infringement of his personal rights as a shareholder. The plaintiff does not require leave of this court to pursue such claim. Even if leave was required, as rightly pointed out by the defendants, this court has no jurisdiction to determine disputes over the internal management of companies. The plaintiff's claim will have to be instituted in the High Court.

With regard to the limb of the application seeking leave to amend the plaint, the same was predicated upon the court granting leave to the plaintiff to continue with this suit as a derivative action. Having made a finding that the plaintiff is not entitled to such leave, this limb of the application must also fail. I wish to add that even if I had allowed the plaintiff to proceed with the suit as a derivative suit, I would not have granted him leave to add another party as a plaintiff to the suit. As pointed out by the 1st and 2nd defendants in their submissions, the plaintiff has no right to add another party as a plaintiff to a suit without the consent of such party. See, order 1 Rule 10(3) of the Civil Procedure Rules. There is no evidence before the court that the party sought to be joined in the suit as plaintiff had consented to such joinder.

In the final analysis and for the foregoing reasons, I find no merit in the plaintiff's Notice of Motion application dated 14th January, 2016. The application is dismissed. Consequently, the plaintiff's suit is also struck out. Since the circumstances that have led to the dismissal of the plaintiff's application arose while the plaintiff's suit and application for leave were pending, I would not condemn the plaintiff to pay the costs of the suit. Each party shall bear its own costs.

Delivered and Dated at Nairobi this 17th day of January 2019

S. OKONG'O

JUDGE

Ruling read in open court in the presence of:

N/A for the Plaintiff

N/A for the 1st and 2nd Defendants

Mr. Nyakundi h/b for Mr. Odera for the 3rd Defendant

Catherine-Court Assistant