



REPUBLIC OF KENYA

IN THE ENVIRONMENT AND LAND COURT OF KENYA AT ELDORET

E&L 56 OF 2013

Formerly 130 of 2012

DAVID LANGATPLAINTIFF

VS

ST. LUKES ORTHOPEADIC & TRAUMA HOSPITAL LTD & 2 OTHES.....DEFENDANTS

(Application to institute a derivative action; principles to be applied; two shareholders holding shares on a 50:50 basis; whether exceptions to the Rule in Foss v Harbottle apply in a 50:50 situation; need to do justice; application allowed)

RULING

A. INTRODUCTION

The plaintiff David Langat, has filed an application dated 22 April 2013 seeking the following orders :-

- (a) That the Honourable Court be pleased to grant leave to the plaintiff to institute derivative proceedings on behalf of and for the benefit of Sunrise Orthopaedic and Trauma Hospital Ltd.*
- (b) That upon leave to institute derivative proceedings being granted the plaintiff David Langat be allowed to enjoin Sunrise Orthopaedic and Trauma Hospital Limited as a defendant in this case.*
- (c) That the Honorable court be pleased to grant leave to the plaintiff to amend the plaint filed herein.*
- (d) That the costs of this application be provided for.*

The application is based on various grounds and for good measure, I think it is imperative that I set them out in full as drawn.

1. The claim before the Honourable Court relates to the breach by the defendant herein of a joint venture agreement (between the plaintiff and the defendant) and the further claim that the defendant has conducted his affairs in breach of his obligations as an implied or constructive trustee of Sunrise Orthopaedic and Trauma Hospital Limited (hereinafter called the Company:) in a manner prejudicial and disadvantageous to the company and he (the defendant) has thereby become unjustly enriched.

2. The gravamen and the essence of the dispute in these proceedings is whether the defendant holds or is deemed to hold as a trustee in respect of;-

(a) that parcel of land known as L.R. No. ELDORET MUNICIPALITY/BLOCK8/90 as a trustee of the

company within the contemplation of the proviso to Section 3(3) of the Law of Contract Act and

(b) moneys which were on diverse dates in the years 2010 and 2011 converted either by the defendant or his spouse from the company's account held at Eco bank Kenya Limited Eldoret Branch.

3. The plaintiff and the defendant are the only directors and shareholders of the company each having subscribed to and taken out 2,500 shares out of the 5000 authorized and issued share capital and by reason of differences between the said directors it is not possible to convene a director's meeting and pass such resolution to facilitate institution of proceedings on behalf of and for the benefit of the said company.

4. The differences between the plaintiff and the defendant as the shareholders and directors of the company have prejudiced the company's ability and right to file proceedings for its benefit and in circumstances it is equitable, just, lawful and reasonable that the plaintiff be granted leave to file derivative proceedings and enjoin the company in this cause.

5. The application seeks orders which are in accord with the relevant and applicable principles of the law and the decision of the Honourable Mr. Justice F. Azangalala delivered herein on the 12th October 2011 when the company's name was struck out of the suit for offending the provisions of Orders 4 Rule I(4) Civil Procedure Rules 2010.

6. It is the sole prerogative and right of a plaintiff to choose who to sue and in the event the defendant so sued shall be adjudged not liable there shall be an appropriate order for compensation by the payment of costs

7. In exercise of the Honourable Court's equitable jurisdiction and application of the maxims of equity that, Equity will not suffer a wrong to be without a remedy, and that Equity imputes an intention to fulfill an obligation, and that Equity regards as done that which ought to be done, the Honourable Court is possessed of jurisdiction to entertain the request for leave to commence derivative proceedings on behalf of and for the benefit of the company, to grant leave to amend the plaint and thereafter receive evidence and ultimately render justice to the parties to this suit.

Probably a little background to this suit will shed light as to why the orders herein are being sought.

B. BACKGROUND

This suit was instituted on 26 July 2011 with Sunrise Orthopaedic & Trauma Hospital Limited (Sunrise Ltd) as the 1st plaintiff and David Langat (Mr. Langat) as the 2nd plaintiff. The defendant is Dr. Lectary Kibor Keiyo Lelei (Dr. Lelei). A preliminary objection was raised in the initial stages of these proceedings, inter alia that there was no resolution passed that permitted Sunrise Ltd to institute these proceedings. Vide a ruling made on 12 October 2011, the objection was sustained and the action by Sunrise Ltd was struck out as incompetent. David Langat therefore remained as the sole surviving plaintiff.

Probably in reaction to that ruling, Mr. Langat filed another suit in the High Court in Nairobi being Nairobi High Court Civil Suit No. 466 of 2012 which was filed on 20 July 2012. In that suit, the plaintiff is Mr. Langat and the defendants are St. Luke's Orthopaedic and Trauma Hospital Limited (St. Luke's), Dr. Lelei and Sunrise Ltd. That Nairobi suit did not proceed and was transferred to this court. It was later consolidated with the suit herein as the issues raised in that case were similar to the issues raised in this suit. It would appear however, that the presence of Sunrise Ltd in the proceedings was still questionable.

Thereafter an application dated 17 May 2012 which sought orders fairly similar to the present application was filed but was later withdrawn on 24 October 2012 without it being prosecuted. It seems that the plaintiff on second thoughts was of the view that the orders sought are important and it is then that this application was filed.

C. THE CASE OF THE PARTIES

The two principal contestants are Mr. Langat and Dr. Lelei.

The case of Mr. Langat as discerned from his pleadings and depositions is that he and Dr. Lelei agreed to enter into a joint venture to operate a hospital in Eldoret town. It is his case that the two agreed to incorporate a company and the company so incorporated was Sunrise Ltd. The company was incorporated with a share capital of Kshs. 100,000/= divided into 5,000 shares of Kshs. 20/= each. Mr. Langat took up 2,500 shares whereas Dr. Lelei took up 2,500 shares. The two therefore hold shares in the company on a 50:50 basis.

It is averred that it was further agreed that Sunrise Ltd would build a hospital in the land parcel Eldoret Municipality/ Block 8/90 (the suit land). That land parcel is in the personal name of Dr. Lelei and was encumbered by a loan from Savings & Loan Ltd. It is further averred that it was agreed that Dr. Lelei would as part of his equity transfer the land into the incorporated company and that David Langat would inject capital in form of cash and building materials and fund the construction and procure equipment for the proposed hospital. It is further pleaded that the plaintiff managed to procure financing from Ecobank Ltd and part of the money so procured being Kshs. 11,518,046.58/= was used to settle the defendant's indebtedness with Savings & Loan Ltd. It is contended that part of the other money was used to construct a hospital on the defendant's parcel of land. The plaintiff has averred that he also injected money and building materials worth about Kshs. 15 Million to construct the hospital. Dr. Lelei did not transfer the land to Sunrise Ltd, an act which the plaintiff contends is not only in breach of their agreement, but has also led to the defendant being unjustly enriched. Fraud and deceit are pleaded. Dr. Lelei formed another company, St. Lukes Ltd, which is owned by himself and his spouse and commenced operating a hospital on the suit land. The plaintiffs (as Sunrise and David Langat in the original plaint) sought orders inter alia for a declaration that the defendant (Dr. Lelei in the original plaint) holds the land parcel Eldoret Municipality Block 8/90 in trust for Sunrise Ltd. In the alternative the plaintiffs sought orders of restitution of the money and building materials expended.

The case of the Defendants, Dr. Lelei and St. Lukes Ltd (combining the original suit and the second suit filed in Nairobi) , is that there was no agreement to have the suit land transferred to Sunrise Ltd upon incorporation. The allegation of the joint venture is denied. It is contended that the personal property of Dr. Lelei could not become the property of Sunrise Ltd merely because Dr. Lelei was a shareholder of Sunrise. He has averred that he purchased the suit land with his own money and some financing that he sourced himself. No agreement was ever entered to have the land transferred to Sunrise Ltd. It is averred that St. Lukes was properly incorporated and there is nothing to bar it from using the premises of Dr. Lelei to operate a hospital. The allegations that Mr. Langat delivered building material are denied and so too the allegations of unjust enrichment. It has also been argued that Sunrise Ltd cannot be a beneficiary, and neither can it enforce, a purported pre-incorporation contract.

In this application, it is contended that part of the subject matter in this suit is that Dr. Lelei has conducted himself in a manner that is prejudicial to the interests of Sunrise Ltd. It is further contended that the suit herein inter alia seeks a declaration that Dr. Lelei holds the suit property in trust for Sunrise Ltd and therefore Sunrise Ltd is a necessary party to the proceedings. However, owing to the 50:50 shareholding in Sunrise Ltd, a resolution cannot be passed to have Sunrise Ltd commence proceedings on its behalf against Dr. Lelei. It is also averred that owing to the differences between the two directors, it is not possible to convene a director's meeting and pass such resolution to facilitate the institution of proceedings.

The application herein was opposed by the filing of both Grounds of Opposition and a Replying Affidavit on the part of Dr. Lelei. In his replying affidavit, he has reiterated that there was no joint venture and neither was there any agreement that he would cede his property to Sunrise Ltd. He stated that he has personally been repaying all loans and that it is the applicant who is hiding behind the company in an attempt to defraud him.

D. ARGUMENTS OF COUNSEL

The application was canvassed before me on 11 June 2013. Mr. Amollo for the applicant pointed out that this suit as initially instituted, had Sunrise Ltd as a plaintiff but its name was struck out for want of a resolution to commence proceedings. He stated that given that position, the only avenue was to have Mr. Langat file a derivative action. It was his view that Mr. Langat despite holding a 50% shareholding in Sunrise Ltd was a "minority". He argued that the Companies Act of Kenya is silent on what majority and minority in a company is, and referred to the definition in Black's Law Dictionary. He pointed out that the dictionary defines a "majority shareholder" as one holding more than 1/2 of the share capital of a company. The converse, "minority shareholder", to him was one holding less than 1/2 of the company's shares and thus cannot control the corporation's management. He stated that in the circumstances of this case, where no one holds more than 50% of the shareholding, David Langat must be considered a minority or be considered a "constructive minority" as he is unable to pass any resolutions in the company. He argued that to hold that Sunrise Ltd in the circumstances herein cannot commence proceedings would be against public policy and doctrines of equity. He referred to Kerr, *On the Law of Fraud and Mistake, 7th edition (1952)* pg 654 and Palmers, *Company Law, 18th Edition, (1948)* pg 245 which outline the exceptions to the rule in *Foss vs Harbottle*. He pointed out that one of the exceptions is where there is a fraud on the minority, and a shareholder in that instance can file suit on behalf of the company.

Mr. Gicheru, for Dr. Lelei, was of a contrary view. It was his position that this application does not meet the test in *Foss vs Harbottle* to enable the plaintiff be granted leave to commence a derivative action. He contended that a derivative action can only be brought by a minority shareholder. He referred to Halsbury's *Laws of England* paragraph 499 and Palmers, *Company Law* both of which were supplied by Mr. Amollo. He stated that the exceptions to the rule in *Foss v Harbottle* only apply where the applicant is a minority. In the circumstances of this case, he contended that the shareholding is 50:50 and therefore the applicant is not a minority and cannot thus fall within the exceptions in *Foss v Harbottle*. He argued that there was no such term as a "constructive minority" which to him is a term unknown in law.

The position of Mr. Njuguna, for St. Lukes Ltd, was that the recourse open to the applicant is not to apply to commence a derivative action but that his remedy lies in Section 135 of the Companies Act. He contended that the court has authority to order a meeting and even if only one person attends, resolutions will be made. He further averred that to enable the applicant commence a derivative action, he must be a minority and he cannot be said to be a minority because he owns 50% of the shares.

E. DETERMINATION BY THE COURT

I have considered the application, the submissions of counsel and the authorities. In this application, David Langat essentially wants leave to commence a derivative action on behalf of Sunrise Ltd for the reason that the company is unable to pass a resolution to commence action owing to the 50:50 shareholding.

It is important to understand what a derivative action is and when it may be commenced.

The Rule in Foss v Harbottle

The starting point is the case of *Foss vs Harbottle*^[1] from which the company law Rule in *Foss vs Harbottle* is derived. In *Foss vs. Harbottle* two minority shareholders in a company alleged that its directors were guilty of buying their own land for the company's use and paying themselves a price greater than its value. This act of directors resulted in a loss to the company. The minority shareholders decided to take action against the directors, but the majority shareholders in a meeting resolved not to take any action against the directors alleging that they were not responsible for the loss which had occurred. The court dismissed the suit on the ground that the acts of the directors were capable of confirmation by the majority members and held that the proper plaintiff for wrongs done to the company is the company itself and not the minority shareholders and the company can act only through majority shareholders. The rationale in that line of reasoning is that a company is a separate legal entity from the members who compose it and as such, if any right of the company is violated, it is the company which can bring an action through the majority.

It was held that, "If the thing complained is a thing which, in substance, the majority of the company are entitled to do, or something has been done irregularly which the majority of the company are entitled to do regularly or if something has been done illegally which majority of the company are entitled to do legally, there can be no use in laying litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes."^[2]

It was also held that, it is an elementary principle of law relating to joint stock companies that the court will not interfere with the internal management of the company, acting within their powers and jurisdiction to do so. It was further held that in order to redress a wrong done to the company or to recover monies or damages due to the company the action should be brought by the company itself.

However, the classic statement of the Rule in *Foss v Harbottle* was not in the case itself, but was tendered by Jenkins L.J in the celebrated case of *Edwards v Halliwell*^[3] where he stated 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

¹*Foss* v *Harbottle*, (1843) Hare 461.

²Above.

³*Edwards vs Halliwell* (1950) All ER 1064.

majority of the members of the company or association is in favour of what has been done, then cadit quaestio."^[4]

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 principal effect in the Rule in *Foss v Harbottle* is to bar actions by minority shareholders.

Exceptions to the Rule in Foss v Harbottle

It is clear that the end result of the Rule in *Foss vs. Harbottle* is that it is the majority rule that prevails in company management. Situations will inevitably arise when the appropriate organ of the company is unwilling to sue even where it will be in the interests of the company to do so. This is likely to be the case when the wrong complained of against the company has been done by the very persons who are in control of the company. The power to sue is therefore capable of being misused to serve personal ends to the detriment of the company. It is through a recognition of these circumstances that the common law allowed certain exceptions to the Rule in *Foss v Harbottle* and permitted a shareholder to institute suit, known as the derivative suit, on behalf of the company.

The case of *Edwards v Halliwell* is taken to be the locus classicus that laid out these exceptions. Jenkins L.J stated as follows :-

"The cases falling within the general ambit of the rule are subject to certain exceptions. It has been noted in the course of argument that in cases where the act complained of is wholly ultra vires the company or association the rule has no application because there is no question of the transaction being confirmed by any majority. It has been further pointed out that where what has been done amounts to what is generally called in these cases a fraud on the minority and the wrongdoers are themselves in control of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring what is known as a minority shareholders' action on behalf of themselves and all others. The reason for this is

that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue. Those exceptions are not directly in point in this case, but they show, especially the last one, that the rule is not an inflexible rule and it will be relaxed where necessary in the interests of justice. There is a further exception which seems to me to touch this case directly... the rule did not prevent an individual member from suing if the matter in respect of which he was suing was one which could validly be done or sanctioned, not by a simple majority of the members of the company or association, but only by some special

⁴ Above , at p 1066.

majority, as, for instance, in the case of a limited company under the Companies Act , a special resolution duly passed as such."^[5]

L.C.B Gower, in his text, *The Principles of Modern Company Law*, 3rd Edition^[6], sets out four clear exceptions and a debatable fifth exception. These are as follows :-

(1) *When it is complained that the company is acting or proposing to act ultra vires.*

The rationale for this exception is that no simple majority of members can confirm or ratify an illegal act, not even if all the shareholders are willing to do so. In case of *ultra vires* acts, even a single shareholder can restrain the company from committing those acts by filing a suit for injunction. Majority rule will not prevail where the act in question is illegal.^[7]

(2) *When the act complained of though not ultra vires the company, could be effective only if resolved upon by more than a simple majority vote, i.e where a special or extraordinary resolution is required and (it is alleged) has not been validly passed.*

There could be certain acts which require, say, a 2/3rds majority. If the requirements of special majority are not fulfilled, any shareholder can restrain the company from acting on such purported resolutions.^[8]

(3) *Where it is alleged that the personal rights of the plaintiff shareholder have been or are about to be infringed.*

Such individual rights include the right to attend meetings the right to receive dividends the right to insist in strict observance of the legal rules; statutory provisions in the memorandum and articles. If such a right is in question, a single shareholder can on principle, defy a majority consisting of all other shareholders.^[9]

(4) *Where those who control the company are perpetrating a fraud on the minority.*

The Rule in *Foss v Harbottle* would create grave injustice if the majority were allowed to commit wrongs against the company and benefit from those wrongs at the expense of the minority, simply because no claim could be brought in respect of the wrong. A resolution would constitute a fraud on minority if it is not bona fide for the benefit of the company as a whole. Similarly, an action of the majority which discriminates between majority shareholders and minority could constitute a fraud of majority. A special resolution would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and minority shareholders, so as to give the former advantage of which the latter were deprived.

5	Above	,	at	p	1067.
6			Pages		584-585.
7	<i>Smith</i>	v	<i>Croft</i>	No2 (1987)	3 All ER 909.
8	<i>Edwards</i>	v	<i>Halliwell</i> ,	above	note 6.

⁹ *Pender v Lushington* (1877) 6 Ch.D 70.

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

This fifth exception, as Gower points out is debatable on whether it really exists as a separate exception under common law and I will turn to this point later in my ruling.

What an applicant must demonstrate before being granted leave

For the court to allow a shareholder to institute a derivative suit, the applicant must surmount two hurdles. He must demonstrate the following :-

(a) that the company is entitled to the relief claimed and

(b) that the action falls within the proper boundaries of an exception to the rule in *Foss v. Harbottle*.^[10]

What the first test essentially means is that the court must be satisfied that there is a cause of action that has accrued upon the company, but for want of a resolution, the company cannot sue. The applicant must show that the relief sought is a relief sought for the benefit of the company.

The threshold at this level, where leave is being sought, is only to demonstrate prima facie that there is a cause of action that may accrue to the company and that the intended action is for the benefit of the company.

In this instance, I can see that what the applicant wants through the intended action is of actual benefit to the company. It is the contention of the applicant that Sunrise Ltd is entitled to the suit land and that the 1st respondent is holding the suit land in trust for Sunrise Ltd. The applicant also seeks orders of restitution to have moneys allegedly belonging to Sunrise Ltd to be restituted back to the company. Prima facie therefore, the action sought to be filed by the applicant on behalf of Sunrise Ltd is for the benefit of the company and not the personal benefit of the applicant. There is of course strong objection to these claims including the arguments that Sunrise Ltd cannot claim the benefit of any purported pre-incorporation contract and that simply because a structure was built on land owned in the person of Dr. Lelei, that does not make him liable as trustee to Sunrise Ltd.

However, I think that the applicant has shown that Sunrise Ltd has a grievance to put across and that the claim is not wholly frivolous. I hesitate at this stage to gauge the strength of the case sought to be presented, which I would rather leave for trial, given the contentious positions taken by the protagonists. Suffice to say that I think that the applicant has laid out a basis that would enable me exercise my discretion to allow a derivative action to be instituted so that Sunrise Ltd can be given an opportunity to ventilate its case and have the court decide on merits, whether on the evidence and the law, Sunrise Ltd is entitled to any of the remedies which the applicant argues has accrued for the benefit of the company.

¹⁰ *Prudential Assurance v Newman Industries Ltd & Others (No.2)* (1982) 1 All ER 354.

The second point is for me to determine whether the applicant's case fits in the exceptions to the Rule in *Foss v Harbottle*. I must say that this point has caused me some difficult moments.

As earlier pointed out, there are four clear exceptions and a fifth debatable exception. I need to be convinced that the applicant can fit himself into these exceptions.

Straight away, I can see that the exceptions (1) (2) and (3) are inapplicable in this case. There is no complaint that there is an act that it *ultra vires* the company. Neither is there any complaint that a resolution has been passed without a special majority or that the personal rights of a shareholder have been infringed.

The debate herein is whether the applicant can fit himself in exception (4), or probably exception (5) if it exists. Exception No. 4 applies where those in control of the company are perpetuating a fraud on the minority and exception No. 5 (if it exists as an independent exception) would give me leeway to permit the derivative action "if the interests of justice so require".

The difficulty in exception No.4 is the wording "fraud on the minority". Does this mean that exception No.4 can only apply if there is a majority and minority shareholding ? This of course was the argument of Mr. Gicheru and Mr. Njuguna for the respondents.

Defining the exact parameters of "fraud on the minority" has presented problems of its own. In relation to this difficulty, of the construction of the words "fraud on the minority", Gower, states as follows :-

"As we shall see, the exact meaning of the expression "fraud on the minority" is not easy to determine. But at least it is clear that both 'fraud' and 'minority' are used somewhat loosely. There need not be an actual deceit...nor is it necessary that those who are injured should be a minority; indeed the injured party will normally be the company itself..."^[11]

Keenan^[12], refers to the "fraud on the minority" exception as ill-defined. He lists two broad categories of "fraud on the minority" to cover first where the company itself is defrauded^[13] and secondly, where the minority individuals are themselves defrauded.^[14] The concept of "fraud on the minority" therefore has to be understood in this wider sense.

For the exception to apply, there needs to be the concept of "wrong-doer control". Wrong-doer control does not have to be majority control but *de-facto* control.^[15]

¹¹At p 564.

¹²Smith & Keenan, *Company Law*, 6th Edition at p 200.

¹³Such as misappropriation of corporate property.

¹⁴Such as the case of expulsion of minorities.

¹⁵Per Vinellot J. in *Prudential Assurance v Newman Industries* (1980)

Majority shareholding no doubt means ownership of more than 50% of the shareholding and minority means ownership of less than 50% shareholding. Although Mr. Amollo tried to argue that a person holding 50% is a minority, I do not think so. All definitions point to a majority owning more than 50% and minority owning less than 50%. Even Black's Law Dictionary^[16] relied upon by Mr. Amollo does not support his argument that where there is an equal shareholding then one party is a minority. Black's Law Dictionary defines "majority shareholder" as a shareholder who owns or controls more than half the corporation's stock^[17]. A "minority shareholder" is defined as a shareholder who owns less than half the total shares outstanding and thus cannot control the corporation's management or singlehandedly elect directors^[18]. In our case, there is no "majority" and no "minority". The two shareholders hold equal shares. None is a majority shareholder and none is a minority shareholder. Neither am I swayed by the ingenious attempt by Mr. Amollo, to construe a minority situation on the part of Mr. Langat and have him held as a "constructive minority".

The question that arises is whether in a 50:50 situation, one of the shareholders who feels that there is a wrong done to the company by the other shareholder, can file a derivative action on behalf of the company. I have been unable to get a direct authority on this point.

The classical application of the exceptions to the Rule in *Foss v Harbottle* are of course situations in which there is a majority and the minority. Generally, an applicant will apply to be exempted from the rule in *Foss v Harbottle* because he is in the minority, as the company will always be in a position to pass any suggestions or resolutions proposed by the majority. That is indeed why the rule in *Foss v Harbottle* is popularly known as the Rule of the Majority.

In a 50:50 situation, a dangerous position to be in I must say, there is always a risk that a deadlock will ensue. Where there is a complete deadlock, does it mean that a derivative action is barred for the reason that there is no clear majority and no minority ?

I think to insist that there must be a majority and minority before the exceptions in the Rule in *Foss v Harbottle* can be applied has the capacity to lead to injustice. In my view the court has inherent jurisdiction to ensure that justice is done. This inherent jurisdiction is indeed the very foundation of the exceptions to the Rule in *Foss v Harbottle*. These exceptions are founded in equity and are meant to cure the hardship and injustice that may be occasioned to the company and to its shareholders by a strict application of the Rule in *Foss v Harbottle*.

I can do no better than echo the words of Lord Denning MR in *Wallersteiner v. Moir* (No.2).^[19]

“But suppose [the company] is defrauded by insiders who control its affairs - by directors who hold a majority of the shares - who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise the proceedings to be taken

¹⁶Black's Law Dictionary, 7th Edition.
¹⁷Above, at page 1381.

¹⁸Above.

¹⁹*Wallersteiner v Moir* (No. 2) (1975) 1 All ER 849.

by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue themselves. Yet the company is the one person who is damnified. It is the one person who should sue. In one way or another some means must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress.”^[20](emphasis mine).

In the situation in this case, I think that the applicant has demonstrated that there could be a probability that the company has been injured by the acts of one of its shareholders. I would therefore allow this application based on the 4th exception to the Rule in *Foss v Harbottle* expanded in the interests of justice to accommodate the situation that the deadlock herein has brought as the company is unable to pass resolution to institute suit. I am more comfortable in fitting the applicant into the fourth exception rather than outrightly endorse the 5th exception , the so called "in the interests of justice" exception as it is still a source of controversy.^[21]

If the 5th exception indeed exists, then I think outright, given the circumstances herein, it would be in the interests of justice that I allow Sunrise Ltd the opportunity to have its case put forth. As stated by Jenkins L.J himself in *Edwards v Halliwell*, *"that the rule is not an inflexible rule and that it will be relaxed where necessary in the interests of justice."* It is a reality that law must evolve and for the situation herein, I am of the view that a strict application of majority/minority must give way to the interests of justice so as to enable the company ventilate its case.

The position in which a shareholder in a 50:50 situation finds himself is no less different from the position that a minority shareholder finds himself. A minority shareholder is handicapped and frustrated because he can pass no resolution to benefit the company. His views are prone to being trampled upon by the majority and he finds himself hamstrung, unable to do anything on behalf of the company. That position is similar to that which a person holding 50:50 shareholding finds himself. He is unable to pass any resolution because the other half must accede to it. If the other half does not permit the resolution to pass then the one shareholder is stuck, just as he would be stuck if he was a minority.

In our case, there is strictly no majority and no minority. The person against whom the action is intended is however in de facto control of all resolutions, including resolutions to sue. There is no other way that Sunrise Ltd can put forth any claims separate from having a derivative action filed on its behalf.

I am aware that Mr. Njuguna submitted that the remedy of the applicant lies in Section 135 of the Companies Act (Chapter 486) Laws of Kenya, but I beg to differ. Section 135 provides as follows :-

²⁰Above, at p 857.

²¹The fifth exception was rejected in *Prudential v Newman (No.2)* above note 10 , although it seems that it has been given latitude in other jurisdictions. In Australia it was permitted in the case of *Biala Pty Ltd vs Mallina Holdings Ltd* (1993) 11 ACSR 785.

135.(1) If for any reason it is impracticable to call a meeting of a company in any manner in which meetings of that company may be called, or to conduct the meeting of the company in manner prescribed by the articles or this Act, the court may, either of its own motion or on the application of any director of the company or of any member of the company who would be entitled to vote at the meeting, order a meeting of the company to be called, held and conducted in such manner as the court thinks fit, and where any such order is made may give such ancillary or consequential directions as it thinks expedient; and it is hereby declared that the directions that may be given under this subsection include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(2) Any meeting called, held and conducted in accordance with an order under subsection (1) shall for all purposes be deemed to be a meeting of the company duly called, held and conducted.

It is true that the court can order a meeting but I do not think the issue in this matter is the calling of a meeting. I think the critical challenge is the probability of having a resolution passed to commence action rather than have a meeting called. I on my part do not see the relevance of Section 135 of the Companies Act.

From the above, I am of the opinion that the application herein is merited. I therefore grant leave to the applicant to institute the intended action. I further grant leave to the applicant to amend the plaint as proposed in the draft amended plaint annexed to the application.

The costs of the application shall shall be costs in the cause.

It is so ordered.

DATED, SIGNED AND DELIVERED THIS 31ST DAY OF JULY 2013

JUSTICE MUNYAO SILA

ENVIRONMENT AND LAND COURT AT ELDORET

Read in open Court

In the Presence of:-

Mr. Amollo for the applicant

Mr. Gicheru for the 1st Respondent. (Dr. Lelei)

Mr. Njuguna for the 2nd Respondent (St. Lukes)
