IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: TUNOI, WAKI & VISRAM, JJ.A)

CIVIL APPEAL NUMBER 42 OF 2007

BETWEEN

EAST AFRICAN SAFARI AIR LIMITED .....APPELLANT

AND

ANTHONY AMBAKA KEGODE ..... 1ST RESPONDENT
ELIZABETH ANN KEGODE ..... 2ND RESPONDENT

(An appeal from the ruling of the High court of Kenya at Nairobi Milimani Commercial Courts, (Emukule, J.) dated 2nd March, 2006

in

H.C.C.C. NO. 345 OF 2004)
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JUDGMENT OF THE COURT

By a plaint dated and filed on 28th June, 2004 in the High Court the appellant (plaintiff in the High Court) sought recovery of substantial sums of money which it claimed the respondents fraudulently transferred from its accounts to the personal accounts of the respondents.

Contemporaneously with the filing of the suit, the appellant filed an application by way of chamber summons seeking temporary orders of injunction restraining the respondents from withdrawing or disposing those funds which they had transferred to their accounts in Charterhouse Bank, the Standard Chartered Bank, and any other accounts that may be discovered later. The High Court granted those interim orders, which were then served upon the relevant banks.

In response, the first respondent, ***Anthony Ambaka Kegode***, filed a motion seeking that both the suit and the chamber summons application filed by the appellant be struck out and that the appellant's advocate, Walker Kontos, be condemned to pay the costs personally, on the following grounds:

"(a) the suit and the application seeking temporary injunction in this matter have been filed without any due authority from the plaintiff company.

(b) there is no resolution or valid resolution of the plaintiff company approving the institution of suit.

(c) there is no resolution or no valid resolution of the plaintiff company appointing Walker Kontos Advocates to institute this or any suit for or on behalf of the plaintiff company.

(d) the filing of this suit and the application for temporary injunction by Walker Kontos Advocates is unlawful for want of authority from the Plaintiff company.

(e) the plaintiff company did not authorize Captain Elly Aluvale to swear the affidavit in support of the application for temporary injunction.

(f) the suit and the application for temporary injunction have been filed in total disregard of mandatory procedural requirements and in abuse of the due process of the court."

Subsequently, in a defence filed on 23rd July, 2004, the 1st respondent denied the claims, as did the 2nd respondent.

The brief background leading to this litigation in the High Court is as follows.

In early 2004, the appellant company was experiencing, what the learned Judge of the High Court called "*a lean period in cash receipts*". The appellant had serious cash flow problems, and required injection of fresh capital. The 1st respondent, who was the company's majority shareholder owning 90% of the shares, entered into an agreement with one ***Adam Craig Ogden*** (Ogden) to sell all his shares to a company called **Four Ninety Investments Ltd**,represented by Ogden. The sale of those shares took effect on 4th June, 2004 when Ogden took over management of the company, becoming its new Managing Director, and also causing the appointment of two new directors, ***Kirankumar Chandubhai Patel*** and ***Elkana Mugalavai Aluvale***. A notification of change of directors was filed with the Registrar of Companies. The minutes of the Board of Directors of the appellant dated 4th June, 2004 recording all these changes were actually signed by ***Anthony Ambaka Kegode***, who acted as Chairman at the meeting of the board on 4th June, 2004. Soon thereafter, Ogden discovered that substantial funds belonging to the appellant had been transferred to the personal accounts of the respondents and promptly instructed the law firm of Walker Kontos, through a Board resolution on 18th June, 2004, to pursue recovery of the same. On 28th June, 2004 the aforesaid law firm, relying on the Board resolution of 18th June, 2004, and on the notification of change of directors filed with the Registrar of the Companies on 21st June, 2004, filed the plaint, followed by the chamber summons application to essentially *"freeze"* the funds so transferred. As we stated earlier, the respondents responded by filing its own motion to strike out the plaint and the chamber summons application. The motion was supported by the affidavit of Anthony Ambaka Kegode, sworn on 19th July, 2004 and was based on the grounds stated earlier in this judgment. The motion was heard by the High Court (Emukule, J.) and in a ruling delivered on 2nd March, 2006 the learned Judge allowed the same, and struck out the appellant's suit and the chamber summons.

In delivering himself, the learned Judge stated, in part:

"Under Article 27 of the company's articles, only the company (not the Board) may from time to time <u>in general meeting</u> increase or reduce the number of Directors, and may by special Resolution remove any director and may appoint another person in his stead. The directors have power to fill a casual vacancy occurring in the Board under Article 28 of the Plaintiff company's articles of association.

The appointment of the new or additional directors was not, in my reading to fill a casual vacancy, but created substantive appointments to the Board arising from the change of ownership of the Plaintiff company. This is a matter that was required by Article 27 of the Articles of the Plaintiff company to be transacted by the company in general meeting, not by the Board of directors. In consequence therefore, the appointment of the new directors that is to say, Adam Craig Ogden, Kiranrumar Chandubhai Patel, and Elly Aluvale as Directors of the Plaintiff company was *ulta vires* the company's Articles of Association.

The purported notification of change of directors filed by Eversec, Association as Secretaries is equally a nullity.

It also means that any subsequent board meetings held subsequent to 4-06-2004 without the previous directors of the plaintiff company did not have the necessary quorum to transact any business on behalf of the company. I would in this regard refer in particular to the purported board meeting of 18-06-2004 and the purported resolutions *"to authorize Mr. Adam Craig Ogden, the Managing Director to investigate the transfer of funds and to appoint advocates and take such steps as may be necessary to investigate the same and recover the company's funds."*

Assuming for one moment that the said Board was quorate (sic) **(which it was not, as the only lawful director was the 1st Defendant), there was no formal resolution passed by the Board at that meeting to institute suit against the Defendants or the 1st Defendant in particular.**

Whereas it is acknowledged that the business of a limited company is managed by a Board of directors the cardinal rule or principle is that the board is in place in accordance with the rules prescribed by the regulations or articles of association of the company. That is the sum total of the principles laid out in all major works on company law as well as judicial precedent. So that where the articles delegate to the directors exclusively the power to appoint directors, a general meeting has no power to do so, since that would be usurping the directors' powers unless the general meeting by a special resolution decide to do so, and only this would override the power reserved to the directors in the articles.

In the current case, the articles having reserved the power to appoint directors in the company in general meeting, the directors could not usurp that power and the purported appointments as stated above is therefore *ultra vires* the Company's Articles of Association, and therefore a nullity.

It means therefore that those directors so appointed, cannot and have no *locus standi* to manage the affairs of the said Plaintiff, cannot hold any meeting and pass any board resolution, and cannot instruct any counsel to act on behalf of the company. Any such resolution remain a nullity unless first ratified by the company in general meeting. The ultimate issue then becomes, whether, in these circumstances the company can maintain an action against its directors for any wrong done by the Defendants to the company. This is the ultimate issue here, and the issue whether it can instruct an Advocate becomes a subsidiary issue."

With regard specifically to the issue of whether the law firm of Walker Kontos was authorized to file suit on behalf of the company, the learned Judge stated:

"The purported appointment of the Advocates was made at a meeting held on 18-06-2004 at which a proposal was made to investigate the withdrawal of the funds by the 1st defendant before the Sale Agreement was executed by the parties thereto. Even if the 1st Defendant had not objected to it, and he did object, the proposal remained a proposal even though it was supported by one other director, or a majority of the Board. Even assuming that the Board was validly constituted and I have held above that it was not, there was however no formal resolution firstly, that a suit be instituted against the Defendants or that one Captain Elly Aluvale be authorized to swear the Verifying Affidavit. It is of course trite law that so far as a Corporation is concerned, its agent for purposes of litigation is an officer authorized under its seal. That is the requirement of Order III rule 2 (c) of the Civil Procedure Rules. Where the authority of an agent is challenged like in this application, it behoves the corporation to show such authority; the mere fact of appointment as a director does not constitute one an agent for purposes of suit.

If the issue were merely the lack or absence of due authority to swear the Verifying Affidavit, I would simply strike out the offending affidavit, and direct that a compliant affidavit be sworn. The issue here goes beyond the Verifying Affidavit, and is, confounded by the lack of such authority to swear the Verifying Affidavit."

It is that ruling that is the subject of this appeal. It is based on 15 grounds as follows:

"1. The judge erred in law and in fact in holding that the appellant had not validly commenced proceedings against the respondents.

2. The judge erred in law and in fact in finding that the directors of the appellant had not been validly appointed.

3. The judge erred in law and in fact when he held that there was an invalid resolution instructing the appellant's advocates to commence legal proceedings against the respondents for the recovery of monies due to the appellant.

4. The judge erred in law and in fact in failing to consider the fact that the Notification of Change of Directors had been registered in the Companies registry thus effectively validating the change of directors.

5. The judge ignored the fact that in compliance with Section 201 of the Companies Act a Notification of Change of Directors and Secretaries had been registered thus empowering the new directors of the appellant to institute proceedings against the 2nd Appellant who is a former director of the appellant and the 1st Respondent who is an existing director of the appellant.

6. The judge erred in law by holding that the appellant's directors had not been validly appointed which was an issue not canvassed in the pleadings.

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7. The judge erred in law and in fact in holding that the suit in the superior court was in respect of a sale agreement gone bad while in actual fact it was a suit for recovery of monies which had been deceitfully and fraudulently removed from the appellant's accounts by the respondents to the detriment of the appellant and the secured creditors which action was ultra vires the appellant's memorandum and articles of association.

8. The judge erred in law by failing to consider and address the legal authorities filed by the appellant's advocates which were of immense persuasive value.

9. The judge erred in law by condemning the appellant's advocates to pay costs of the suit when a resolution was obtained from the appellant's directors and the receivers subsequently ratified the continuation of the proceedings after the appellant was placed in receivership.

10. The judge erred in law in imposing a duty on advocates to go beyond a search in the companies' registry to verify if the directors of the appellant had been validly appointed.

11. The judge erred in law by ignoring the fact that the appellant's new directors were appointed by virtue of the new shareholder who attained 90% control of the company after the respondents' had conceded to the sale and no requirement of the appointment of new directors was required under Article 27 of the Articles of Association.

12. The judge erred in law and in fact by failing to find that following the resignation of the former directors of the appellant, save for the 1st respondent, the new directors were validly appointed pursuant to Articles 28 and 31 of the appellant's article of association.

13. The judge erred in law by striking out the entire suit while in fact the suit as against the 2nd respondent should not have been affected as she was a former director who failed to account for her past actions in her capacity as a director.

14. The judge erred in fact by failing to consider the totality of the evidence adduced by the appellant and delaying the ruling for more than a year.

15. The judge erred in law and in fact when he ignored the letter dated 20th September, 2004 that was written by the receivers' of the appellant who effectively ratified the continuation of the proceedings in the superior court."

In his oral and written submissions before this Court, Mr. Allen W. Gichuhi, learned counsel for the appellant, argued that the High Court erred in striking out the suit on a technicality, based on an erroneous holding that the directors had not been properly appointed and had no authority to appoint advocates, when, in fact, those actions had been subsequently ratified; that the learned Judge completely disregarded the principle of ratification in law; that the learned Judge erred in ignoring that the new directors were appointed by a shareholder who owned 90% of the shares of the appellant company; and that an advocate was not expected to go beyond the search results carried out at the companies registry to ascertain if the directors who appear in the register were validly appointed in order to determine the validity of his instructions. He relied on the cases of **Royal British Bank v. Turquand [1856] 6 E. & B. 327**, **Ital Dry Cleaners Ltd v Daxa Gosrani & 2 Others HCCC No. 2408 of 1997** (unreported), **Pender v Lushington (1877) 6 Ch.D 70**, **Danish Mercantile Co. Ltd v Beaumont & Ano. [1951] 1 All ER 925** and **Alexander Ward & Co. Ltd v Samyang Navigation Co. Ltd [1975] 2 All ER 424**.

He also relied extensively on well known texts on company law, such as Palmers (24th Ed.); Gower's Principles of Modern Company Law (7th edition) Halsbury's Laws of England (4th edition) and Company Law by R. Pennington (6th edition).

Prof. Albert Mumma, learned counsel for the 1st respondent, on the other hand, in his oral and written submissions, argued that the appointment of new directors by Ogden was *ultra vires* the Articles of Association of the company; that therefore all subsequent acts of the directors, including the one purporting to appoint Walker Kontos to file suit against the respondent, was a nullity; and that there was no proper ratification of such appointment. He also relied on several authorities including the texts on company law referred to earlier, and to the cases of **Bamford and Another v Bamford and Others [1970] 1 Ch**. and **John Shaw and Sons (Salford)' Limited v Peter Shaw and John Shaw [1935] 2 K.B**.

Dr. Kenneth Kiplagat, learned counsel for the 2nd respondent, associated himself with the submissions of the 1st respondent.

We have anxiously considered the submissions made before us, the authorities cited, and the record, and wish to state from the outset that the only relevant issue before us at this time is whether the High Court erred in striking out the chamber summons application and the suit on the ground that there was no valid resolution appointing the law firm of Walker Kontos to file the suit on behalf of the appellant company. This will become evident at the conclusion of this ruling. Hence, we will not comment at this stage on whether the new directors were properly appointed at a meeting of the shareholders.

With regard to the issue before us relating to the appointment of Walker Kontos to commence litigation on behalf of the appellant company, we have the following to say. What, indeed, is the duty of the advocate when instructed by a corporate client? In holding that Walker Kontos had had no valid authority to act for, and file suit on behalf of, the appellant, the learned Judge observed: -

"In practice, an Advocate may have general instructions to act for or on behalf of a client, and receive an agreed retainer as his fees. When an Advocate is however instructed to file a suit, particularly against current or sitting directors or immediately former directors of a company, special care is required on the apart of the advocate or his firm that necessary authorization by way of clear resolutions of the Board have been taken to institute suit.

The reason for this is quite simple. Where the necessity of filing suit against a director or directors of a company has risen(sic) it should trigger alarm bells in the mind of an Advocate that serious disputes in the company have arisen or that serous mischief is afoot. These ringing bells will alert the Advocate concerned to ensure that all necessary steps have been taken to authorize the institution of the proposed

suit. Where counsel fail to pay heed to such warning bells, they do so at their own or their firm's peril as to costs.

In the matter at hand the Plantiff's counsel ignored or misread those warning bells and thereby invited upon themselves the peril of incurring the costs of not only the application but also the suit itself."

The law firm of Walker Kontos was appointed by Ogden, purporting to act as the Managing Director of the appellant, to recover funds he believed were owed to the company. The record shows that the said law firm relied on the notice of change of directors that had been filed with the Registrar of Companies on 21st June, 2004 and satisfied itself that the new directors had indeed the authority to retain advocates to file a suit for the benefit of the company. According to Mr. Gachuhi, the aforesaid notification had not been challenged, and in any event, even if the initial appointment was defective, the subsequent act of ratification of the advocate's appointment by the Receiver, who was eventually appointed to manage the appellant's company, cured any such defect. One of the persons appointed on 8th September, 2004 as the Receiver of the appellant, Mr. Harveen Gadhoke, confirmed in a deposition sworn on 19th October, 2004 that *"we have effectively ratified the continuation of the present proceedings that seek the recovery of moneys taken out of the plaintiff's account by the defendants."* In a letter dated 20th September, 2004, addressed to Mr. Gachuhi, Mr. Gadhoke confirmed that Walker Kontos should continue to represent the appellant. In our humble view, all these three acts taken together – namely the formal appointment of Walker Kontos by the Managing Director of the appellant; the unchallenged notification of change of directors; and the subsequent ratification of the appointment by the Receiver – gave Walker Kontos the authority to file and continue with the suit for the benefit of the company.

We agree with Mr. Gachuhi that the ***Rule in Turquand's Case*** (supra) applies in this situation. The rule says:

"While persons dealing with a company are assumed to have read the public documents of the company and to have ascertained that the proposed transaction is not inconsistent therewith, they are not required to do more; they need not inquire into the regularity of the internal proceedings – what Lord Hatherley called "*the indoor management*" and may assume that all is being done regularly. <u>This rule, which is based on the general presumption of law, is eminently practical, for business could not be carried on if a person dealing with the apparent agents of a company was compelled to call for</u> <u>evidence that all internal regulations had been duly observed. Thus, where the articles give power to borrow with sanction of an ordinary resolution of the general meeting, a lender who relies on this power need not inquire whether such sanction has in fact been obtained. He may assume that it has, and if he is acting bona fide he will, even though the sanction has not been</u> <u>obtained, stand in as good position as if it had been obtained</u>." (emphasis added).

Gower's Principles of Modern Company Law has summarized the rule in Turquand's case as follows: -

"This rule was manifestly based on business convenience, for business could not be carried out if everybody who had dealings with a company had meticulously to examine its internal machinery in order to ensure that the officers with whom he dealt with had actual authority. Not only is it convenient, it is also just. <u>The lot of creditors of a limited liability company is not a particularly happy one; it would be</u> <u>unhappier still if the company could escape liability by denying the authority of</u> <u>the officers to act on its behalf</u>." (emphasis added).

It is our view that an advocate need not go beyond the search carried out at the Registrar of Companies to ascertain whether the director giving him or her instructions had the authority to do so, unless he had, or ought to have had, knowledge to the contrary of any mischief or fraud on the part of such director. Such an advocate must also obtain the relevant company resolution under its cooperate seal. Furthermore, if the initial act of giving authority was defective, the principal can also ratify the same, and upon ratification it is deemed to have been properly given. The doctrine of ratification is a powerful tool, in the relationship of a principal and agent, to *"cure"* an irregularity. In ***Danish Mercantile Case*** (supra) the Court of Appeal set out the principles to be considered in a situation where an action was commenced in the name of a company without authority. In this case the company went into liquidation and the liquidator adopted

the proceedings on behalf of the company. The Court held:

"I find nothing in any of those cases to constrain me to hold that the issue of a writ and the commencing of an action without authority of the purported plaintiff is a matter which admits of no validation by subsequent ratification of the act of the solicitor concerned. So to hold would be to introduce, as I see it, an entirely novel doctrine into the ordinary law of principal and agent, and to make a new exception to the general rule that every ratification relates back, and is deemed equivalent, to an antecedent authority.'

'It is common practice in such cases to adjourn any motion brought to strike out the company's name with a view to a meeting being called to see whether the company desires the action to be brought or not.'

'I think that the true position is simply that a solicitor who starts proceedings in the name of a company without verifying he had proper authority to do so, or under an erroneous assumption as to the authority, does so as at his own peril, and, so long as the matter rests there the action is not properly constituted. In that sense it is a nullity and can be stayed at any time, provided the aggrieved party does not unduly delay his application, but it is open at any time to the purported plaintiff to ratify the act of the solicitor, who started the action, to adopt the proceedings, and say: 'I approve of all that has been done in the past and instruct you to continue the action.' When that has been done then in accordance with the ordinary law of principal and agent and the ordinary doctrine of ratification, the defect in the proceedings as originally constituted is cured, and it is no longer open to the defendant to object on the ground that the proceedings thus ratified and adopted were in the first instance brought without proper authority." (emphasis added).

The House of Lords in the case of **Alexander Ward & Co. Ltd v Samyang Navigation Co. Ltd [1975] 2 All ER 424** approved and followed the dicta of **Danish Mercantile Co. Ltd v Beaumont & Anot**. In this case the company had not appointed directors and a suit was filed without authority. The plaintiff company went under but the liquidator ratified the proceedings. The House of Lords held that any act within the company's powers could still be undertaken on its behalf and ratified by the company at a later date. Recovery of a debt due to the company was such act. The liquidator could validate the proceedings retrospectively.

The House of Lords also addressed the effect of the appointment of the liquidator and stated:

".....that the ratification relied on is not that of the liquidator, but that of the company acting by the liquidator. The proceedings were *ab initio* in the name of the company. By the time he was seized and adopted the proceedings, the liquidator was authorized to act for the company....."

Similarly, in **Presentaciones Musicales SA v. Secunda [1994] 2 All ER 737**, the solicitor filed proceedings in respect of a company without authority. Ratification was done after the expiry of the limitation period. The question was whether such ratification was valid. The Court of Appeal held that a writ issued without authority was not a nullity as the liquidator could adopt it notwithstanding the expiry of the limitation period. The Court of Appeal approved the dicta of the ***Danish Mercantile case***.

It is our view that the proper thing for the High Court to have done was not to strike out the proceedings, but to stay the same pending ratification if it was of the view that the evidence of ratification was not clear. Here is what ***Palmer*** states: -

"If an individual shareholder, without authority to do so, initiates litigation in the name of the company, the normal practice upon a motion to strike out the company's name is for the court to adjourn, whilst ordering that a meeting of the shareholder's be held to see if the company supports the litigation. If it does not, the motion will succeed and the solicitor who commenced the proceedings without authority of the company will be personally liable for the defendant's costs."

Cordery's Law Relating to Solicitor states that:

"Proceedings will not be set aside because the solicitor acted without authority, if the party on whose behalf they were taken adopts what has been done, but ratification of an agent's act can only be effective where, at the time of the act, the principal was himself competent to perform it, or to authorize its performance, and a plaintiff cannot so adopt an action after having apparently repudiated it to the defendant."

We think we have said enough to show that the High Court erred in striking out the suit at that stage, instead of giving the appellant the opportunity to demonstrate that the appointment of its advocates, even if irregular at the beginning, had been regularized. We say nothing at this stage about whether the directors were appointed validly, and about other issues. Those are for hearing at the High Court. We simply say the High Court was wrong in striking out the suit on the grounds that it did, at that early stage.

Accordingly, we allow this appeal with costs to the appellants; set aside the orders of the High Court; and order that the chamber summons application dated 28th June, 2004 be heard on its merit before any Judge other than Emukule, J. Those are our orders.

Dated and delivered at Nairobi this 27th day of July, 2011.

P.K. TUNOI

.....
JUDGE OF APPEAL

P.N. WAKI
.....
JUDGE OF APPEAL

ALNASHIR VISRAM
.....
JUDGE OF APPEAL

I certify that this is a true copy of the original.

DEPUTY REGISTRAR