

MINORITY SHAREHOLDER LITIGATION IN KENYA



It is a fundamental principle of Kenyan law that a company is a legal person with its own corporate identity, separate from the directors or shareholders and with its own property rights and interests to which alone it is entitled. If it is defrauded by a wrongdoer, the company itself is the one person to sue for the damage. The rule is easy enough to apply when the company is defrauded by outsiders.

The company itself is the only one who can sue. Likewise, when it is defrauded by insiders of the minor kind, once again the company is the only person who can sue. 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 authorize the proceedings to be taken 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 indemnified. 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. A shareholder derivative suit is therefore a lawsuit filed by a shareholder on behalf of the company against directors, officers, or third parties who have harmed the company by breaching their duties. The Courts have defined a derivative suit as a suit brought forward by a minority shareholder in instances where the majority shareholder's actions have caused harm to the company and cannot be rectified by internal company mechanisms.

A salient feature of a derivative claim is that it can only be commenced or continued with the express sanction and/or permission of the court. The two-stage test when it comes to instituting a derivative claim is as follows;

- there should be a prima facie case on either of the causes of action stipulated under **section 238(3) of the Companies Act**. On consideration of the provisions of Section **238(3) of the Companies Act**, the Court will decide on whether to grant leave or not. This is done to ensure that the derivative suit raises substantive issues to be decided and establishes a prima facie case, not frivolous or an abuse of the Court process as stated in **Isaiah Waweru Ngumi & 2 others v Muturi Ndung'u [2016] KEHC 3032 (KLR)**.
- this is the substantive hearing of the suit which is subject to granting of leave in the first stage. The Court considers statutory provisions and factors which ordinarily guide judicial discretion specifically in the sphere of a derivative action.

For a party to succeed while instituting a derivative claim, he/she must show that:

- they are a member of the company that they are instituting a claim on its behalf;
- the proceedings must be in respect to a cause of action vested in the company;
- the applicant must first seek leave from the court on behalf of the company;
- the proceedings must be for protection of members against unfair prejudice brought under the Companies Act and;
- the proceedings are in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default or breach of trust by a director or company.

While it is a requirement that leave should be filed before a derivative claim is instituted, it is critical to note that the procedure for seeking leave is not codified in law. In the case of **Amin Akberali Manji & 2 others v Altaf Abdulrasul Dadani & another [2015] KECA 356 (KLR)**, the Court of Appeal noted as much stating that there are no express provisions in Kenyan company laws to govern the procedure. The Courts can therefore exercise discretion as seen from different pronouncements as in **Harjinder Singh Rihal V Jaswinder Singh Rihal (2020) eKLR** where the Court held that the Plaintiff could commence a derivative suit without leave of the court and regularize the process after commencement of the suit. It would therefore be important for the Courts to develop a test or circumstances under which the need for leave can be set aside to ensure minority shareholders access justice in a timely manner.



By: Wesley Muriuki
Associate Advocate
Civil and Commercial Dispute Resolution
Department