THE REPUBLIC OF UGANDA

IN THE HIGH COURT OF UGANDA AT KAMPALA

(COMMERCIAL COURT)

CIVIL SUIT NO. 191 OF 2002

ALLIED BANK INTERNATIONAL LTD ……APPLICANT

VERSUS

SADRU KARA AND ABDUL KARA …….DEFENDANTS

BEFORE: THE HONOURABLE MR. JUSTICE JAMES OGOOLA

**RULING**

At the commencement of the hearing of the above suit, learned counsel for the two Defendants to the Counter-claim (Mr. Muwema and Ms Samula) raised a preliminary point of law, challenging the competence of the counter-claim. The grounds of the challenge were stated to be:

That the derivative action brought by the 1st and 2nd Plaintiffs (for the benefit of the 3rd and 4th Plaintiffs) to the Counterclaim:
(i) has not been sanctioned by "leave of court";
(ii) lumps together as Plaintiffs the minority shareholders as well as the two wronged companies (on behalf of whom the suit has been brought): and
(iii) the companies being under receivership, the Receiver (not the shareholders/directors) would be the right Plaintiff.

The general rule for derivative actions is that the proper plaintiff in an action to redress an alleged wrong to a company, is the company itself — see **Foss v Harbottle (1843) 2 Hare 461.** However, there are exceptions to that general rule, the parameters of which have been carefully crafted and strictly defined. The rationale for these exceptions is articulated by **Gower's Principles of Modern Company Law (2 Edn.) at p.528,** thus:

> *"If there were no such exceptions, the minority would be completely in the hands of the majority. Even the limitations imposed by the substantive law would be stultified, for as*

*long as the company remained a going concern no action could effectively be brought to enforce them."*

It was argued by learned counsel (Mr. Muwema) that with or without exceptions to the general rule, any person bringing a derivative suit must first seek the Court's leave. Learned counsel for the counter claimants (Mr. Kanyerezi) challenged this view of the law. He contended that that was the law of England, which has been codified into statute — see Order *15,* r.12A RSC. I agree. The law in England appears to be succinctly stated by **Charlesworth & Moss on Company Law (j6th Edn.), at p.313,** thus:

*"The preliminary procedure was approved by KNOX J in* ***Smith v Croft (No.2) [1987) BCL 206*** *as a half way house between assuming for procedural purposes either that all allegations are true or requiring the Plaintiff to prove everything as a preliminary issue ……0.15, rule 12A of the RSC implements these decisions by requiring a minority shareholder to apply for leave to continue the action if the defendant has given notice of intention to defend."*

There is no Ugandan equivalent to the English 0.15, r.12A. The Ugandan law on derivative actions appears to have been effectively articulated and compacted into the case of **Salim Jamal v Uganda Oxygen Ltd,** Civil **Appeal No. 64/95 S.Ct,** in which ODER JSC quoted DENNING M.R. *in extenso* to the effect that:

(a) It is a fundamental principle of our law that a company is a legal person, with its own corporate identity, separate and distinct from its directors or shareholders and with its own property rights and interests to which alone it is entitled.

(b) If it is defrauded by a wrongdoer, the company itself is the one person to sue for the damage.

(c) To redress the injustice that would otherwise ensue [where the miscreant majority refuse to sue],

*"a suit could be brought by individual corporators in their private characters, and asking in such character the protection of rights to which in their corporate character they were entitled"* - per WIGRAM V-C, in **Foss v Harbottle.**

(d) In the case described in (c) above, the minority shareholders might file a bill asking leave to use the name of the company. If they show reasonable grounds for charging the directors with fraud, the Court would appoint the minority shareholders as representatives of the company to bring proceedings in the name of the company against the wrong done to it — see WOOD V-C in **Merry Weather [1867] LR 5 EO 464n.**

(e)According to LORD DENNING, to sue in the manner described in (d) above, would be "a circutous course", at any rate in cases where the fraud itself could be proved on the initial application.'

To avoid that circuity, LORD HEATHERLY LC held that:

*"the minority shareholders themselves could bring an action in their own names (but in truth on behalf of the company) against the wrong doing directors for the damage done to the company; provided always that it was impossible to get the company itself to sue them."*

(f) Stripped of mere procedure, the principle is that, where the wrong-doers themselves control the company, an action can be brought on behalf of the company by the minority shareholders, on the footing that they are its representatives, to obtain redress on its behalf.

In light of all the above, ODER JSC concluded thus:

*"Two recent decisions in our jurisdiction will, I think, suffice to illustrate that Courts will go behind the corporate veil in the interest of justice, on grounds of fraud, to enforce compliance with contractual obligations or enforce economic realities obtaining under a holding company and its subsidiaries.*

**[See National Enterprise Corporation v. Nile Bank, Civ. Appeal No. 17/94 (SCV)** (unreported); and Earn **International v. Mohamed Halid el Fathi, Civ. Appeal No. 6/93 (SCV)** (unreported]."

Such is the law applicable in Uganda. There is no overt reflection in that law requiring the minority shareholder to first seek and receive permission in order to use the company's name in a suit; nor is the minority shareholder required to first seek and receive Court's leave prior to filing his derivative suit.

What is abundantly obvious, however, is the obligation for the particular shareholder to bring himself squarely within the ambit of the exception to **Foss v Harbottle**. The criteria for this have been clearly established by, among others, **Gower's Principles of Modern Company Law (3rd Edn.).** The principles were recited, with approval, by ODER JSC in **the Uganda Oxygen case** *(supra)* **at p.137, thus:**

*"(i) Normally, the wrong complained of must be such as to involve fraud on the minority, which could not be validly waived by the company in a general meeting, such con duct include:*

*(a) Expropriation of the property of the company or, in some circumstances that of the minority;*

*(b) Breach of the director's duties of subjective good faith;*

*(c) Voting for company resolutions not bona fide in the interests of the company;*

*(ii) It must be shown that the alleged wrong doers control the Company;*

*(iii) The Company must be a defendant in the action ... the company is the true Plaintiff, and if a money judgment is recovered against the true defendants — the wrong doing directors or controllers — this will be in favour of the company and not in favour of the individual shareholder who is nominal Plaintiff The company cannot, in fact, be the Plaintiff, because neither of its organs —the board of directors and the general meeting — will authorise suit by it. As the next best thing the court insists upon its being made the nominal defendant* (-- see **Spokes v Grosvenor Hotel [1897] 2 QB 124).**

*- If the company has ceased to exist and cannot be resuscitated... it seems that no action can be brought:* ***Clarkson v Davies [1923] AC 100***

(iv) The shareholder must sue in a representative capacity or on behalf of himself and the other members other than the real defendants ... for it ensures that all the other shareholders are also bound by the result of the action [i.e. *res judicata].”*

All the above forms a compact summary and encapsulation of the law on derivative actions. It answers broadly all the three grounds advanced by learned counsel Muwema and Samula. Nonetheless, to answer those grounds even more specifically, I will now deal with each one of the three grounds *seriatim:*

**1. Court’s permission/leave** No such requirement is directly reflected in the Ugandan law analysed above.

**2. Proper Plaintiff/Defendant** — It was contended that only the company itself can bring a derivative action; that the minority shareholders cannot sue as Plaintiffs together with the Company (also as Plaintiff); and that the shareholders’ complaint must be distinct from that of the Company. This is clearly wrong. Where the company itself refuses to sue (or those who control it refuse to), then clearly the minority may bring the action in their **own names** (but in truth on behalf of the Company -- see **East Pant du Lead Mining Co. v. Merryweather (1864)2 H & M 254.** The Plaintiff shareholder:

*“Is not acting as a representative of the other shareholders but as a representative of the Company, and the action will necessarily present features quite different from those in the normal representative action.”* [Emphasis added]

- see Gower’s **Principles of Modern Company Law (2 Edn.) p.531.**

One of the “different/unusual” features redounds directly on the proper parties to the suit and their proper designation. In this regard, **Gower** *(supra)* observes, *inter alia,* that:

“…..*the company is the true Plaintiff* ... the *individual shareholder is the nominal Plaintiff. The company cannot be the Plaintiff, because neither of its organs — the board of directors and the general meeting — will authorise suit by it. As the next best thing the Court insists upon its being made the nominal defendant.* [Emphasis added]

The complexity of the procedural features attaching to a derivative action as set forth above does, in my view, merely mask the simplicity of the real intention underlying this kind of suit — namely to enable the minority redress a wrong wrought upon the company by a miscreant majority. To that extent, the propriety of particular designations put on the parties is totally subsidiary to the discussion of the true and real issues at hand. I find totally nothing amiss concerning the joinder of parties in this instant case — and if I did, I would not hesitate to invoke the provisions of 0.1, r.9 of the Civil Procedure Rules (under which no suit shall be defeated by reason of the misjoinder or non-joinder of parties).

**3. Receivership** — For the third ground, it was contended that in the instant case, only the receiver can sue on behalf of the Company. Yes, but if the receiver (who is by definition "in control of the company") is at the same time a wrong doer and refuses to sue, then he is no different from a controlling shareholder/director who similarly refuses to sue — see **Gower (2nd Edn), p.529.** In the instant case, it has been alleged that ALLIED BANK, together with the Receiver (Mr. Mutiso) seized the Company's property, without benefit of any valid debenture, and then sold that property illegally (see paragraph 13 of the counterclaim). If this is true — and now is not the time to go into the merits of this case — then it would fall squarely within the criterion of "fraud", constituted by **"expropriation** of the company's property."

The contention by learned counsel Muwema that in the instant case there was no evidence (except that emanating from Mr. Kanyerezi at the bar) to the effect that the Receiver refused to institute proceedings on behalf of the company, is answered authoritatively by **Gower *(supra),*** at **p.533,** thus:

*"English* cases *recognise that there is no point in formally asking the directors to institute the proceedings if they are to be the defendants, and that it is not necessary to convene a general*

*meeting and to invite it to resolve upon proceedings in the company's name, provided that the Court can be satisfied* ***aliunde*** *that the wrongdoers are in effective control —* ***Atwool v. Merryweather (1867) 5 Eq. 464 n."***

Equally, learned counsel's vigorous argument concerning the law's requirement to plead "fraud" specifically, and then to give 'particulars" thereof, was misplaced. Clearly, the argument

confused the concept of “fraud”, as used in criminal statutes *strictu sensu,* with “fraud” as used for purposes of derivative actions. I am satisfied that the two concepts are quite different. The latter is, in effect, a term of art which is interchangeable with “wrong doing” — see especially LORD DENNING’s statements *(supra),* in which the term “defraud” is very clearly used as a synonym for “wrong doing”. See also Gower *(supra)* at p.588, where the learned author talks of a “wrong” done to the company - interchangeably with “fraud” — and then specifically lists the following examples of such “fraud” as including:

(i) expropriation

(ii) breach of directors’ duties

(iii) voting resolutions that are not bona fide the interests of the company.

The preliminary point of law is hereby overruled.

Costs to be in the cause.

**Ordered accordingly.**

James Ogoola

JUDGE

01/07/02

DELIVERED IN OPEN COURT, BEFORE:

Fred Muwema Esq.}

Claire Samula,} — Counsel for 3rd & 4th Defendants to counter-claim

Masembe Kanyerezi, Esq. — Counsel for 1st & 2nd Plaintiffs to counter-claim

J.M. Egetu — Court clerk

James Ogoola

JUDGE

01/07/02