THE REPUBLIC OF UGANDA
IN THE HIGH COURT OF UGANDA
HOLDEN AT MBALE

HCT-04-CV-CS-0019-2013

COTTIFIELD EAST AFRICA (U) LTD :::::::::: PLAINTIFF
VERSUS
UGANDA GINNERS AND COTTON EXPORTERS ASSOCIATION LTD ::::::::: :: DEFENDANT

BEFORE: THE HON. MR. JUSTICE HENRY I. KAWESA

JUDGMENT

Plaintiff sued the defendant for recovery of Shs. 2,000,000/= and 2,920,649,200/= being subscription fees and Cotton Development Fund (CDF) respectively collected to by the defendant from Plaintiff for seasons 2010/2011 and 2011/2012. Plaintiff averred that those payments were illegal and/or made under 'mistake, undue influence and misrepresentation.

Defendant denied all the allegations as per their Written Statement of Defence.

At scheduling the following were the issues agreed on:

1) Whether the annual subscription collected by the Defendant from the Plaintiff is illegal and *ultra vires* the Defendant's Memorandum and Articles of Association.
2) Whether it is recoverable from the Defendant.
3) Whether payment of CDF was illegal and was paid mistakenly by the Plaintiff.
4) Whether CDF paid by the Plaintiff is recoverable from Defendant.
5) If so how much of it is so recoverable.

6) What are the remedies?

This case is based on witness statements that were filed in support of the individual pleadings, consisting of the Plaint, Written State of Defence, and the agreed scheduling notes. As agreed on during scheduling each party relied on a number of documentary exhibits.

Given the above, this court will not reproduce all of the above verbatim but will discuss the relevant facts, evidence and law applicable for every issue as raised. I will therefore discuss the issues in the order presented as herebelow:

Issue 1: Whether annual subscription/membership fees paid by Plaintiff to the Defendant was illegal and ultra vires its memorandum and Articles of Association.

The plaintiff's claim here is that the subscription fees it paid to the Defendant was illegal and/or *ultra vires* its Memorandum and Articles of Association as pleaded in paragraphs 3 and 4 of the plaint. In reply to this allegation defendants pleaded in paragraphs 2, of the Written Statement of Defence, that this was not the position, where after plaintiff further affirmed the position in paragraphs 2, 3, and 4 of his reply to the Written Statement of Defence.

In submissions, Counsel for the plaintiff submitted that the subscription fees were illegal because;

i) Defendant was incorporated as a Company Limited by shares in 1988 (as per evidence of PW.1 and Exhibit P.1 and evidence of DW.1).
ii) Exhibit P.1 shows that it provided for normal capital divided into shares and those shares were allotted to various persons. (Ref. Exhibit P.3, P.4, P.5, P.6, P.7, P.89, P.87, P.88, P.90, P.91).

Counsel argued that to become a member of the defendant one was required to buy shares as a legal requirement and the companies Act section 3 (2) (a) and section 29 thereof.

iii) Exhibit P.1, required share capital, but also required a member to contribute Shs. 1,000,000/= on winding up as if it was a company limited by guarantee.

According to Plaintiff's counsel, the requirement by Article 5 of its Articles of Association for a member to contribute an entrance fee and annual subscription was not only a contradiction but superfluous and illegal being a company limited by shares.

Counsel further argued that the defendant's legal status had been earlier on challenged by the plaintiff at the time he applied to join, where after the Defendant attempted to change into a company limited by guarantee without success. (ref. PW.1's evidence, exhibit D.14, Exhibit D.28, 29, and 30. Evidence of DW.1).

Counsel further argued that the law as of then could only allow a company limited by guarantee to provide for member contribution as well as share capital and not vice versa (per section 4 and 13 of the Company's Act).

In response counsel for the defendant company argued that counsel's arguments above were flawed on grounds that counsel did not address the issue of "*ultra vires*" and only argued the element of "illegality."

He referred to the Articles of Association of the defendant company to argue that there was no illegality committed. He cited the following reasons for his argument.

1) Failure by plaintiff to show that defendant is an illegal company.
2) The illegality that plaintiff alleges does not amount to illegality in view of section 14 of the Judicature Act, the known English definition of illegality, or by any other legal standard in law- because
   (i) The plaintiff though it purchased no shares in the defendant is its member.
   (ii) Plaintiff is a member by Article 5(2) of the Articles of Association.
   (iii) If payments made were illegal then plaintiff is privy to that illegality.
   (iv) By construction of the Articles of Association the defendant argues that although by Exhibit P.1 and P.2 the defendant was termed a limited liability company, it was, to all intents and practical purposes a company limited by guarantee with share capital which was conducive to it as an association and at all material times conducted its business as such. To prove so defendant referred to evidence by DW.1, Exhibit D.35, D.14, Section 392 Companies Act and Exhibit D.27, Exhibit P.1, Article 14, Article 5, Exhibit P.1, all defence exhibits as listed from page 3-6 of his arguments.

He concluded that the subscription fees were neither *ultra vires* nor illegal and if they were illegal the plaintiff would not recover them when it was privy to the transaction.

I have carefully considered the arguments by both counsel on this issue.

I have also noticed that the plaintiff only addressed himself on the element of illegality and abandoned the element of "*ultra vires*". It is therefore taken as abandoned.

I will therefore restrict myself on arguments made by plaintiff's counsel and responded to by defendant's counsel.

The illegalities pointed out related to the legal status of the defendant company; the issue of shares, membership contribution, duo status of defendant (being limited by shares and guarantee at same time).

The defence as seen above argues that no illegality was committed.

In resolving this issue, one has to first warn myself of the law applicable, which for this purpose is the Company's Act.

According to Section 27 (1) of the Act:

> "*The subscribers to the memorandum of a company shall be deemed to have agreed to become members of the company and on its registration shall be entered as members in its register of members*."

Section 27 (2);

> "*Every other person who agrees to become a member of a company and whose name is entered in its register of members, shall be a member of the company*."

The first question therefore is was the plaintiff a member of the defendant company? And if so did he join it as per the provisions of the law above?
The plaintiffs through **PW.1 Panel Kuzemenko** stated in evidence on oath that in 2010 upon application for a cotton ginning and export licence from CDO were informed by CDO that they were supposed to be a member of the "Ginners Association." They were therefore referred to the Defendant. (See paragraph 3).

That the defendants informed them that they were to pay subscription fees of shs. 1,000,000/= per season for 2010/11 and 2011/12 cotton season. He referred to Exhibits PE.9, 10, 11, 12, 13, 14).

He further stated in paragraph 5 that;

> "*Because of that situation and since they wanted to engage in the business they paid the subscription fees in order to be licensed. They paid 2,000,000/= as subscription fees and shs. 4,675,448,000/= as CDF (Exhibits P.21-73, and 79).*"

This was also referred to by DW.1 Bruce Robertson who testified in evidence in chief under paragraph 5 that in the year UCKL joined in 2004 the UGCEA in a general meeting resolved (on 9.12.2004) that every ginner shall be a member of UGCEA for purposes of supporting cotton production (Exhibit P.83). Also paragraph 8 of his statement indicates that defendants were members of plaintiff company. The evidence referred to shows without doubt that plaintiff knowingly and voluntarily joined the defendant company. The evidence as received from **Mr. Pavel Kuzemenko**'s testimony (paragraph 1-6) is that his company joined defendant's company as a member.

The second question is was the defendant company an illegal company?

According to Section 3 of the Companies Act. Any seven or more persons, or where the company to be formed will be a private company any two or more persons associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration form an incorporated company with or without limited liability. These companies are according to section 3 (2) of the Companies Act in the following categories:-

(a) Limited by shares;

(b) Limited by guarantee

(c) Unlimited.

From the law, the Act specifically provides for specific modalities and requirements for the formation of each individual company. There is a specific mode of incorporation for a company limited by shares and one limited by guarantee. It is therefore true that the defendant company was by the time, plaintiff joined it a kind of "hybrid" company. If that was the case, did the requirement that the members had to pay subscription fees and share capital, illegal?

The defendant's explanations on this point would require a liberal interpretation of the law as opposed to the strict interpretation proposed by the plaintiff. strictly by virtue of the Companies Act, the law is as stated in Section 3.

However the Liberal Common Law approach to this situation provides that a Company can be hybrid (See *Myson, French and Ryan on Company Law: 21st Edition 2004-2005*).

Also from the official site of "corporate options: enquiries@corporateoptions.com". The term hybrid company is used for a company whose responsibility is limited by its members' guarantees and amount of contributed capital. It is a company limited by guarantee and which has a share capital possibly used as an alternative to a trust."

From the above common law position and from the submissions on the evidence by plaintiffs and defendants, I find that no illegality was committed by the

defendants when they formed a company which appeared "hybrid" by implication but legally licensed as a company limited by shares. There was no law that was violated at incorporation. No fraud, or fraudulent intention was committed. There is no evidence that plaintiff was coerced into becoming a member. Everything was voluntary and within the prescribed laws (Section 16 of the Companies Act).

The Evidence Act under Sections 101, 102, 103 requires the one who asserts a fact to prove it on a balance of probability. The evidence by PW.1 and exhibits attached, when compared with evidence of DW.1 and exhibits attached, swings the balance of probability in favour of defendants. I agree with counsel for the defendant that the memorandum and Articles of Association are a contract between the Company and its members. They are a business document to be construed to give business efficacy, where a construction tending to that result is admissible on the language of the Articles in preference to a result which would or might prove unworkable as per *Hallsbury Laws of England 4th Edition 1996 Reissue Vol. 7 (1) paragraph 140 page 120*.

I am also in agreement that as per *Hallsbury's Laws of England 4th Edition 1996 Reissue Vol. 7 (1) page 277, paragraph 358*;

> "*The members of a company are those persons including corporate if any who collectively constitute the company or in other words are its corporators. A member is not necessarily a shareholder and Allotment of shares is not a condition precedent to a member becoming a member of the company*."

Consequently I have reached a conclusion that contrary to the submissions of the plaintiff,

1) The plaintiff was and is a member of defendant company for reasons I have stated, together with those raised by defendant counsel in rebuttal.
2) I hold that the submission that the Defendant company was a hybrid company and hence could be construed as a company limited by guarantee with a share capital. I uphold this argument as argued by counsel for defendants.

I therefore find that the annual subscriptions collected by the defendant from plaintiff was not illegal and *ultra vires* the defendant's memorandum and Articles of Association. This issue is terminated in the negative.

This finding also answers the second issue.
Whether the subscription is recoverable from the defendant.
This money is not recoverable for the following reasons.

1. The subscriptions as already found were a contractual obligation payable under the Articles (Article 5). The company was dully incorporated legally and under section 16 (1) Companies Act a Certificate of Incorporation can only be impeached for fraud. No such fraud has been pleaded or proved. The membership to this company as argued by defendants was not premised strictly on payment of subscription fees, as already found under issue 1.

2. The fees if illegally paid cannot be recovered on the basis of a transaction which itself was illegal and *void abinitio*.

The position as stated in the case of *Active Automobile Spares Ltd versus Crane Bank Ltd & Anor. SCC No. 21 of 2001* (unreported), is that courts cannot enforce an illegality.

The principle is that;

> "*Neither party can recover what he has given to the other under an illegal contract if in order to substantiate his claim his driven to disclose the illegality*."

These are common law principles set out in cases as far back as *1892 in Scott versus Brown Doering Mac Nab & Co. (1892) 2 QB 724 pg. 724*. This case refers to the principle of "*Pari dilcto potior est conditio Defendentis*" which applies the rule that the defendant may keep what he has been given if for instance, a seller sues for the recovery of goods sold and delivered under an illegal contract he will fail, for to justify his claim he must necessarily disclose his own iniquity. See: *Taylor versus Chester (1969) 4 QB 309*.

I therefore agree with counsel for defendants that in this case even if court had held that the collections were illegally received under an illegal transaction, they would not be recoverable on account of the principles of law above.
Either way of looking at it, this claim cannot be sustained. This issue is therefore found in the negative.

Issue 3: Whether the payment of CDF was illegal and paid mistakenly by the Plaintiff:

The plaintiff's counsel argued that payment of CDF was illegal and paid mistakenly by the plaintiff because the plaintiff;

i) Wanted to be licensed/registered by CDO.
ii) It paid it as an obligation set up by defendant purporting to be the association referred to under the cotton regulations.

iii) – (xii) – raises the innuendo that the defendant exerted undue influence upon the plaintiff posing as the "Association" referred to in the regulation, and made plaintiff pay the said CDF, which was not a legal requirement for licensing.

The defendant counsel argued that CDF could not be illegal because all the alleged twelve grounds cited by plaintiff do not fall within the ambit of what is illegal as defined by the Dictionary of English. *The Dictionary of English Law by* **W.J Bryne (London, Sweet and Maxwell)** *1923 page 466* define "illegal" as
"*an act is illegal when it is one which the law directly forbids…*"

Counsel argued that an illegal payment is one which is paid contrary to the law (which the law prohibits) or in pursuance of a transaction which the law prohibits. He argued that there is no law, statutory or otherwise or transaction that has been cited which makes payment of CDF illegal.

Secondly he argued that CDF or purpose for which it was paid was/were legal as per evidence of PW.1 paragraphs 14, 15, 16, 17, 19, 20, 21, 24, 25, 26 including the exhibits referred to by DW.1 in his statement.
He argued that CDF was paid voluntarily by every member of the defendant to boost cotton production which was beneficial to the members of the defendant. He referred to defendant statement and exhibits.

The above arguments when considered in view of the pleadings, facts and evidence shows the following.

(i) The complaint by plaintiffs regarding CDF is premised on the question of what amounts to an illegality in the circumstances.

(ii) It is the duty of this court to assess the evidence and establish if there is ample evidence on record to prove allegations raised by the plaintiff.

Regarding the definition of illegality, it will be assigned the natural meaning in English.

According to Merriam Webster Dictionary, illegal is defined as;

> "*not according to or unauthorized by law, unlawful, illicit or not sanctioned by official rules*."

This definition is the same as that referred to by defendant's counsel. The question to ask therefore is to find out if the payment of CDF was in violation or was not according to law, unauthorized by law or was unlawful.
What rules or laws were violated by defendants in collecting the CDF?

According to PW.1 in his statement (paragraph 3) said that he was informed by the CDO that they were supposed to be members of defendant company. Defendants then informed them that they were required to pay a "CDF" to which all ginners had resolved to pay. From paragraph 4- he said he was informed that all members of UGCEA had resolved to establish the CDF to which a ginner licensed by CDO must contribute a certain amount of money per kilograme of raw cotton he/it buys.

Paragraph 5 he stated that they voluntarily opted to pay the CDF in order to be licensed by CDO. These were supported by Exhibits P.9, 10, 11, 12, 13, 14, 21-73, 79).

DW.1 also testified regarding how the CDF is collected, managed and utilized. (See paragraphs 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15-22, 25-28). The essence of

the evidence of DW.1 in the paragraphs quoted is that CDF was regulated, and members always discussed its management by meetings and resolution.

Going by the evidence on record above I make the following findings of fact:

1. The evidence shows that there were well laid down procedures by which defendants and plaintiffs (by virtue of Exhibit P.9 and 15) operated the CDF.
2. There is evidence through Exhibit P.10, showing that there were well laid down guidelines for collection and safe deposit of the CDF contributions made by the ginners.
3. From Exhibits P.10, P.11, P.13, P.14 there is evidence that management of CDF involved all members, who regularly met and resolved on various management issues, pertaining to management and control of CDF.
4. From the above, CDF contributions was voluntary.
5. Management was transparently handled.
6. There is no evidence to show that collection of CDF was done on behalf of "the Association" envisaged in the cotton development rules. (See paragraph 53) of DW.1's statement on oath, and paragraph 13 of PW.1's statement on oath.

From the evidence as it is I do not find any action that amounts to an illegality that was committed by defendants while collecting the CDF.

This finding was legally provided for in the Articles. All members including the plaintiff company agreed to make contributions. Regular management meetings were held and CDF considered. Resolutions were made. There is no evidence showing that defendants went against any of the established rules or laws that governed the CDF.

I therefore agree with defence counsel's arguments that there was no evidence of illegality or undue influence. His arguments on this issue are adopted. The plaintiff has failed to prove on a balance of probability that the payment of CDF was illegal and paid mistakenly by plaintiff. This issue therefore terminates in the negative.

Issue 4 and 5:

Whether the CDF paid by the plaintiff is recoverable and if so how much?

The plaintiff's argument under this ground is that CDF which was collected was to be applied to promotion of cotton production in Uganda. However plaintiff, contended that defendant used CDF funds on other activities other than the stated promotion of cotton production. The rest of plaintiffs arguments are premised on that statement of fact.

The defendant counsel also in rebuttal contended that all the grounds plaintiff raised were premised on illegality and mistake which were the basis of the cause of action. The defendant counsel made arguments to the effect that the plaintiff having earlier on based his argument on the contention that CDF payment was an "illegality" and premised on a "mistaken belief," he cannot recover what is an illegality.

Arguments aver that since the plaintiff contributed, money, ideas and participated in decisions that led to how CDF was expended it was privy to all decisions taken and cannot seek to be refunded money whose expenditure they had participated in sanctioning.

I have gone through all the evidence as led by PW.1 and exhibits referred to, and DW.1 and supporting exhibits and do hold as herebelow:

The principles that govern pleadings preclude/prohibit a party from departing from his pleadings. In this case I find that plaintiff categorically pleaded the issue of illegality and mistake in paragraphs 5, 6, 7, and 8 of the plaint.

It is therefore not correct to allude to the fact that plaintiff departed from its pleadings.

It is however, not possible for plaintiff to sustain this pleading for reasons that inspite of the argument it raises, and facts in attached exhibits 15, 25, 26 21-76, etc there was no proof that these expenditures were illegal and recoverable by the plaintiff. This is so because evidence through PW.1 and DW.1 and exhibits referred to by either of them shows that both parties participated in the process of management of CDF as per the provisions of the Company Articles, and the members resolutions made from time to time. There is evidence D.25 and D.26 through DW.1- paragraphs 14, 20, 21, 22, 27-36, 37, 38, 52 and 53, which evidence largely is uncontroverted and shows that CDF belonged to ginners who took decisions how to collect it and disburse it. UGCEA (defendant) acted on behalf of the ginners to effect all the expenditures complained of by plaintiff (paragraph 37). The accounts of UGCEA were audited and approved by the ginners in a general meeting as per annex “C” and “C1” (Min 6/11/14 (1); and approved audited accounts annextures “C.2” and “C3”.

The plaintiff refers to the same documents in his submissions on page 10 that the audited accounts presented (exhibit D.25 and 26) are reflections of Defendant’s accounts as on 30th June 2012/2013 but do not account for each individual contributor’s money; and do not specify how much of the contributor’s money was spent.

I do not agree with that conclusion. The purpose of an audit is to conduct a formal examination of an organization's accounts or financial situation. An audit entails a complete and careful examination of the financial records of a business or a person. (See **Merriam** –*Webster Dictionary for definition*).

An audit is a careful check or review of something.

The examination done by a certified auditor of a company's accounts is formal proof that all accounting transactions are as presented in the audit report. I am therefore satisfied that the report given by the auditors was sufficient to explain the financial position of the defendant company as presented in the defence case.

Secondly it was the duty of the plaintiff as a member to raise the issues of his dissatisfaction with the way CDF funds were being utilized during the annual general meetings held from time to time to discuss CDF. He could not keep quiet, let resolutions pass, (as per DW.1's evidence) and then complain after the event.

For all reasons stated above am in further agreement with defendant's counsel that CDF having been legal and the plaintiff having based its claim on illegality, its claim must fail. This is so because even if CDF was found to be illegal, the plaintiff having participated and benefited from the illegality, it cannot be aided by court to recover. The principle of approbation and reprobation also does not allow plaintiff to recover what it claims was a product of an illegality in which it fully participated.

The principle is well laid out in common law. According to *Versclures Creameries Ltd versus Hull and Netherlands Steamship Co. Ltd (1921) KB 608 at P.612* Per **Scrutton L.J**, stated that:

> "*It is a well known principle of equity that one cannot approbate and reprobate all the same time. This principle is*

based on the doctrine of election which postulates that no party can accept and reject the same instrument and that; a person cannot say at one time that a transaction is valid and thereby obtain some advantage to which he could only be entitled on the footing that it is valid and then turn round and say it is void for the purpose of scoring some other advantage."

From the above discourse the plaintiff cannot claim CDF was illegal and again ask court to base on its operations to order a refund to him. I find that there was no mistake, as no evidence of such mistake exists on the record.

In the result I find that CDF paid by the plaintiff is not recoverable. Both grounds 4 and 5 are not proved.

In the final result, I find that the plaintiff has failed to prove its case on the balance of probability. The case/suit is accordingly dismissed with costs to the defendants. I so order.

Henry I. Kawesa

JUDGE

03.03.2016