REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAKURU

CIVIL CASE NO. 33 OF 2020

KENNETH MAWEU KASINGA ..... PLAINTIFF

VERSUS

CYTONN HIGH YIELD SOLUTION LLP ..... 1ST DEFENDANT
CAPITAL MARKETS AUTHORITY ..... 2ND DEFENDANT

RULING

1. The 1st Defendant is a limited liability partnership that offers structured investment solutions to high net individuals as restricted private offers as defined in Regulation 21 of the Capital Markets (Securities)(Public Offers, Listings, and Disclosures) Regulations, 2002.

2. On 03/10/2019, the Plaintiff entered into an investment Agreement with the 1st Defendant. For an investment of Kshs. 3 Million, the 1st Defendant promised to pay the Plaintiff a "Pre-agreed Return" upon maturity.

3. The contractual relationship between the Plaintiff and the 1st Defendant was subject to both the Investment Agreement and the Partnership Agreement between the 1st Defendant and all the other partners.

4. Sometime in June, 2020, the 1st Defendant communicated to the Plaintiff that due to the effects of the Coronavirus Pandemic, it would be unable to pay the Pre-Agreed Return at the end of the maturity period. Instead, the 1st Defendant gave the Plaintiff two options: to either extend his investment by 12 months after the date of maturity; or to enter a standstill agreement where his funds would be extended for an additional two years after the date of maturity. Thereafter, the 1st Defendant extended the Plaintiff's investment for 12 months and varied the mode of payment of the periodic interest payable: half would be paid within 5-15 days of falling due while the other half would be capitalized into the Plaintiff's principal.

5. The Plaintiff is aggrieved by the decision by the 1st Defendant to modify the dickered terms of their Investment Agreement. The 1st Defendant says that the changes were necessitated by the negative economic effects arising out of the "understandable and necessary drastic steps taken by the government to contain the Global COVID-19 Pandemic." It further says that the effects of the Pandemic was not only to curtail lucrative opportunities but also triggered a contagion of withdrawals from investors. This, the 1st Defendant says, forced it to invoke the *force majeure* provisions of the Investment Agreement, and extended the maturity period for all investments.

6. The Plaintiff is persuaded that the 1st Defendant was not justified in acting as it did, characterizes the action as "unilateral", and

further now states that the Investment Agreement was entered into as a result of misrepresentation since the number of investors was allegedly more than 100 (and, therefore, contrary to the law) which, according to the Plaintiff, made it a public offer not the promised private offering.

7. In a Plaint dated 04/08/2020 in which the Capital Markets Authority is enjoined as the 2nd Defendant, the Plaintiff prays for the following orders.

    a. *A declaration that the 1st Defendant's product known as Cytonn High Yield Solutions is a public offer which is subject to the approval and regulation of the 2nd Defendant and an order directing the 2nd Defendant to audit all the activities of the 1st Defendant for purposes of approval and regulation.*

    b. *A permanent injunction restraining the 1st Defendant either by itself, its agents, servants, employees, tenants or otherwise howsoever from extending the maturity of date the sum invested by the Plaintiff when the contract expires on 7th September, 2020.*

    c. *An order compelling the 1st Defendant to specifically perform the investment contract by paying the agreed monthly interest and paying the Plaintiff the total amount of his investment upon maturity.*

    d. *General damages for breach of contract.*

e. Costs of the suit.

f. Interests on (d) and (e) above.

g. *Any other or such further relief this Honourable Court may deem fit to grant.*

8. The Plaintiff filed a Notice of Motion Application contemporaneously with the Plaint seeking, in the main, an injunction restraining the 1st Defendant from extending the maturity date and modifying the terms of payment of the Agreed Return and a mandatory injunction compelling the 2nd Defendant to audit the activities of the 1st Defendant for the purposes of "approval and regulation pending the hearing and determination of this application."

9. The 1st Defendant responded to the pleadings and Notice of Motion application by the Plaintiff with a Chamber Summons Application dated 14/08/2020 with the single substantive prayer that "all further proceedings herein be stayed and referred to arbitration in terms of Clause 25 of the Investment Agreement and Clause 16 of the Partnership Agreement."

10. This is the Application coming up for determination. The Application was canvassed by way of written submissions. The singular question presented is whether the suit should be stayed and referred to arbitration or whether the subject matter of the suit is non-arbitrable and therefore not subject to the Arbitration Agreement between the Plaintiff and the 1st Defendant.

11. There is no dispute between the parties that there is an arbitration clause between them. The Arbitration Agreement is in clause 25 of the Investment Agreement and Clause 16 of the Partnership Agreement.

12. The more pertinent provision is Clause 25 of the Investment Agreement which reads as follows:

> *This Agreement shall be governed by and construed in accordance with the Laws of Kenya. In the event of any dispute with respect to the construction and performance of the Agreement, the parties shall first resolve the dispute through amicable negotiations. However, if the parties fail to reach an agreement within 15 days of commencement of the negotiations, the dispute shall be resolved through Arbitration, through the selection of a single arbitrator by the Chair of the National Chapter of CIArb, in the event that the parties are unable to agree on an arbitrator.*

13. The starting point for analysis is Section 6 of the Arbitration Act, 1995. It provides as follows:

> *6(1) A Court before which proceedings are brought in a matter which is the subject of an arbitration agreement shall, if a party so applies not later than the time when that party enters appearance or otherwise acknowledges the claim against which the stay of proceedings is sought, stay the proceedings and refer to the parties to arbitration unless it finds:*

(a) That the arbitration agreement is null and void, inoperative or incapable of being performed; or

(b) That there is not in fact any dispute between the parties with regard to the matters agreed to be referred to arbitration.

14. It is true that Article 159(2)(c) of the Constitution and section 6 of the Arbitration Act provide a strong basis and textual foundation for respecting arbitration clauses in parties' contracts. As both the Plaintiff and the 1st Defendant agree, where the parties have entered into an arbitration clause, none of the parties will be permitted to commence an action in Court unless they bring themselves within two exceptions:

    a. Where they demonstrate that the arbitration agreement is null and void, inoperative or otherwise incapable of being performed. This would be the case, for example, where there are grounds for rescinding the arbitration agreement *qua* contract.

    b. Where the subject matter of the controversy is not covered by the arbitration agreement. Stated differently, parties to an arbitration agreement are not required to go to arbitration when the specific subject matter of the controversy is non-arbitrable.

15. In the present case, the Plaintiff says that the issues raised in the suit are non-arbitrable and are therefore within the second exception. In particular, the Plaintiff argues that the Plaintiff's

suit is based on alleged misrepresentation of Regulation 21 of the Capital Markets (Securities) (Public Offers, Listings, and Disclosures) Regulations, 2002 by the 1st Defendant. The misrepresentation was, the Plaintiff states, that the offering he received from the 1st Defendant was a private offering while it was, in fact, a public offering. Further, the Plaintiff says that he was induced to enter into the investment agreement through misrepresentations.

16. The 1st Defendant responds that the Plaintiff merely attempts, by "strategic pleading", to circumvent the Arbitration Agreement by pre-textually pleading misrepresentation while the suit is for "all intents and purposes a suit for breach of contract." The 1st Defendant states that the starting point is to parse, without adjudicating, the Plaintiff's claim to determine its true basis. Though the Plaintiff has thrown in paragraph 7 of the Plaint containing what the 1st Defendant claims are "wild allegations of misrepresentation", the core of the claim, the 1st Defendant says is found in paragraphs 8 – 14 of the Plaint all of which are predicated on the terms of the Investment Agreement and their alleged breaches. The 1st Defendant further argues that, indeed, one can know the core of the claims by looking at the prayers in the Plaint: none of the reliefs, argues the 1st Defendant, is sought on the basis of alleged misrepresentation such as avoiding the terms of the Investment Agreement or compensation for injuries caused by the alleged misrepresentation.

17. A review of the decisional law in Kenya on the "fraud exception" to the rule that Courts would ordinarily respect arbitration agreements between the parties, reveals three governing principles which have emerged.

18. *First*, where a party plausibly pleads fraud and the fraud relates to a right *in rem* (as opposed to a right *in persona*), then the matter is non-arbitrable. See ***Laiser Communications Limited & 5 others v Safaricom Limited [2016] eKLR*** and ***Telkom Kenya Ltd vs Kam Consult Ltd [2001] 2 EA 574.***

19. *Second*, even where the matter of fraud relates to a dispute *in persona* but involves a serious or complex question of fraud, then arbitration is similarly ousted as an appropriate forum for the dispute. See ***Gerick Kenya Limited v Honda Motorcycle Kenya Limited [2019] eKLR*** citing with approval *A****. Ayyasamy v A. Paramasivam & Ors Civil Appeal No. 8245 – 8246 of 2016 and Booz Allen & Hamilla Inc –vs- SBI Home Finance Limited and others 2011 5 SCC 532.***

20. *Third*, the Court does not oust the arbitration jurisdiction merely on the allegation of fraud: it is upon a party seeking to oust jurisdiction on the ground of fraud to sufficiently demonstrate the nature of the alleged fraud and the circumstances which not only inoculates against pre-textual pleading but also provides *prima facie* evidence of the alleged fraud. See ***Gerick Kenya Limited v Honda Motorcycle Kenya Limited [2019] eKLR***. This guards against the strategic pleading the 1st Defendant complained about. It is not enough to pepper a Plaint or Statement of Defence

with allegations of fraud in the hope that that the allegations will stick long enough to oust the arbitration jurisdiction.

21. In making a determination whether the allegations of fraud are merely sprinkled on the pleadings as a jurisdictional hook or whether they disclose sufficiently plausible claims of fraud to warrant the ousting of arbitration on public policy grounds, the Court primarily looks at two aspects of the pleadings. First, the Court looks at the fit between the allegations made and the prayers in the Plaint. Where the prayers sought are in the nature of remedies for a breach of contract as opposed to its rescission due to the alleged fraud, a Court is more likely to conclude that the allegations of fraud are pre-textual and strategic and insufficient to oust arbitration jurisdiction. On the other hand, where structurally the pleading shows a close fit between the allegations of fraud made and the prayers which are not in the nature of enforcing the contract but avoiding it, the Court is more likely to oust arbitration jurisdiction and hold that the dispute must be litigated in Court.

22. The second aspect of the pleadings that the Court looks at is the *prima facie* plausibility of allegations and whether they reveal a true dispute based on deliberate misstatements of material fact knowingly made in order to deceive the party alleging the fraud. The nature of the allegations including the details disclosed helps the Court make a determination whether the allegations are

merely pre-textual and also whether the alleged fraud is complex or serious enough to oust arbitration jurisdiction.

23. In the present case, the Plaintiff's claim that the central aspect of the case is fraud fails on both indicators. First, the overwhelming majority of the Plaint carefully pleads a case sounding in breach of contract. Second, a look at all the prayers other than prayer (a) reveals that the Plaintiff is interested in enforcing the contract – not avoiding it. The Plaintiff wants to obtain the benefits of the contract as concluded between himself and the 1st Defendant and wants the 1st Defendant compelled to specifically perform certain clauses of the contract. Having made this choice, the Plaintiff cannot turn around and make the claim that he is, in fact, suing for fraud and deception. The structure of the Plaint and the prayers sought betray a radically different claim.

24. It is true that the Plaintiff has included paragraph 7 in the Plaint which lists what it calls "particulars of misrepresentation." The central thrust of that paragraph seems to be that the 1st Defendant engaged in fraud and deception in inducing him to sign off on the Investment Agreement as a "private offering" while the offering was, in fact, a "public offering." If this was, in fact, the central thrust of the suit, I would be prepared to say that it would have survived the arbitration forum challenge posed by the 1st Defendant. Such a claim would have been a public law claim: that by violating a statute aimed at protecting a class of people to

which the Plaintiff belongs, the 1st Defendant harmed the Plaintiff; and that the Plaintiff, therefore, was entitled to damages. Such a claim would, however, not be a breach of contract claim.

25. Litigants are generally permitted by the rules to plead inconsistent claims. Most of the time, a volley of disparate claims only results in outright dismissal of some claims or the embarrassment of the claimant. There are some instances, however, where a Claimant cannot have his cake and eat it too. These are the instances where the choice of a Claimant to pursue a particular claim disentitles him to pursue a contradictory claim in the same forum. This happens when the legal foundation of the claim lawfully determines the forum for the controversy – permitting the hearing and disposal of particular types of claims in a forum outside the Courts while constitutionally, statutorily, or by public policy disabled from ousting the jurisdiction of the Courts in some other types of claims. A Claimant caught in the horns of such a jurisdictional dilemma must make careful strategic choices: either to parcel out his claims and pursue them in the different fora having due consideration to the doctrines of *sub judice* and *res judicata*; or to choose which of the two sets of contradictory claims better aggregates and represents his grievances. Such is the case here. Either the Plaintiff believes the Contract between him and the 1st Defendant is lawful and wishes to pursue remedies for its breach or he believes it was unlawfully concluded and pursues public law remedies of the sort indicated in prayer (a) of his Plaint. The Plaintiff cannot do both in this

instance. Where he attempts to do both, the Court is called upon to be a surgeon – to determine the greater controversy represented in the claims. Fortunately for the Plaintiff, the Court is called upon to be a surgeon and not a mortician: the suit does not suffer a fatal blow of dismissal; but a non-lethal deflection to a different forum – a forum which the parties had chosen in their contract.

26. A second aspect of the pleadings gives the impression that the allegations against the 1st Defendant are not of a category that makes them inappropriate for private arbitration. The Plaintiff advertently uses the term "misrepresentation" throughout the Plaint. Indeed, it is in his Written Submissions that the Plaintiff uses, for the first time, the loaded term "fraud". This is not mere semantics. There is a difference in the Law of Contracts between fraud and misrepresentation simpliciter. While sometimes the term "misrepresentation" is used generically to refer to all three categories of misrepresentations whether innocent; negligent or fraudulent, when used on its own it denotes a distinction between a statement not in accord with the facts innocently or negligently made; and one fraudulently made, that is, with the willful intention to deceive.

27. Only the second types of statements which are not in accord with the facts (that statements which are consciously false and intended to mislead) would come within the category of misrepresentations which are non-arbitrable. Further, the misrepresentation must be material.

28. A glance at the specifics provided in paragraph 7 of the Plaint leaves it unclear that the Plaintiff considers the alleged misrepresentations by the 1st Defendant both fraudulent and material. This uncertainty is further clouded by the fact that the Plaintiff has neither pursued claims for damages in torts or for the avoidance of the contract. The implication is that the Plaintiff neither considers the alleged misrepresentations material nor fraudulent in inducing him to enter into the Investment Agreement. If he did, his prayers would have reflected these facts. Here, instead, the Plaintiff robustly seeks to enforce the Investment Agreement which he urges the Court to provisionally hold was induced by fraudulent misrepresentation. The cognitive dissonance of the two positions cannot survive even the superficial scrutiny required at this stage.

29. **The upshot is that the Plaintiff and the 1st Defendant are bound by the Arbitration Agreement they concluded between themselves. Further, the subject matter of the dispute herein is arbitrable. Consequently, the Application dated 14/08/2020 is merited: all further proceedings herein are stayed and are referred to arbitration in terms of Clause 25 of the Investment Agreement and Clause 16 of the Partnership Agreement**.

30. **In the spirit of amicable settlement of disputes in good faith whose ethos is clearly espoused in Clause 25 of the Investment Agreement, and careful not to penalize a party**

simply for seeking legal redress in Court where it has not been shown that the party was acting in bad faith, I will, at this point, use the Court's discretion to rule that each party will bear its own costs on this Application.

31. Orders accordingly.

Dated and delivered at Nakuru this 26th day of November, 2020.

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JOEL NGUGI
JUDGE

NOTE: This judgment was delivered by video-conference pursuant to various Practice Directives by the Honourable Chief Justice authorizing the appropriate use of technology to conduct proceedings and deliver judgments in response to the COVID-19 Pandemic.