



**REPUBLIC OF KENYA
IN THE COURT OF APPEAL OF KENYA
AT NAIROBI**

Civ Appli 57 of 2006

KENYA SHELL LIMITED APPLICANT

AND

KOBIL PETROLEUM LIMITED RESPONDENT

(An application for leave to appeal against the order of the High Court of Kenya at

Milimani Commercial Courts, Nairobi (Mutungi, J.) dated 14th February, 2006

in

H.C. MISC. C. APPL. NO. 59 OF 2004)

RULING OF THE COURT

Although the record of the application before us looks voluminous and arguments of counsel were protracted, the matter that arises for determination is fairly straightforward. It is whether we should grant leave to the applicant to appeal against the order of the superior court made on 14th February, 2006 in High Court Miscellaneous Civil Application No. 59 of 2004. Issues raised by the respondent at a preliminary stage as to whether this Court had any power to entertain such an application in the first place, were resolved by a majority decision of this Court (Omolo & O’Kubasu JJ.A, Onyango Otieno, J.A dissenting) made on 5th April, 2006. We revert therefore to the jurisdiction exercisable by the court under **rule 39** of the rules of this Court which provides in relevant part as follows:

“39. (b) Where an appeal lies with the leave of the court, application for such leave shall be made in the manner laid down in rules 42 and 43 within fourteen days of the decision against which it is desired to appeal or, where application for leave to appeal has been made to the superior court and refused, within fourteen days of such refusal.”

The salient facts behind the application are common ground and may be related briefly. The two combatants, **KENYA SHELL LTD** (hereinafter “*Shell*” or “*the applicant*”) and **KOBIL PETROLEUM LTD** (hereinafter “*Kobil*” or “*respondent*”) are oil marketing giants in their own rights, operating in this country. They acknowledge that they are competitors in the industry, but for ten years between May 1990 and November, 2000 they were bound together by a commercial agreement executed on 11th May, 1990. By that agreement Shell, amongst other terms, undertook to blend, supply or deliver blended lubricants to

Kobil for resale to Kobil's customers. To facilitate this, Kobil would furnish Shell with the necessary formulations and specifications, and also the base oils required for the blending. They would also, upon delivery of the product by Shell, pay for it. The termination clause for the agreement was that it would be in force for twelve months from 15th May 1990 and to be automatically renewed for a similar period unless terminated by either party giving the other six months notice in writing. Without recourse to that clause however, Shell wrote to Kobil on 17th November, 2000 informing them that they would no longer use the formulations and specifications provided to them by Kobil from another oil company known as Castrol Ltd which, as well as Shell, are subsidiaries of British Petroleum International Ltd, an overseas company. By 23rd November, 2000 Shell had stopped the blending of the lubricants altogether although they had in stock large quantities of base oils supplied by Kobil for that purpose. Kobil felt aggrieved by the sudden repudiation of the contract. They thought Shell had conspired and colluded with Castrol Ltd to undermine and paralyse Kobil's business and accused Shell of malice. They took some measures in mitigation of their loss and eventually went to court in March 2001 and obtained a court order enjoining Shell to blend the lubricants pending the resolution of their dispute by arbitration.

The contract between the parties provided that any dispute between them be resolved through arbitration. In accordance with that provision, the two parties nominated a retired Judge of the High Court, the Hon. Mr. Justice Edward Torgbor, and a retired Senior Advocate, Mr. Bryon Georgiadis, as arbitrators. The two then, in accordance with the contract, nominated a senior partner in the Accounting Firm of Deloitte and Touche, Mr. Daniel Ndonge, to complete the arbitral Tribunal. Before that tribunal, Kobil sought in excess of Ksh. 600 million on account of items ranging from loss of profits, cost of finance on base oils, cost of finance on profit, mitigation costs, loss of goodwill, aggravated damages, costs and interest. Shell denied all liability, and so both parties and their advocates narrowed down the issues which they submitted to the tribunal by consent. These were: -

- “(a) Has the respondent breached the parties’ contract by repudiating it”**
- (b) Whether the respondent was entitled to stop blending lubricants for the claimant using Castrol formulations and specifications.**
- (c) Whether the alleged breach by repudiation was actuated by malice.**
- (d) Whether the claimant suffered any loss or damage as a result of the breach by repudiation and if so what loss or damage.**
- (e) Whether the claimant failed to mitigate its loss if any.**
- (f) Whether the claimant is entitled to make any claim for damages in view of clause 18 of the contract.**
- (g) Which party is entitled to the costs of the reference and of the award”**

After hearing ten witnesses on both sides and sifting through two thousand pages of documents over a period of two years, the tribunal determined the dispute on all issues and made its award on 17th November, 2003. It summarised the award made in favour of Kobil as follows: -

“1. On Loss of Profit the Claimant is awarded the sum of Kshs.25,256,483.28 and Kshs.8,468,420.80 for the period 23rd November 2000 to 30th April 2001 i.e. a total of Kshs.33,724,904.08.

2. On cost of Finance on Base Oils the claim is rejected.

3. *On cost of Finance on Profits the Claim is rejected.*
4. *On Mitigation Costs the claim for price reductions or discounts is rejected but the Claimant is awarded Kshs.152,807.60 being the total of Kshs.105,607.60 and Kshs.47,200.00 awarded per Issue 4(iv).*
5. *On loss of Goodwill the Claimant is awarded Kshs.16,862,452.04 for loss of revenue due to loss of market share and Kshs.7,500,000.00 for expenses incurred on restoration of lost market share.*
6. *There is no award for aggravated damages as the above amounts are deemed adequate compensation in all the circumstances of this case.*
7. *Costs are awarded as determined under Issue 7 above. The amounts awarded to the Claimant shall be paid within 30 days from the date of this award. In default interest shall be charged on the unpaid amount at Court rates from the date of default until payment in full."*

The award was filed in court on 6th February, 2004. Shell however was not happy with it. By an application filed in the superior court and dated 14th February, 2004, they sought the setting aside of the award and invoked **section 35 (2) (a) (iv)** of the **Arbitration Act No. 4 of 1995** which provides as follows: -

"An arbitral award may be set aside by the High court only if the arbitral award deals with a dispute not contemplated by or not falling within the terms of reference to arbitration or contains decisions on matters beyond the scope of the reference to arbitration, provided that if the decision on matters referred to arbitration can be separated from those not so referred, only that part of the arbitral award which contains decisions on matters not referred to arbitration may be set aside.

The basic argument upon which the application lay, and the basis on which it was decided, was two-fold: -

"a) The arbitrators were required to award (sic) the agreement between the parties dated 11/5/1990. By going outside the meaning of clause 18 of the agreement the arbitrators have gone beyond the scope of the reference.

b) There has been excess of jurisdiction by the arbitrators."

Clause 18 of the contract which was in issue provides: -

"LIMITATION ON LIABILITY

In no circumstances whatsoever shall SHELL be liable for any loss or damage including loss of profit or expenditure howsoever caused, whether direct, indirect, consequential, in contract or in tort unless caused by the negligence of SHELL."

The decision of the superior court (Mutungi, J.) did not come expeditiously as it took over one year. When it came on 14th February, 2006 however, it emphatically rejected the contention that the arbitral award dealt with a dispute not contemplated by, or not falling within, the terms of reference to arbitration or contains decisions on matters beyond the scope of the reference. The court found that the mandate or jurisdiction of the tribunal was given to it by the parties in express unambiguous terms when the

parties, by consent, submitted the issues for determination and the tribunal did not deal with any question outside or beyond the scope of those issues. The contentious exclusionary clause 18 was part of those issues and it was considered and a determination of it was made. There could therefore be no basis for the contention that the award was made contrary to section 35 (2) (a) (iv) above.

On the issue of negligence which Shell argued was neither pleaded nor proved by adduction of evidence and therefore afforded a complete answer to the dispute, the superior court found that the issue did not arise, firstly, by virtue of the issues referred to the tribunal which said nothing about negligence, and secondly, because all the depositions on both sides dwelt on breach of contract. The tribunal, in the superior court's view, would have gone beyond the scope of its terms of reference if it had made a decision on negligence without supporting evidence.

Finally the superior court found that the argument advanced on behalf of Shell that the tribunal misunderstood or misinterpreted the law in their interpretation of clause 18 was not tenable. Questions of law could only be raised on the stringent terms stated under **Section 39** of the **Arbitration Act** but the section had not been invoked. The award was otherwise a final one as contemplated by the law and by the parties, and it could not be set aside under section 35 (2) (a) (iv) as sought. The application was dismissed with costs. An attempt to seek leave to appeal against the decision was promptly shot down, the court stating that it would unnecessarily prolong a matter that had already taken long to adjudicate. Undaunted by that rejection, Shell now comes before us with the application stated above, which we now revert to.

Whether or not the court would grant leave to appeal is a matter for the discretion of the court. As in all discretions exercisable by courts, however, it has to be judicially considered. Some guidance in that regard was given by this Court in **Machira t/a Machira & Company Advocates v Mwangi & Anor. [2002] 2 KLR 391** as follows: -

“The Court will only refuse leave if satisfied that the applicant has no realistic prospects of succeeding on the appeal. The use of the word “realistic” makes it clear that fanciful prospect or an unrealistic argument is not sufficient. When leave is refused, the Court gives short reasons which are primarily intended to inform the applicant why leave is refused. The Court can grant the application even if it is not so satisfied. There can be many reasons for granting leave even if the Court is not satisfied that the appeal has no prospects of success. For example, the issue may be one which the Court considers should in the public interest be examined by this Court or, to be more specific, this Court may take the view that the case raises a novel point or an issue where the law requires clarifying. There must, however, almost always be a ground of appeal which merits serious judicial consideration.”

See also **Mohamed Yakub & Anor t/a Yasser Butchery vs. Mr. Badur Nasa & 2 others Civil Appl. NAI. 285/99 (ur)** where the court added that the approach will naturally differ depending on the category and subject matter of the decision and the reason for seeking leave to appeal. It is those principles that we shall apply in this matter.

Learned counsel for the applicant Mr. Kimani Kiragu sought to persuade us that the issues raised and arguments advanced but rejected by the superior court are fairly weighty and stand a good chance of success before this court. They were also of public importance and ought to be allowed agitation before the highest court. The crucial issue is this: **What is the power or jurisdiction of arbitrators"**

Take this case: there was an agreement under **clause 18** by parties who had equal bargaining power that no loss would ever arise against Shell, whether in contract or in tort, unless negligence was

proved. It did not matter how onerous, absurd or unreasonable that clause would appear, but it was the contract between the parties which no one else including the courts could rewrite. Under **Section 29 (5)** of the **Arbitration Act**, an arbitral tribunal is obliged to follow the agreement between the parties. **Section 29**, which makes provision for the rules applicable to the substance of the dispute, provides in **sub-section (5)**:

“(5) In all cases, the arbitral tribunal shall decide in accordance with the terms of the particular contract and shall take into account the usages of the trade applicable to the particular transaction.”

So that, he submitted, all the arbitral tribunal in this matter needed to do was to find out from the pleadings and the evidence whether the issue of negligence was pleaded and proved, failing which the dispute would end summarily. It was common ground, and the superior court so found, that indeed there was no issue of negligence raised or proved by Kobil. In the event, Mr. Kiragu submitted, the arbitral tribunal acted outside the law when, in construing **clause 18**, it purported to find that the clause did not intend to exclude deliberate non-performance of the contract. That would be a re-introduction of the doctrine of fundamental breach which the House of Lords put to rest in **Photo Productions Ltd v Securicor [1980] 1 All ER 557**, a case approved and followed in our jurisdiction. There was thus excess of authority or jurisdiction by the arbitrators and it was therefore the duty of a court of law to intervene.

Mr. Kiragu further submitted that the introduction of, and reference to, **section 39** of the **Arbitration Act** by the superior court was irrelevant since it was not invoked by the applicant and such reference only served to clog the decision whether **Clause 18** took the matter outside arbitration. All these were issues put forward in the draft memorandum of appeal and, according to Mr. Kiragu, they merit serious consideration by this Court.

On the other hand, Mr. Oyasti, learned counsel for Kobil was of the view that both parties were conscious of the provisions of Clause 18 of their contract and that is why they made it an issue determinable by the arbitral tribunal. If it was objectionable in law to commence the arbitral proceedings on the ground that there was no pleading made in relation to negligence and therefore the matter was not suitable for arbitration, then the issue could have been raised under **section 17 (3)** of the **Arbitration Act**, but it was not. It was therefore a waiver of the remedy and the applicant cannot be heard to raise it at a late stage. On the contrary the applicant went ahead and called several witnesses and produced numerous records to disprove the claim as laid before the tribunal. The tribunal cannot in the circumstances be faulted for having considered those matters which by their own consent, the parties wanted determined. The parties gave power, authority and jurisdiction to the arbitrators and their decision was therefore within, not outside the law. He cited for support of that submission **Kihuni v Gakunga & Another [1986] KLR 572** where the court held that: -

“A party cannot be heard to challenge issues referred to arbitration especially in a case such as this where the parties and their respective advocates drew the issues. The parties are deemed to know the real questions between them. The arbitrators will consider evidence on issues which are referred to them”.

Clause 18, according to Mr. Oyasti, did not bind the arbitrators to make a finding as to whether there was negligence. Negligence was not an issue. Damages were to be awarded, or not awarded, on the basis of interpretation of Clause 18 which was left to the arbitrators, a duty which the arbitrators carried out. The award thus became final. Mr. Oyasti emphasized the issue of finality as a guiding principle in arbitrations and drew our attention to the commercial purpose for which the **Arbitration Act**

No. 4 of 1995 was enacted. He submitted that there was nothing novel about the issues intended to be raised and there was therefore no basis for exercise of discretion by this Court in favour of the applicant.

We have anxiously considered the application and the lucid submissions on both sides. We thank both counsel for their assistance and for the generous dose of legal authorities which we regret we shall not make full reference to, but have perused. In the end however, we have come to the conclusion that we will not exercise our discretion in this matter in favour of the applicant.

Arbitration is one of several dispute resolution methods that parties may choose to adopt outside the courts in this country. The parties may either opt for it in the course of litigation under **Order XLV** of the **Civil Procedure Rules** or provide for it in contractual obligations in which event the **Arbitration Act, Act no. 4 of 1995** (the "Act") would apply and the courts take a back seat. In the matter before us, the parties had an arbitration clause and therefore the Act applies. The Act, which came into operation on 2nd January, 1996, and the rules thereunder, repealed and replaced **Chapter 49** Laws of Kenya, and the rules thereunder, which had governed arbitration matters since 1968. A comparison of the two pieces of legislation underscores an important message introduced by the latter Act: the finality of disputes and a severe limitation of access to the courts. **Sections 6, 10, 12, 15, 17, 18, 28, 35** and **39** of the Act are particularly relevant in that regard. The message, we think, is a pointer to the public policy the country takes at this stage in its development.

Public policy, which is a factor we may consider in the exercise of our discretion, is of course an indeterminate principle or doctrine. In years of yore, it was branded "*an unruly horse, and when you get astride it, you never know where it will carry you*"- **Richardson v Mellish (1824) 2 Bing 229**. Nevertheless, it clearly has reference to ideas which for the time being prevail in a country as to the conditions necessary to ensure its welfare. It is variable and must fluctuate with the circumstances of the time. Ringera J (as he then was) examined several authorities in **Christ For All Nationals vs. Apollo Insurance Co. Ltd [2002] 2 EA 366** and formed the view that: -

"although public policy is a most broad concept incapable of precise definition.... . an award could be set aside under section 35 (2) (b) (ii) of the Arbitration Act as being inconsistent with the public policy of Kenya if it was shown that either it was:

- a) **inconsistent with the constitution or other laws of Kenya, whether written or unwritten or**
- b) **inimical to the national interest of Kenya or**
- c) **contrary to justice and morality."**

The matter before us has of course nothing to do with **section 35 (2) (b) (ii)** (supra). But, in our view, public policy considerations may enure in favour of granting leave to appeal as they would to discourage it. We think, as a matter of public policy, it is in the public interest that there should be an end to litigation and the Arbitration Act under which the proceedings in this matter were conducted underscores that policy. Do we think there is a realistic prospect of success of the intended appeal or, put another way, is there a ground of appeal that merits serious judicial consideration" We think not.

The only ground taken up by the applicant to challenge the award was under **section 35 (2) (a) (iv)** of the Act. The plain reading of that provision and the issues submitted to the tribunal for adjudication does not reveal that the tribunal went outside its jurisdiction. The argument intended to be advanced that **clause 18** was not considered at all or was considered outside the context of the agreement between the parties is, in our view, fanciful. It was in fact considered and if it is the

contention that the tribunal completely misconstrued the clause in law, then we say with the superior court that there was no challenge made in that respect before it and it does not arise before this Court. At all events the tribunal was bound to make a decision that did not necessarily sit well with either of the parties. It would nevertheless be a final decision under **section 10** of the Act unless either party can satisfy that court that it ought to be lawfully set aside. In this case the decision was final. We do not feel compelled therefore to extend the agony of this litigation on account of the issues raised by the applicant. As stated earlier, we decline to exercise our discretion in favour of the applicant and we dismiss the application with costs.

Dated and delivered at Nairobi this 10th day of November, 2006.

R.S.C. OMOLO

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JUDGE OF APPEAL

P.N. WAKI

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JUDGE OF APPEAL

J.W. ONYANGO OTIENO

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JUDGE OF APPEAL

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