**REPUBLIC OF KENYA**

**IN THE HIGH COURT OF KENYA AT NAIROBI**

**MILIMANI COMMERCIAL & ADMIRALTY DIVISION**

**CIVIL CASE NO. 537 of 2013**

**KENYA INDUSTRIAL RESEARCH &**

**DEVELOPMENT INSTITUTE ……...…….. PLAINTIFF**

**VERSUS**

**MADISON INSURANCE COMPANY LIMITED ……...…… DEFENDANT**

**R U L I N G**

1. Exactly 3 months from the delivery of the Final Award of the Arbitrator dated 28th February 2013, the Defendant herein filed its Chamber Summons pursuant to **section 35 (2) (a) (iv)** of the *Arbitration Act* as well as **rule 4 (2)** of the *Arbitration Rules, 1997*. The Application sought to set-aside the Final Award on the grounds that the Arbitrator had made a fundamental error of law in determining a dispute other than that contemplated by the agreement between the parties. The Defendant maintained that the Arbitrator had exceeded the scope of the reference by implying terms into the contract contrary to the explicit terms thereof and trade usage as applicable to the transaction as contemplated by **section 29 (5)** of the Arbitration Act. He had, in fact, according to the Defendant, decided the dispute between the parties contrary to the express terms of their contract. The Arbitrator had also exceeded the scope of the reference by allowing the Plaintiff herein to amend its original claim for negligence to one which the Defendant considered was materially different.
2. To support its Application, the Head of Underwriting and Claims in the Defendant's Life Division, one **Matthias Sabala** swore a Supporting Affidavit on 28th May 2013. He related that the parties entered into a Deposit Administration Pension Scheme Policy Contract executed on 19th October 1995 (hereinafter "the Contract"). He maintained that under the Contract, the Defendant was to manage the Plaintiff's pension scheme and avail retirement benefits to the Trustees of the scheme who would thereafter make payment of retirement benefits to members. He noted that the Plaintiff had filed this suit but that the dispute between the parties had been referred to arbitration as provided for in the Contract. On 2nd March 2010, the then Chairman for the time being of the Chartered Institute of Arbitrators (Kenya Branch) had appointed Mr. Kamau Karori to determine the dispute. The Arbitrator issued his Final Award as above in favour of the Plaintiff in the sum of Shs. 9,092,885.70 plus costs. Mr. Sabala took exception to the Final Award firstly as regards whether the said pension scheme was registered at least by August 1996. In the deponent's view, the Tribunal imposed an obligation on the part of the Defendant to register the pension scheme whereas under the Contract, the Defendant had undertaken to manage the pension scheme as a registered scheme. This, Mr. Sabala maintained was outside the Arbitrator's ambit.
3. The Affidavit continued by detailing what the deponent had been advised by the Defendant's advocates on record which, in my view, was best suited to submissions rather than Affidavit

evidence. Mr. Sabala then went on to say in paragraph 19 of his said Affidavit that the 2nd Claimant had a duty to pay taxes. This was difficult for the Court to understand when one bears in mind that there are only two parties to the suit before it. Presumably such related to the 2nd Claimant in the arbitral proceedings who were enjoined therein and who were basically the trustees of the pension scheme? However, Mr. Sabala's point in this regard was that the Arbitrator had found that the dispute concerned the payment of tax liabilities and this consequently was outside his remit as the Defendant was only responsible for the proper management and/or administration of the pension scheme. He pointed to the Third Schedule to the Contract which limited the liability of the Defendant to the provision of such annuities purchased from it in terms of the policy and the provision of funds equal to the balance in the Pension Account for the provision of benefits due in terms of the pension scheme's rules. Mr. Sabala had been advised that in the presence of an explicit contractual term limiting the Defendant's liability, the Arbitrator was unreasonable and operated outside the terms of the reference to him by imposing a contrary interpretation that did not accord with the express provisions of the Contract.

4. In terms of the reference, Mr. Sabala deponed that the claim wholly revolved around a case in tort as had been summarised at paragraph 19 of the Amended Statement of Claim. Having detailed what the Amended Statement of Claim had put forward as regards the negligence of the Defendant, the deponent believed that such a claim was not within the contemplation of the parties when they entered into the Contract. Further, in the course of the arbitral proceedings, the Plaintiff herein had amended its Statement of Claim on three occasions allowing for the determination of the dispute to far exceed the matters contemplated by the parties under the Contract. As a result, Mr. Sabala believed that the Arbitrator had made a determination outside the scope of the dispute referred to him and it was only just that the Final Award should be set aside by this Court.
5. The Chief Executive of the Plaintiff, Mr. **Mechah Charles Zuriels Moturi** swore a Replying Affidavit on 9th October 2013. First of all he dealt with the three amendments to the Statement of Claim of the Plaintiff as before the arbitral tribunal. He maintained that these were perfectly ordinary amendments and denied that the effect thereof was that the Statement of Claim far exceeded the matters contemplated by the parties under the Contract. He believed that the Arbitrator in arriving at his decision and finding the Defendant liable, had relied on the performance by the Defendant of its contractual obligations under the Contract as well as the nature of the agency, usage of trade and customs, practices and ethics of business, all as contemplated by **section 29 (5)** of the Arbitration Act. As regards the question of whether the pension scheme was registered or otherwise, the deponent pointed out that the Defendant had undertaken to run the Plaintiff's pension scheme as a registered scheme and for this to happen, it had to be registered first. The fact that it had not been registered had occasioned loss and damage to the Plaintiff and/or its Trustees.
6. Rather unfortunately, Mr. Moturi's said Affidavit departed from matters of fact and referred to matters of law including quoting from various textbooks all of which matters should have been dealt with by way of submission and not contained in an affidavit of fact. The deponent went on to record the registration of the pension scheme on 31st December 1999 and the Defendant by treating the pension scheme as registered in its management thereof (whereas it was not) had caused the Trustees to incur a loss of Shs. 14,738,524.00. In Mr. Moturi's view the correct and accurate position was that the Defendant had failed to manage and administer the pension scheme with due diligence and skill thus leading to the said loss. He observed that the pension scheme was not registered under the *Income Tax (Retirement Benefit) Rules, 1994* and was therefore subject to penalty under the *Income Tax Act* in respect of its investment income. Consequently, benefit payments made to retiring members were overpaid by the amount of tax erroneously retained at the expense of the remaining members of the pension scheme, who had to bear the burden.
7. Mr. Moturi concluded his Replying Affidavit by stating that he had been advised by the Plaintiff's advocates on record that the arbitral tribunal was not unreasonable and did not operate outside the terms of reference. Further, it did not impose a contrary interpretation as regards the limitation of the liability of the Defendant in terms of the Third Schedule to the Contract. Mr. Moturi also observed that the claim did not wholly revolve around a case in tort. The pleadings before the Arbitrator had been amended, in paragraph 19 thereof to reflect the breach of a contractual obligation by the Defendant. He maintained that the Defendant had totally ignored this fact and its submissions had concentrated wholly upon it claim based on tort. This, the deponent maintained,

was deliberate. He averred that the determination of the Arbitrator was not outside the scope of the dispute referred to him and he urged this Court to uphold the Final Award.

8. The Defendant's submissions were filed herein on 13th November 2013. The Defendant set out the aegis of the Application before Court relating events as to the appointment of the Arbitrator. Under the heading as to what was the dispute contemplated by the parties, the Defendant referred to **section 29 (5)** of the *Arbitration Act* which reads:

**"(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."**

The Defendant submitted that the above sub-section did not bend to party autonomy nor give the Arbitrator any discretion as its provisions were mandatory. It referred to the authority of **Associated Engineering Company v Government of Andrha Pradesh & Anor. (1991) INSC 153; AIR 1992 SC 232** in which the Supreme Court of India had held that the Arbitrator cannot determine a dispute independent of the contract. An arbitrator who acted manifestly disregarding the provisions of the contract was without jurisdiction. The Defendant noted that the Indian decision had been followed in the case of **Airtel Network Kenya Ltd v Nyutu Agrovet HC Misc. Cause No. 460 of 2011 (unreported)**. The Defendant also pointed to the decision in **HC Appeal No. 13 of 2010 Kenya Pipeline Company Ltd v Kenya Oil Company Ltd & Anor (unreported)** in which **Musinga J.** (as he then was) sitting with **Kimondo J.** had held:

**"When an arbitrator has meandered beyond the boundaries of the contract between the parties, trade or usages applicable, it is safe to say he has exceeded his jurisdiction and gone beyond the contemplation of the parties."**

9. In the view of the Defendant, the Award purported to determine a dispute outside the Contract between the parties. The Contract had been identified as the Deposit Administration Pension Scheme (Policy Number 0A12994). The issues which the Arbitrator had dealt with which were outside the Contract was:

(a) the responsibility for registering the Scheme and

(b) reliance upon the Defendant's skill and knowledge in respect of tax matters.

Further, the Arbitrator had ignored of the limitation of liability of the Defendant as per clause 18 of the Third Schedule to the Contract. In this regard, the Defendant referred to the case of **Harilal v Standard Bank Ltd (1967) EA 512** (as regards the responsibility for registering the Scheme), **Food Corporation of India v Surendra, Devendra, Devendra & Mahendra Transport Co. (2003) INSC 54** which follow the decision in **Rajahstan State Mines & Minerals** in which it was detailed:

**"In order to determine whether the arbitrator has acted in excess of his jurisdiction what has to be seen is whether the claimant could raise a particular claim before the arbitrator. If there is a specific term in the contract or law which does not permit or give the arbitrator the power to decide the dispute raised by the claimant or there is a specific bar in the contract to the raising of the particular claim then the award passed by the arbitrator in respect thereof would be in excess of jurisdiction."**

10. The Defendant also referred to the decision in **Steel Authority of India Ltd v J. C. Budharaja, Government and Mining Contractor (1999) 8 SCC 122** in which the Supreme Court of India observed as follows:

**"In order to determine whether the arbitrator has acted in excess of jurisdiction what has to be seen is whether the claimant could raise a particular dispute or claim before the arbitrator. If the answer is in affirmative, then it is clear that arbitrator would have the**

**jurisdiction to deal with such a claim. On the other hand if the arbitration clause or a specific term in the contract or the law does not permit or give the arbitrator the power to decide or to adjudicate on a dispute raised by the claimant or there is a specific bar to the raising of a particular dispute or claim, then any decision given by the Arbitrator in respect thereof would clearly be in excess of jurisdiction.**

**The Court further held that in order to find out whether the Arbitration has acted in excess of the jurisdiction, the Court may have to look into some documents including the contract as well as the reference of the dispute made to the Arbitrator limited for the purpose of seeing whether the Arbitrator has the jurisdiction to decide the claim made in the arbitration proceedings.**

**The Court further held thus:**

**An arbitrator who acts in manifest disregard of the contract acts without jurisdiction. His authority IS DERIVED FROM THE CONTRACT AND IS GOVERNED by the Arbitration Act which embodies principles derived from a specialized branch of the law of agency (see Mustill and Boyds Commercial Arbitraiton, 2nd edn., p. 641). He commits misconduct if by his award he decides matters excluded by the agreement (see Halsburys Laws of England, Volume II 4th edn., para 622). A deliberate departure from contract amounts to not only manifest disregard of his authority or a misconduct on his part, but it may be tantamount to mala fide action. A concscious disregard of the law or the provisions of the contract from which he has derived his authority vitiates the award".**

The Defendant concluded its submissions as regards the first category of the claim before the Arbitrator, by detailing that it was based upon an alleged advisory relationship between the parties which the Plaintiff contended imposed an obligation upon the Defendant to advise it as to its tax obligations. The Defendant maintained that the Contract between the parties showed that they specifically contracted upon the basis of the administration of the Plaintiff's retirement funds and such negated any possibility of a general or specific advisory duty coming into existence.

11. The Plaintiff filed its submissions herein on 20th January 2014. Like the Defendant, the Plaintiff set out the background of the dispute and then addressed the question as to what was the dispute contemplated by the parties. It is noted that the Defendant herein during the course of the arbitration, had relied heavily on the authoritative study course material published by the Chartered Insurance Institute of Great Britain. Its Document No. 3 and referred to the textbook: **Pensions and Related Benefits** by **David Trebilcock** where it had been recognised that where Rules had been prepared, the policy document would be abbreviated in many respects because those Rules supplemented the same. The Rules would spell out the day-to-day operation of the pension scheme, whereas the Policy would specify the underwriting conditions applicable thereto. In the Plaintiff's view the Policy need not reproduce the Rules but they would have to be read together. In the matter before the arbitral tribunal, both the proposal and the Policy were very short. However, the Policy made reference to the Rules such that they could not be altered without the agreement of the Plaintiff, since the pension scheme was to be managed and administered in accordance with both the Trust Deed and the Rules. As a result, the Contract had to be read together with the Trust Deed and the Rules and the Award did not purport to determine a dispute outside the Contract.
12. As regards the responsibility for registering the pension scheme, the Plaintiff pointed to the duties of the Trustees as were set out in both the Trust Deed and the Rules. Clause 8 (f) of the Trust Deed empowered the Trustees to delegate any matters relating to the collection and administration/investment of the assets from time to time, comprising the funds of the pension scheme, and the income generated by such assets to such agents, advisers and managers of their choosing. They had delegated the management and administration of the pension scheme to the Defendant including the power to prepare and register the pension scheme documents. The Plaintiff went on to say that upon appointment by it, the Defendant had commenced the preparation of the Trust Deed and Rules which would mean that it was aware of the necessity of

securing the registration of the said pension scheme. Preparation and registration of pension scheme documentation by insurers was common practice in the industry at the time. In the Plaintiff's view, it had attained the requirements laid down by Sir Charles Newbold in the **Harilal v Standard Bank** case (supra).

13. As regards the reliance by the Plaintiff on the Defendant's skill and knowledge in respect of tax matters, the Plaintiff outlined the legislation involved so far as pension schemes in Kenya are concerned. These included the Finance Acts, the Income Tax Act, the Insurance Act and lately, the Retirement Benefits Authority Act. In the Plaintiff's view, there was no excuse for the Defendant lacking expertise in its line of business. If it had no such expertise, it should not have been in the business of pension administration. The Plaintiff pointed out that **John Hotchkin's** text on the **Role of the Life Company when it is Trustee** had detailed that when the life company was acting as a Trustee, it should ensure that the pension scheme that it was administering was in accordance with the Inland Revenue Practice Notes. That volume had been relied upon by the Defendant as before the Arbitrator. Finally, the Plaintiff submitted that for the Court to understand how the loss incurred by the Plaintiff had arisen, it should refer to paragraphs 101 and 102 of the Award. Such detailed that the proximate cause of the loss suffered by the Plaintiff was the fact that the Defendant had administered the Plaintiff's unregistered scheme as though it was registered. The Plaintiff's claim was in respect of the amount that ought to have been deducted and paid as tax on investment income but which was not so deducted because the Defendant improperly continued to treat the unregistered scheme on the same footing as a registered scheme. The Plaintiff maintained that one of the basic functions of any Trustee was to ensure that the pension scheme was administered in accordance with the Trust Deed and the Rules as well as the various statutes to which the scheme pertained. It reiterated that the Policy could not be read alone but together with the Trust Deed and the Rules. The Plaintiff heartily endorsed the Arbitrator's conclusion that it was reasonable for both the Plaintiff and its Trustees to expect and rely upon the Defendant's skill and knowledge in the management of the pension scheme.

14. I have carefully perused the following documents as placed before the Arbitrator:

a. Deposit Administration Pension Scheme Policy No.0A12994
b. Trust Deed dated July 1995 between the Plaintiff and the Chairman of the Kenya Industrial Research and Development Institute's Board of Management.
c. The Rules of the Retirement Benefits Scheme incorporated as the First Schedule to the Trust Deed.
d. The Chartered Insurance Institute (England) Study Course on Pensions Law, Administration and Taxation.
e. Minutes of a joint meeting of the Board of Trustees, Auditor, Madison and Administrator of 22nd April 2003.
f. The Arbitrator's Final Award dated 28th February 2013.

With reference to the responsibility of having the pension scheme registered, the Arbitrator review the position from paragraph 42 to paragraph 67 in his Final Award. At paragraph 66, the learned Arbitrator noted that the Defendant was to administer the pension scheme and the issue as to who was to attend to the registration of the pension scheme was clearly covered by the parties' first issue for determination. He then went on to say that he was determining an issue determined by the parties and the founder that he had jurisdiction to enquire into and determine that issue. The Arbitrator's conclusion at paragraph 67 of his Final Award was that he held that the terms of the contract between the parties were as set out in the Policy and the Proposal and included the following clear obligations on the part of the Defendant:

> **"(a) To administer a registered scheme on behalf on the Claimants.**
>
> **(b) To undertake and secure the registration of the Scheme and the backdating of the exemption certificate issued by KRA."**

I am fully in agreement with the Arbitrator's adopted position in connection with the registration of the pension scheme. The Defendant set about administering the Plaintiff's pension scheme as if it

were registered. It is apparent from the minutes of the joint meeting dated 22nd April 2003 that it had embarked upon such administration and thereafter came to realise that the pension scheme was not registered. At minute No. 2.10 it was detailed that:

**"Mr. Komo was requested to liaise with Mr. Aranga of Income Tax Department of KRA with a view of reviewing and backdating registration date of the scheme to 1996 as intention to have the scheme registered was expressed then from correspondences in 1996."**

As a result, I find that the issue as regards registration of the pension scheme for tax purposes was well within the purview of the Arbitrator and his decision did not fall outside his terms of reference.

15. The second major point relied upon by the Defendant as to where the Arbitrator had gone wrong, was in his finding that the Defendant had or should have had skill and knowledge in respect of tax matters. Here again, the Arbitrator considered the Defendant's breach of its obligations under the Contract in paragraphs 68 to 88 of his Final Award. In that last paragraph, the Arbitrator found that by administering an unregistered pension scheme as though it was a registered scheme, the Defendant breached its contractual obligation to administer the scheme selected by the Plaintiff. Again, I have no quarrel with his finding and, in my view, his decision in that regard was within his terms of reference. Whether the Plaintiff relied upon the Defendant's skill and knowledge in respect of tax matters was considered by the Arbitrator in paragraphs 89 to 93. Strictly speaking, it was not the question of whether the Defendant had skill and knowledge in relation to tax matters or otherwise. The Arbitrator found it surprising that in operating an unregistered pension scheme as a registered one, the Defendant could not have been aware of the potential tax liability. It was not a question of consulting with the Plaintiff's auditors who were tax experts and for the Plaintiff to rely upon their advice as opposed to that of the Defendant. In my view, even though the Defendant insisted that its role was only managing the pension scheme, it should have been aware of the fact that non-registration of the same would lead to a tax liability. One doesn't need to be a tax expert to deduce that position. My having found already as above, that the registration of the pension scheme was a factor that the Arbitrator should take into account in his terms of reference, it follows that the tax position in relation to an unregistered pension scheme would also fall under the Arbitrator's remit.
16. As a result, I find that the Defendant's Chamber Summons dated 28th May 2013 fails and I refuse to set aside the Final Award of the Arbitrator dated 28th February 2013. The Plaintiff will have the costs of the Application.

**DATED and delivered at Nairobi this 7th day of August, 2014.**

**J. B. HAVELOCK**

**JUDGE**