REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI LAW COURTS

COMMERCIAL & ADMIRALTY DIVISION

CIVIL CASE NO. 787 OF 2003

JAMES NJUGUNA WAINAINA ……..…….....1ST PLAINTIFF

ROSEMARY NJERI WAINAINA ……..……..…….2ND PLAINTIFF

Versus

EAST AFRICAN BUILDING SOCIETY ..……. DEFENDANT

JUDGMENT

Introduction

[1] I have been called upon to decide whether the Defendant is entitled to penalty interest it loaded on the Plaintiffs account apparently on the default by the Plaintiffs. Then, I should decide which of the two Reports by Messrs. PKF Consulting Limited (PKF), the auditors herein form the basis of the judgment in this suit.

Brief background of case

[2] By the Ruling of 13th June 2007, by Azangalala J. (as he then was)) the Court reduced the issues in the suit and ordered that the residue of the issues being calculation of the account on the direction of the court be undertaken by Messrs Ernest and Young, auditors. The said appointed auditors did not undertake the task. Parties herein then consented and appointed Messrs PKF Consulting Limited (PKF) to audit the account on the parameters set by the Court. After studying the documents and brief presented, PKF requested for more documents, including notices or evidence of notices of default sent to the Plaintiffs under the charge. None were provided to the auditors. As a result the auditors prepared two sets of accounts: one depicting the scenario had there been notices of default served upon the Plaintiffs, and gave the balance due to be **Kshs. 3,**

278, 726.00 as at April 2003; and the other depicting the scenario where there had not been any notices, showing the balance to be **Kshs. 1, 398, 300.00** as at April 2003. The auditor's report is produced as **JNW-2** in the affidavit of **James N. Wainaina** filed herewith.

Issues

[3] I discern the issue for determination to be:

a. **What is the correct outstanding sum of the account herein as at April 2003; is it Kshs. 1, 398, 300.00 or Kshs. 3, 278, 726.00;**
b. **Whether the Defendant is entitled to charges any further interest on the account as at April 2003 and how much that should be, in the circumstances of the case; and**
c. **Costs of the suit.**

Submissions by the Plaintiff

[4] The Plaintiffs submitted on Issue 1 and contended that the amount due and payable is Kshs. 1, 398, 300.00. The two scenarios by the auditors are differentiated by the penalty interest. The basis of the argument by the Plaintiff is the Charge document dated 26th April 1995 and the finding of the Court on the circumstances under which additional interest penalty was chargeable. At page 8 of the Ruling, Azangalala J. (as he then was) held as follows:

> **'In the matter at hand, therefore additional interest can only be the reasonable pre-estimate of the loss the defendant has suffered…..The Interest was payable subject to there being default and prior notice in writing having been served'.**

[5] The aspect of the Ruling above quoted on penalty interest has not been challenged to date. It thus follows that for the additional interest to be charged, the Defendant was enjoined to first demonstrate the default and second demonstrate a written notice was served upon the Plaintiffs. The Plaintiffs have denied receipt of any such notice. And it is for the Defendant to prove the existence and service of the written notice. This is eleven (11) years and no evidence of such notices has been filed in court through list of documents or as an annexure in the Replying Affidavit to the Plaintiff's applications herein. That window is now closed and any such notices if they be revealed now will be irrelevant and an ambush. The just and correct balance is Kshs. 1, 398, 300.00.

[6] On Issue 2, the Plaintiff submitted that no interest should be exacted against the Plaintiffs on the Kshs. 1, 398, 300.00. Any interest can only be after the date of the report/audit by PKF and not before. The reasons for that position, according to the Plaintiff are that; the Defendant in breach of contract clogged the Plaintiffs right of redemption. The relationship of the parties was that of Chargor and Chargee. The Plaintiffs had borrowed the sum of **Kshs. 3,000,000.00** in the year 1995 and until 2003, a period of eight (8) had repaid a sum of **Kshs. 8,757, 189.00.** The Plaintiffs were continuing to redeem the account at the rate agreed in the contract, but were inhibited by unlawful sums that were demanded by the Defendant. The Defendant demanded from the Plaintiffs by Statutory Notice dated 21st October 2003 the sum of **Kshs. 4,234,577.56**, threatening to sell the security if the Plaintiffs failed to pay in 90 days. This is what necessitated the suit. The Plaintiff, in prayer (c) of the Plaint sought for an order for the release of title upon payment of any balance fairly found due. Were it not for the breach by the Defendant, the Plaintiff would have exercised its right of redemption in 2003. The Report by the auditors vindicates the Plaintiffs' claim that the sum of Kshs. 4,234,577.56 was illegal, and it is that illegality that

necessitated this suit. Interest is chargeable only on a lawfully outstanding sum. The delay in conclusion of this issue has been occasioned by the Defendant who failed in its duty to render just account of outstanding sum to the Plaintiff.

[7] According to the Plaintiff, in the circumstances, it will be grossly to grant the Defendant interest and that shall be a punishment on the Plaintiff for delayed payment which was caused by the fraudulent/negligent acts of the Defendant. As a consequence of such order, the Defendant shall be unjustly enriched at the Plaintiffs' expense. The conduct of the Plaintiffs is in line with the law. They simply came to court out of necessity and they have been vindicated. The Plaintiffs have followed through all the steps in absolute diligence until the Report by the auditors was attained. When Messrs Ernest and Young declined to complete the accounts, the Plaintiffs sought the Defendant for amicable discussions with a view to speedier settlement and even made a payment of **Kshs. 523,000.00** to the Defendant. The Plaintiffs should not be punished for their vigilance by exacting interest from them as a result of fraudulent/negligent acts of the Defendant. Such action would clog their right of redemption of the security. It will also be unjust enrichment of the Defendant.

[8] The Plaintiffs, however, made other submissions on an entirely without prejudice basis, that, in the event interest is payable, the limitation of section 44A (6) of the Banking Act (Chapter 488 of the Laws of Kenya), the in duplum Rule should apply. The tabulation following the application of section 44A (6) of the Banking Act is in the table below:

Principal Amount (KES)	**Year**	**Interest Rate**	**Interest (Kshs.)**
1,398,000.00	2003	24%	223,680.00
1,398,000.00	2004	23%	372,986.40
1,398,000.00	2005	21%	418,879.94
1,398,000.00	2006	21%	506,844.73
1,398,000.00	2007 to May	21%	255,534.22
	In duplum rule takes effect		
1,398,000.00			1,398,000.00
	June 2007		
1,398,000.00			**3,175,925.30**

Total Interest + Principal	4,573,925.30
Less payment in 2009	(530,000.00)
Total Outstanding	**4,043,925.30**

[9] On costs, the Plaintiffs submitted that, since the event is achieved by consent of the parties, it shall only be fair that each party bears their own costs.

The Defendant equally submitted

[10] The Defendant made equally rational submissions. It recited the prayers in the plain as follows:-

a. **An order be made under Section 52 of the Indian Transfer of Property Act (Amendment) Act 1959 that during the pendency of this suit THAT A CT FRUTHER REGISTRATION on change of registration in ownership, leasing, subleasing, allotment, user occupation or possession or in any kind of right, title of interest IN ALL THAT property comprised in L.R. NO. 209/7570/1, situated in the city of Nairobi of the Nairobi Area re glistered in the plaintiff's names and all other registering authorities BE AND IS HEREBY PROHIBITED**
b. **A permanent injunction restraining the defendant whether by itself or its servants or Agents or Advocates or auctioneers or any of them or otherwise from doing the following acts or any of them that is to say from further advertising for sale, selling by public auction or private treaty or otherwise howsoever, the Plaintiff's piece of land known as L.R No. 209/7570/1 situate in the City of Nairobi of the Nairobi Area registered in the plaintiff's names.**
c. **An order that the defendants deliver up to the plaintiffs or to such persons as they appoint, the title documents and an executed instrument of discharge in respect of the Plaintiff's property known as L.R No. 209/7570/1 situate in the City of Nairobi of the Nairobi Area upon full payment of the sum found due after an independent audit.**
d. **An order that the defendant forthwith concurs in doing all acts and things and executes all the necessary deeds and documents in order to effectuate the orders aforesaid.**
e. **In the alternative and without prejudice to the foregoing and or in addition to the foregoing a declaration that the defendant the making a claim of four million two hundred and thirty thousand seven shillings and sixty cents (Kshs.4,234,577.60) for payment at the expiry of three (3) months has to the prejudice of the plaintiffs introduced a matter not the contemplation of the parties and in breach of the agreement between is estopped and barred from claiming or recovery any sues under the charge and that the plaintiffs are discharged of all liability under the charge.**
f. **General damages for breach of contract**
g. **Such other or further orders as this honour able court may deem fit to grant.**
h. **Costs of the suit.**
i. **The defendant, on the hand filed a defence dated 5th January, 2004 and on the same date and denied the plaintiff's averments in the plaint and prayed for the suit to be dismissed with costs.**

[11] A consent order was recorded in court on 18th July, 2006 on the following terms:-

a. **The honourable court be pleased to interpret the provision of the charge document dated 26th April, 1995 with regard to the charging and calculation of interest initially.**
b. **The parties be at liberty to make submissions in aid of the above interpretation of the provision of the charge document dated 26th April, 1995 as to charging and calculation.**
c. **Thereafter the matter be submitted to the firm of Ernest and Young for purposes of computation of the interest in accordance with the interpretation of the honour able court as to charging of interest.**

[12] The Defendant, then, reproduced the Ruling delivered by Azangalala J (as he then wa) on 30th June, 2007, as follows:-

1. **Both the offer of Advance and the charge document provided.**
2. **For calculation of interest initially at the rate of 26% p.a on a reducing balance basis with annual rests.**
3. **Clause 1 (d) of the charge document provided for variation of interest rate subject to prior written notice having been served and variation would not be in excess of the rate normally charged by the society on new advances which in the opinion of the defendant's Board of Directors were of the same type as the advance made to the plaintiffs**
4. **Additional interest was provided for in Clause 1 (e) (i) of the charge document. Rule 32 (d) of the defendant's Rules was not applicable.**
5. **Clause 2(e) of the charge document permitted the defendant to pay on behalf of the plaintiff money in respect of insurance cover for the charged property and that payment was classified as a charge on the charged property and attracted interest at applicable rates.**
6. **Under Clause 2(f) of the document money paid as premiums under the mortgage protection policy was a charge on the charged property and attracted interest at applicable rates.**
7. **Under Clause 2 (g) of the charge document rates, taxes, duties, charges assessment and outgoings made by the defendant on behalf of the plaintiff were classified as a charge on the charged property and the same attracted interest at the applicable rates.**
8. **Under Clause 3(I) all expenses incurred by the defendant for the enforcement protection or improvements of the charge were classified as principal sum and attracted interest at applicable rates.**
9. **On the basis of the above findings and in terms of paragraph 3 of the consent order recorded on 18.7.2006, M/s Ernest & Young auditors should now compute the interest accordingly.**

[13] By mutual agreement of the parties, the Report by PKF Accountants and Business Advisers was adopted with two (2) scenarios to which the Plaintiffs have alluded to. The court had already made a finding that the letter of offer and the charge instrument provided for a rate of interest initially at 26% p.a. with the right of variation being agreed upon but subject to the borrowers/chargors being notified in writing. The court had further noted that additional interest was provided for in Clause 1(e) (i) of the charge instrument. Clause 1(e) (i) states that,

> **"if and wherever any monthly instalment payable hereunder or any part of such instalment shall remain unpaid after seven (7) days from the date upon which the same shall have fallen due, it is hereby agreed by and between the par ties hereto that a reasonable pre-estimate of the loss suffered by the society by reason of such non-payment will so long as such non-payment shall continue, be a sum such equal to interest at the rate aforesaid on the full amount for the time being remaining unpaid."**

[14] The judge at paragraph 1 (page 8) of his ruling aforesaid held that,

> **"in the matter at hand, therefore additional interest can only be the reasonable pre-estimate of the loss the defendant suffered due to non-payment of the monthly instalments by the plaintiffs and the loss was equal to the reigning interest rate which was charged on the amounts remaining unpaid by the plaintiffs for the period that the non-payment continued. The interest was payable subject to them being in default and**

prior notice in writing having been served."

According to the Defendant, variation of interest charged or default interest could only be charged subject to the borrowers/chargors being notified.

[15] On the issue Whether or not the defendant was entitled to charge default interest pursuant to Clause 1 (e) (i) of the Charge instrument and if so, whether the plaintiffs were duly notified; the Defendant was of the view that it is not in dispute that the contract documents execute by the parties provided for default penalty interest. The only question is whether the Plaintiffs were duly notified of the intention to charge default interest. The defendant maintains that the plaintiffs were duly notified and that in the correspondence between the plaintiffs and the defendant, it is evidence that the plaintiffs were duly aware that the defendant had charged default interest. The Court should consider the detail and contents of the plaintiffs letter dated 24th March, 2003 addressed to Central Bank of Kenya and which defendant has tendered as exhibit PG3 (pages 29 to 35). At page 1 paragraph 4 (title; Account operation), the plaintiff acknowledge that, **"The account has carried various amounts of arrears since 1996, attracting penalty charges on a continuous basis which has raised the outstanding loan balances. There has [sic] also been changes in the ruling interest rate at various times over the period."**

The said letter is part of the court record and in the letter the plaintiffs did not complain and or dispute that they were notified prior to penalty charges or change of interest. The plaintiffs only complained was on the manner in which the defendant calculated the installments payable resulting into the plaintiffs being overcharged. The said letter formed the basis within which the plaintiffs filed the suit herein. The court to note also that the plaint does not plead and or allege that they were not notified prior to penalty charges being loaded. Parties are bound by their pleadings. The upshot of the above submission is that the plaintiffs were duly notified of intention to charge default interest and increase of rate of interest.

[16] According to the Defendant, issue 2 is in the affirmative; that the sum of Kshs. 3,278,762 including penalties is due from the Plaintiffs as at April, 2003 and continues to accrue interest until full payment. The default interest was, therefore, lawfully charged. The outstanding sum as at April, 2003 is Kshs. 3,278,762 and Kshs. 1,398,300, and continues to accrue interest at the rate of 24% p.a. until full payment. As a result, the court should take into account the fact that prior to the institution of this suit the defendant had issued a statutory notice demanding Kshs. 4,234,577.60 as at October, 2003. The findings of the Auditors are that as at April, 2003 a sum of Kshs. 3,278,762 was due and outstanding and continued to accrue interest. The report did not falter the statutory notice in so far as the amount claimed was concerned and accordingly the notice was validly issued. In any event, it is now clear that the plaintiffs were indebted to the defendant at the time the statutory notice was issued. The court should find that the defendant is entitled to exercise its statutory power of sale and reject the prayers sought and dismiss the suit.

[17] On costs, the Defendant stated that costs must follow the event and the award the defendant the costs of this suit.

COURT'S RENDITION

[18] I stated from the beginning that:

> **I have been called upon to decide whether the Defendant is entitled to penalty interest it loaded on the Plaintiffs account on the default by the Plaintiffs. Then, I should decide which of the two Reports by Messrs. PKF Consulting Limited (PKF), auditors should form the basis of the judgment herein.**

That answers to the three issues I had formulated that:

a. **What is the correct outstanding sum of the account herein as at April 2003; is it Kshs. 1, 398, 300.00 or Kshs. 3, 278, 726.00;**

b. **Whether the Defendant is entitled to charge any further interest on the account as at April 2003 and how much that should be, in the circumstances of the case; and**
c. **Costs of the suit.**

[19] On subtle reflection, there is not dispute that the letter of offer and the charge- and the Court ruled on this- provided for a rate of interest initially at 26% p.a. with the right of variation being agreed upon but subject to the borrowers/chargors being notified in writing. The Court further ruled that additional interest was provided for in Clause 1(e) (i) of the charge instrument. Clause 1(e) (i) states that,

> **"If and wherever any monthly instalment payable hereunder or any part of such instalment shall remain unpaid after seven (7) days from the date upon which the same shall have fallen due, it is hereby agreed by and between the par ties hereto that a reasonable pre-estimate of the loss suffered by the society by reason of such non-payment will so long as such non-payment shall continue be a sum equal to interest at the rate aforesaid on the full amount for the time being remaining unpaid."**

[19] The Learned judge Azangalala specifically held on the Clause that:

> **"In the matter at hand, therefore additional interest can only [be] the reasonable pre-estimate of the loss the defendant suffered due to non-payment of the monthly instalments by the plaintiffs and the loss was equal to the reigning interest rate which was charged on the amounts remaining unpaid by the plaintiffs for the period that the non-payment continued. The interest was payable subject to their being in default and prior notice in writing having been served."**

[20] So, the only point of contention is whether the penalty interest was really payable. That would call for evaluation of whether the Plaintiffs were accordingly served with a notice in writing notifying them that interest is accruing on the amount of such instalment or instalments remaining unpaid and unless and until the outstanding installments or instalments together with the amount of such interest are paid all interest accruing due thereon will be added to the principal moneys payable under the charge. These requirements are in Clause 1(e) of the Charge herein. In reply to this issue, the Defendant placed a heavy premium on two things; 1) the letter dated 24th March, 2003 written by the plaintiffs to the Central Bank of Kenya; and 2) the plaint. According to the Defendant, the Plaintiffs acknowledged in the said letter that they had fallen in arrears as far back as 1996 and for that certain penalty interest had been loaded on the account. To them, the Plaintiffs were aware of the default as well as the penalty interest charged on their account and thus, they were duly notified of the same. They argued further that, if they had not been notified they should have placed that issue as one of its complaints in the said letter. Again, the Defendant claimed that the plaint did not plead lack of notice for default and the charging of penalty interest thereto. Therefore, in sum, the Plaintiffs are precluded from denying they were duly notified, and the interest is due and payable.

[21] I should deal with this question more decisively. Clause 1(e) (iii) specifically requires service of such Notice upon the Borrower- the Plaintiffs in our case. Service acquires technical as well as legal connotation when it is used in a legal instrument or process. And service of Notice, may not be dispensed with simply because the Plaintiffs did not raise that omission in its complaints to the Central Bank. In fact the letter to the Central Bank of Kenya cannot constitute or substitute Notice of charging of interest in accordance with the Charge instrument herein. The letter was merely a complaint lodged by a dissatisfied customer to the Regulator of Banks (CBK) and may not serve to take away rights of a party in or supplant requirements of the Charge of doing some act or taking of some step by a party such as service of Notice in the event of default. The argument that the Plaintiffs did not raise lack of notice in their complaint to the CBK does not, therefore, yield much and is dismissed.

[22] Similarly, I wish to tackle the other argument that the Plaintiffs did not plead lack of notice

in the plaint. As a general rule, parties are bound by their pleadings. Except, when it comes to issues for determination by the Court other pertinent rules come into play. Issues draw from the pleadings or the evidence or submissions of the parties or as are framed by the parties. I say this well aware of the seeming dichotomy of opinion on this issue emanating from the varied decisions of the Court of Appeal. But see also **ODDS v JOBS** on the matter**.** My own view, arising from those decisions is that, when issues have been framed by the parties, the Court is bound to determine them unless they are of such a nature that they are irreconcilable with the case at hand or would lead to absurdity. In this case the parties framed the issues for determination by the Court, and the issue of Notice to the borrower [read Plaintiffs] became one of the issues for determination by the Court when the parties by consent asked the Court to interpret the provisions of the Charge with specific emphasis on the question of payment of interest. I do not, therefore, accede to the argument by the Defendant that the issue of notice was not pleaded and should not be entertained by the Court. Be that as it may, as a matter of substantive significance, every provision of the Charge is important and should be observed by the parties. The essence of the overall impression gathered from the Charge is that notice was a prerequisite to the charging of additional interest or variation of interest. And the bank disregarded the provisions of its own Charge and charged default or additional interest or varied interest rates without following what the Charge or law stipulates; thus, running contra the intention of the parties in the Charge and the law. But, issues of service of notice of default on the borrower will no longer be mind-boggling because the law now, under section 90 of the Land Act makes it a mandatory statutory requirement.

[23] On that finding, what is the correct amount due and payable as at April, 2003? It is clear on the direction the Court is taking on this matter. The Defendant is in default of the provisions of the Charge. The law is that no one should benefit from own default. You will be estopped. Therefore, I hold that the amount outstanding as at April, 2003 is Kshs. 1, 398, 300.00. But, the Plaintiffs are not blameless. They should have paid what they calculated to be the outstanding amount either to the Defendant or tendered it to court at the time of filing suit. They did none of that. The said amount of Kshs. 1, 398, 300.00 shall, thence, attract interest at the lending rate agreed in the Charge per annum from April, 2003 till payment in full. Except, however, given the circumstances of this case, the in duplum Rule in section 44A (6) of the Banking Act (Chapter 488 of the Laws of Kenya) will apply in determining the entire outstanding sum. Applying the prescriptions of this ruling, the auditors should file in court the actual figures on the outstanding sum within 30 days of the judgment.

[24] On costs; needless to state that ‘’Costs follow the event’’ and looking at the result of the entire proceedings, this is a perfect case where each party should shoulder its own costs. It is so ordered.

Dated, signed and delivered in open court at Nairobi this 18th day of September, 2014

F. GIKONYO

JUDGE