REPUBLIC OF KENYA

High Court at Nairobi (Milimani Commercial Courts)

Civil Case 376 of 2007

JAMES MUNGAI MAGARI.....PLAINTIFF

VERSUS

HOUSING FINANCE COMPANY OF LIMITED.....DEFENDANT

J U D G M E N T

1. The Plaintiff's claim against the Defendant is for the refund of Kshs.1,827,140/29 allegedly being the excess interest charged on his mortgage account held in the Defendant Bank. The admitted facts of this case are briefly that in or about October, 1998, the Plaintiff and his deceased wife, Rahab Muthoni Mungai, obtained a loan facility from the Defendant for the principal sum of Kshs.2,225,000/- which secured by a charge dated 6th October, 1998 in favour of the Defendant over Title No. Ndumberi/Riabai/689/6 registered in the joint names of the Plaintiff and his deceased wife (hereinafter "the charged property"). The terms of lending included repayment of the sums advanced together with interest of 29% per annum payable. The amount repayable in monthly installments of Kshs.57, 016/=. The Charge included a condition for the issuance of a one month notice to the Plaintiff by the Defendant before any interest variation.

2. In his Plaint dated 24th July, 2007, the Plaintiff pleaded that he commenced repayments of the Loan facility on 12th October, 1998. That without issuing notice and contrary to what was agreed to by the parties, the Defendant arbitrarily levied interests, penalty interest, default charges and interest on arrears, at rates higher than what was agreed in contravention of the express terms of the Charge instrument. In addition, the Plaintiff alleged that the Defendant also arbitrary lumped insurance charges which to date have not been explained or accounted for. The Plaintiff, further claimed that as a consequence of the illegal penal interest charged by the Defendant, he was subjected to immensurable pressure and agony as the sums owing continued to escalate despite payments made to offset the loan. This, according to the Plaintiff, led him to seek an opinion from the Interest Rates Advisory Center (hereinafter referred to as "IRAC") who advised him that Kshs.1,827,140/29 should not have been paid as the charges were illegal and arbitrary. This was captured by a Re-calculation Report prepared by IRAC dated 25th September 2006. This led the Plaintiff to institute this suit seeking the various reliefs and remedies as outlined in the Plaint.

3. In its Defence dated 3rd September 2007, the Defendant contended that all variations of interest and application of penalties were applied to the Plaintiff's mortgage account strictly in accordance with the terms of the contract between the parties. That the Charge instrument provided that the interest rate would be applied on all balances whether principal or interest or any arrears resulting from a default on the part of the Plaintiff as borrower. The Defendant also contended that it levied default charges on the mortgage account in accordance with the express and implied terms of the Charge, the prevailing customs and usage in the mortgage, banking and financial industry as the Plaintiff was in default in the repayment of

the Loan facility. It was further contended that the insurance charges imposed on the Plaintiff's account were mutually agreed between the parties in the Charge instrument and the Letter of Offer dated 7th September, 1998. With regard to the opinion rendered by IRAC, the Defendant contended that the aforesaid IRAC lacked the competence to express opinions on matters pertaining to the interest charges and other issues between the parties. The Defendant therefore denied being indebted to the Plaintiff and contended that the Plaintiff's suit was incompetent as it did not disclose any reasonable cause of action against it. The Defendant prayed that the Plaintiff's claim be dismissed with costs.

4. Two witnesses testified in support of the Plaintiff's claim. The Plaintiff (PW1) testified that sometimes in October, 1998, he and his late wife, approached the Defendant for a loan facility of Kshs.2,000,000/-, that he signed a Letter of Offer to advance which indicated the loan amount to be Kshs.2,000,000/- with a monthly installment of Kshs.53,150/- and for a period of 10 years at an interest rate of 29% per annum. In his witness statement dated 14th February, 2012, he stated that he signed a Charge document for a loan facility of Kshs.2,225,000/=, that the loan repayment period was for 10 years at an interest rate of 29% per annum with a monthly repayment of Kshs.57,016/-. That the property given as security was developed and comprised of three storey commercial cum residential building. He indicated that the Defendant explained that there was to be variation of interest and a one month notice would be given requiring payment of such increased or reduced interest. Subsequently, the funds were released and the repayments commenced on 12th October, 1998. The Plaintiff contended that the Defendant did not at any one time, issue him or his wife with a month's notice of variation of interest though from time to time it continued to vary the interest on the principal amount. He testified that the Bank statements reflected interest on capital, interest on arrears, default charges and other charges which he did not understand. The Plaintiff recounted how he was forced to sell off a series of his properties, including the charged property in order to offset the loan amounts owed to the Defendant. As a result he sought advice from IRAC with regard to his loan account as they were experts in this field. IRAC subsequently did a recalculation of the mortgage and found that a sum of Kshs.1, 827,140/29 had been illegally charged on his account and that in effect, he had overpaid the loan amount by such sum. He indicated that he and his wife were paid by the Defendant Kshs.2, 238/- as a refund of the fire insurance premium funds as well as the life insurance. The Plaintiff asked the Court to note that he and his wife borrowed from the Defendant a sum of Kshs.2,225,000/- but ended up paying a sum of Kshs.7,961,086/30 which rendered him destitute.

5. On cross examination, the Plaintiff admitted signing a Letter of Offer dated 7th September, 1998 for a loan facility of Kshs.2,225,000/-, with monthly installments of Kshs. 57,016/= and monthly insurance premiums of Kshs.1,900/- totaling to Kshs.58,916/=. He admitted having signed the Charge instrument over the charged property before an advocate. He however testified that he did not know what clause 4(ii) of the said Charge meant with regard to the rate of interest being compounded monthly. That he was not given notice of the varying interest rates as agreed between the parties. That he did not receive the five (5) letters dated 1st August, 2002, 1st October, 2003, 6th April, 2004, 1 March, 2005 and 10th March, 2005, respectively that were produced by the Defendant in this case. He told the court that the said notices were not for 30 days before the new interest rates would take effect as agreed in the charge. The Plaintiff admitted that he defaulted in repayment of the loan facility and that he wrote letters dated 20th September, 2000 and 15th January, 2007 to the Defendant admitting that fact. That the Bank sold the charged property after it was duly advertised in order to recover the outstanding debt. He also admitted that the Bank remitted the balance of the sale proceeds to him after deducting the amounts outstanding.

6. PW2 was Wilfred Abincha Onono, a Managing Consultant with IRAC. In his statement dated 26th March 2012, he told the Court that IRAC specializes in financial consultancy and undertakes objective and independent audit of borrowing contracts and interest recalculations. That such audit entails revealing interest overcharge, interest undercharges and confirming the exact amounts owed by a borrower to a financial institution and vice versa. He noted that IRAC's objectives were achieved through a two stage process. First, the company extracts the terms of the contracts from the agreements signed by the parties. This is followed by extraction of applicable interest rates and the agreed mode of repayment as set out in the contracts. He testified that the Plaintiff approached IRAC to recalculate the interest Charged in his Loan account. That the total loan advanced to the Plaintiff was Kshs.2, 225,000/=. At the initial rate of 29% per annum, the expected repayment would amount to Kshs.6, 841,920/- in 120 months. That

between October, 1998 and August, 2006, the amount paid by the Plaintiff was Kshs.7,961,086/30 and that was in a period of 96 months which was less than the 120 months originally expected. This was so notwithstanding the expected reduction of interest with the periodical payments made by the plaintiff. That there was therefore an overpayment as at 31st August, 2006 of Kshs.1, 827,140/29/-.

7. On cross examination, PW2 told the court that though IRAC based it's recalculation on the Loan amount of Kshs. 2, 225,000/- at the initial rate of 29% per annum interest rate, the Offer to Advance letter indicated in his statement was dated 21st August, 1998 which had a loan amount of Kshs.2,000,000/-. He admitted that the recalculation statement did contain a statement that no additional interest on arrears had been applied in the recalculation as they were not provided for in the Charge. He testified that in the foregoing notwithstanding, IRAC took into consideration the variation of interest by the bank. He concluded that IRAC took into consideration the insurance premium in the re-calculation of the mortgage account though in their letter dated 29th September, 2006 to the Plaintiff they had indicated otherwise. He was firm on the figures IRAC had arrived at in the re-calculation report.

8. The Defendants presented one witness. DW1 was Migui Mungai, a Legal Manager in the Defendant Bank. In his statement dated 9th July, 2012, he told the court that the Plaintiff was granted a loan facility by the Defendant amounting to Kshs.2,225,000/- upon such terms and conditions agreed upon in the Charge registered against the charged property. That the Plaintiff defaulted in repaying the loan as agreed and the outstanding amounts continued to accrue interest. That the Plaintiff made numerous appeals to the Defendant for its indulgence which it granted for late payments, non-payment or payment of installment amounts which were below the agreed amounts. That despite such indulgences, the Plaintiff failed to service the loan as expected. He elaborated that as a result of the Plaintiff's failure to repay the loan amounts, the Defendant issued several notices requiring such repayment. That the Plaintiff applied for the rescheduling of the loan to create favorable repayment terms, which the Defendant acceded to. That, however, the Plaintiff was still in persistent default. DW1 testified that the loan accrued interest on both the principal and unpaid installments. He admitted that during the subsistence of the charge, the Defendant did vary the interest rate upwards or downwards but in all such instances, the Defendant notified the Plaintiff of such variations. He stated that the plaintiff eventually repaid the balance of the loan after the sale of the charged property. He told the Court that the Plaintiff thereafter demanded repayment of what he termed as overpayments, which the Defendant denied. That the relationship between the Plaintiff and the Defendant was contractual and all documents in relation to the loan were freely and voluntarily executed and the terms thereof performed by the respective parties, without coercion or duress. DW1 also told the court that the Defendant charged interest on the loan advanced, strictly in accordance with the terms of the letter of offer and the Charge, and that the Plaintiff's suit was therefore unmeritorious.

9. On cross examination, DW1 confirmed that the information contained in his statement was based on records of the Defendant. He admitted that a letter dated 29th April, 2004 was prepared by the Defendant to be signed by the Plaintiff as consent to sell the charged property by private treaty for Kshs.5,000,000/-. The said letter was purported to be addressed to the Director of Risk of the Defendant Company and in a letterhead paper of the Defendant. It was however not signed by the Plaintiff. He told the Court that it would appear that this was a letter made pursuant to some agreement of the parties as the Plaintiff had sought various indulgences from the Defendant bank. He however admitted that he did not know the maker of the document, though the same was in the Defendant's letterhead. It was DW1's opinion that the letter did not constitute duress as the Defendant was trying to assist the Plaintiff by selling the property via private treaty rather than public auction. He admitted that a letter addressed to the Plaintiff dated 15th December, 2004 by Chrales Kamari, the Director of Risk at the Defendant bank indicated that the property should be sold at its value price of Kshs.3,500,000/- as opposed to a proposed Kshs.2,000,000/- which was too low compared to the outstanding balance of Kshs.3,165,735,735.48. DW1 admitted that through the Redemption Notice issued by Nguru Enterprises dated 27th March, 2006, the Defendant pegged the Open Market Value of the charged property at Kshs.3,500,000/- and the reserve price at Kshs.2,800,000/-. He was of the opinion that the value of the charged property since December, 2004 until the date of the redemption notice did not change. He also concluded that though the Plaintiff had written to the Bank on 2nd July, 2005, indicating that the charged property was valued at Kshs.5,500,000/-

the said value was queried by the Defendant's Director of Risk.

10. On 25th February, 2010, the parties filed a statement of agreed issues which fall for determination in this judgment. I have considered the evidence and the rival submissions by counsel. There is no dispute that the Plaintiff and his late wife, Rahab Muthoni Mungai borrowed a sum of Kshs.2,225,000/- from the Defendant in 1998 at an initial interest rate of 29% per annum. That the contract between the parties was reduced into writing by way of a charge dated 6th October, 1998. The Charge document provided that the Defendant could vary the interest rate chargeable to the repayment of the loan amount on giving one month notice. There is also no dispute that from time to time there was variation of the rate of interest. The issue is whether such change was lawful and in accordance with the terms of the contract between the parties. In order to discern whether the changes were in terms of the contract, it is necessary to revert to the said contract for its terms and conditions. I have examined the said document and it is clear that in Clause 5, variation of interest had to be accompanied by a Notice that should be "served" on the borrower (the Plaintiff). The fact that under clause 5 (ii) the document uses the phrase *"may from time to time serve the chargor not less than one month's notice"* is not permissive as was submitted by learned Counsel for the Defendant. This is so given the provisions of clause 5(iii) which state that:-

"In the event of the Chargee requiring a variation of the rate of interest under the provisions of sub-clause (ii) of this clause the Chargee will notify the Chargor of the amount of the resulting varied monthly installments payable under the provisions of Clause 3 hereof and the first of such varied monthly installments shall become due and payable on the first day of the month next after notification of the amount thereof to the Chargor" (Emphasis supplied)

The import and meaning of the said Clause is that for any change of interest to be effected, notice of the same is a prerequisite requirement and that the same takes effect on the first day of the month following the notice. Such notice under Clause 5(ii) must not be less than one (1) month. From the evidence tendered by the Defendant, there seems to be letters of notification of change of interest rate given to the Plaintiff. The same are contained in Defendant's Exhibit 1. They are letters dated 1st August, 2002, 1st October, 2003, 6th April, 2004, 1st March, 2005 and 10th March, 2005. They are shown to have been sent to the Plaintiff's postal address. However, the Plaintiff contended that he did not receive any of these notices. In view of the Plaintiff's contention as such, I think it was imperative for the Defendant to rebut same. The issue is, were those letters served on the Plaintiff. How was service effected? The charge document was silent on this aspect. The Defendant other than producing the said letters did not go further to prove that they were posted to the Plaintiff. Service cannot be implied it must be proved. Evidence of how those notices were sent out to the Plaintiff missing, I hold that there were no notices issued in accordance with the contract between the parties. Even if there were such notices, they did not come into effect after one month as contemplated in the contract. They were immediate or they gave a shorter period than agreed in the Charge thereby distorting the accrual and calculation of interest on the Loan. It is trite law that parties are bound by contracts they have freely entered into. Such contracts carry with them benefits and obligations. For one to reap the benefit therefrom, he must be prepared to strictly carry out his/its obligations thereunder. Any deviation carries with it penal consequences. The same way a borrower is penalized with increased interest (in this case compounded), the lender cannot act outside the confines of the Charge. By giving a shorter notice of application of interest, in effect the lender thereby clogs a borrower's equity of redemption by distorting the amount due.

11. The second issue for determination is whether the Defendant arbitrarily levied penalty interest charges, interest on arrears and interest at rates higher than what was agreed by the Parties. I shall answer this issue with issue number 6 of whether these charges were contrary to justice and hence illegal. The contract between the parties is contained in the charge document dated 6th October, 1998. I have carefully scrutinized the charge document and I seem not to find any charge or term called default interest or interest in arrears. What was provided for and agreed to by the parties under Clause 4 was ***"interest on money advanced or becoming owing by the chargor on monthly balances with monthly rests by way of compound interest."*** In my view, it was in the parties' contemplation that there would be one single charge of interest that was to apply and/or charged on the entire sum that would be due and outstanding at any given time. This of course would be on the principal and arrears together, thus the use of the term

compound interest in clause 4 of the Charge document. From the statement of Account, it is clear that in every given month, the Defendant made entries into the Plaintiff's account which it christened ***"interest on capital", "default charge" "other charges".*** The so called ***"default charge"*** would sometimes appear twice in one given month. Why so, it was not explained by the Defendant. There was also the item on "***other charges"*** appearing each month. This did not emanate from the charge document. Nowhere did the parties agree in the Charge document that the Defendant would levy this particular item. The only place where there is a reference of some charge other than interest on principal amount due is clause 11(i) of the Charge. That Clause however does not state that the Defendant would charge the Plaintiff any such charge.

12. That clause does not show that the Defendant was entitled to charge Kshs.2,000/- but that the Plaintiff was entitled to pay to the Defendant over and above the monthly repayments a sum not less than Kshs.2,000/- towards repayment of the loan. The reason for raising the issue is to emphasize the fact that once parties have reduced into writing the terms of their contract, none should be allowed to operate outside the same. In the same way, none would be allowed to interpret such terms in a skewed manner so as to give the contract a meaning other than the one originally contemplated by the parties. From the evidence on record, it is clear that the Defendant charged the Plaintiff different rates of interest on Capital as well as arrears which it called interest on arrears. The rate of interest on arrears was always higher than the rate agreed whilst Clause 4 of the Charge contemplated one flat rate of interest, though variable on any amount outstanding, both capital and arrears.

13. The Plaintiff did admit being in default on several occasions through his various letters. It is normal that when any loan account goes into arrears, there are charges that may be chargeable and since the Plaintiff did not service his loan account properly and continuously as he has admitted, then the bank may have been entitled to take into consideration the risk factor associated with such default. It is customary that the issue of levying interest is both a consideration and also based on the risk associated with the default by a borrower. However, in ***SHAH –VS- GUILDERS INTERNATIONAL BANK LTD [2003] KLR 8*** the Court held that if by their agreement, the parties have fixed the rate of interest payable then the court has no discretion in the matter and must enforce the agreed rate unless it be shown in the usual way either that the agreed rate is illegal or unconscionable or fraudulent.

14. In this regard, I hold that since the agreement between the Plaintiff and the Defendant clearly did not provide for default interest/interest in arrears to be charged separately then, as contemplated in Clause 4 of the charge document, the same should not have been factored in the Plaintiff's account. In this case, there is a high likelihood that the Plaintiff's equity of redemption may have been clogged due to excessive penalty charges leading him to repay almost three times what he was initially advanced in terms of the loan amount and for a shorter period than originally intended. This may explain why the Plaintiff eventually lost a series of his properties including the charged property, in a bid to repay the sums owed. I therefore find that the default interest/interest in arrears charged by the Defendant on the Plaintiff's Loan account was not contractually agreed to and should have not been charged.

15. The next issue pertains as to whether the monthly loan repayments payable were Kshs.57,016/- or Kshs.52,250/-. I think this issue is rather straight forward. The Defendant's Offer to Advance dated 7th September, 1998 and the schedule contained in the Charge document clearly set out the monthly installment payable. Whilst the Offer to advance dated 21st August, 1998 indicated that the monthly repayments would be Kshs.51,250/-, the Charge was express as to what was the installment payable. The Charge document takes precedence over the offer to advance or letter of offer. In any event PW1 admitted that Kshs.57,016/- was the amount agreed as the monthly repayment sum. Accordingly, I hold that the contractually agreed monthly loan repayment was Kshs.57,016/-.

16. I now turn to the question as to whether the Defendant arbitrarily lumped up the insurance charges on the Plaintiff. Clause 7 (iii) of the Charge provided:-

"(iii) That at all time during the continuance of this security the Chargee may on its own or some other agency and <u>at the expense of the Chargor insure and keep insured for such amounts in such names against such risks and with such insurers as the Chargee may from time to time select</u> .

a) The buildings forming part of the said property and all fixtures and fittings therein and all additions and improvements thereto of an insurable nature.

b) The Life of the chargor

(iv) That the chargor will repay every sum from time to time paid by the Chargee for effecting or keeping on foot any such insurance within fourteen days after the date on which the same was paid by the Chargee and that such sum until it is repaid shall bear interest at the rate for the time being payable hereunder and with the interest thereon shall be charged on the said property." (Emphasis provided).

It is clear from the foregoing that under the terms of the Charge, the Defendant was entitled to take out insurance at the expense of the Chargor. The Charged property was developed and therefore the Chargee needed to protect its interest therein. This is normally done through insurance. The agreed figure for such insurance premiums according to the Offer for advance dated 7th September, 1998 was Kshs.1, 900/- which would be paid together with monthly repayments of the loan. This was the agreement. Unless the Plaintiff illustrates that such insurance was not effected towards what was outlined in the Charge, then the Court has no option but to effect the terms of that agreement. I cannot re-write the agreement or the contract between the parties. I have to give effect to its letter and spirit even if it causes hardship to either of them. The parties executed the same willingly and they are therefore bound by it. Having said that, it is clear that the sums charged as insurance did indeed escalate from the original sum agreed at Kshs.1,900/- to Kshs. 2,705/- as at 1st January, 2000, Kshs.2,254/- as at 31st December, 2001 and Kshs.5,820/- as at 30th June, 2003. Of course once debited on the loan account, the same yielded interest. All this is derived from the Defendant's statements of the loan Account for the Plaintiff produced at pages 25 to 48 of PExh1. Although there was such a variation, since the figures were not contested, I am of the view that, the Defendant did not arbitrarily lump the insurance charges on the Plaintiff as any charges levied towards insurance were explicitly agreed to by the parties. Further, the Plaintiff admitted that he had received a refund on the insurance money which was too little. However, since no evidence was led or submissions made as to how much he ought to have been refunded, the Court cannot go into such a determination.

17. As to whether IRAC was competent to express opinion on matters of interest rates, it was the Defendant's counsel's submission that the opinion rendered by IRAC was inaccurate especially given PW2's evidence. It was the submission of the Defendant that the opinion of PW2 was based on a loan of Kshs.2,000,000/- as stated in his witness statement. In addition, the monthly insurance premium of Kshs.1900/- was not included in the recalculation as the amounts due and payable by the Chargors to the Defendant on a monthly basis and that as per PW2's opinion and written statement, the monthly loan installments payable by the Plaintiff was Kshs.51,250/- and not Kshs.57,016/- as provided in the Charge. The Plaintiff disputed these assertions and submitted that PW2 based his recalculations on the initial loan amount of Kshs.2,225,000/- at the initial rate of 29% p.a. and this gave a total repayment sum of Kshs.6,841,920/- over the contractual period of 120 months. That within 96 months, the Plaintiff had paid Kshs.7, 961,086/30 with an overpayment of Kshs.1,827,140/-. The Plaintiff contended that no evidence was offered by the Defendant to rebut this arithmetic. Further, it was submitted that the Defendant did not explain to the court how it was able to collect Kshs.7,961,086/30 within 96 months. I have scrutinized the re-calculation report by IRAC dated 25th September, 2006. The same clearly indicates that IRAC did its recalculation based on the loan advance of Kshs.2,225,000/- and not Kshs.2,000,000/- as contended by the Defendant. The monthly repayments that IRAC factored seem to be based on the remittances of the Plaintiff as reflected in his statement of accounts. They applied the interest rate of 29% calculated on monthly rests using the reducing balance method. IRAC however, did not factor in certain charges. That is what was referred to in the Plaintiff's statements of accounts as "Interest on Arrears" or "Default charges". PW2 clarified in his testimony that IRAC took into consideration the issue of insurance. The question that arises is whether the Court can reliably rely on this report when the issue of default charges was not considered. In my view, PW2 was categorical on the basis of the re-calculation. I have already held that by charging the Plaintiff two sets of interest, interest on Capital and default charges or interest on arrears (and considering that a higher rate of interest than agreed was being charged), the Defendant was acting out of contract. More so, the Defendant did not call any evidence to rebut Mr. Onono's

evidence. In my view, the evidence of DW1 was in conclusive and did not address the issues raised by PW2. To my mind, the report by IRAC was plausible. There is evidence that in 96 months, the Defendant was able to recover the amount meant for a period of 120 months and more. There was an overpayment as testified to by PW2. I agree with the Plaintiff's counsel, that the Defendant did not call any witness to disprove the arithmetic shown in the Re-calculation report presented by IRAC. I note that DW1 could not give any proof with regard to this aspect as he was not an expert in that field. He only sought to explain the legal effect of the charge document which I have anyway analyzed above.

18. Accordingly, the Plaintiff has in my view proved his case on a balance of probability. I will therefore enter judgment in favour of the Plaintiff against the Defendant for:-

a) Kenya Shillings One Million Eight Hundred and twenty Seven Thousand, One Hundred and Forty and Twenty Nine (Kshs.1,827,140/29) with interest at Court rate from the date of filing suit.

b)The Plaintiff shall also have Costs of this suit and interest thereon.

DATED and **DELIVERED** at Nairobi this 8th day of March, 2013.

A. MABEYA
JUDGE