



REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA AT NAIROBI
MILIMANI COMMERCIAL & ADMIRALTY DIVISION

CIVIL CASE NO. 264 OF 2010

PALM HEALTHCARE INTERNATIONAL

LIMITED (IN RECEIVERSHIP) PLAINTIFF

VERSUS

DEVELOPMENT BANK OF KENYA LIMITED DEFENDANT

R U L I N G

1. The Plaintiff's Notice of Motion dated 27th April 2010 is for determination before this court. The same is brought under the provisions of **sections 1A, 1B, 3A and 63 (e)** of the *Civil Procedure Act*, **Order 39 rules 1, 2, 5 and 9** of the *Civil Procedure Rules* as well as **sections 95, 96 and 348** of the *Companies Act*. The orders sought by the application, which was brought under Certificate of Urgency, were that, pending the determination of the same, the Defendant be ordered to immediately credit to the Plaintiff's receivership Account No. 0200876008 with the Defendant's Loita Street Branch, Nairobi the sum of Shs. 83,709,403 .60 together with accumulated interest. The application also sought a mandatory injunction to be issued as against the Defendant with regard to the payment of the above sum. In the alternative, the Plaintiff requested of the court that the said sum of Shs. 83,709,403.60 as above be deposited in a joint interest earning account in the names of the advocates of both parties pending the determination of this suit.
2. The application before court was grounded as follows:

“(a) A receiver and manager was appointed on 6th April 2009 in respect of the Plaintiff company pursuant to the powers vested in a Debenture dated 31st January 2006 in favour of the Eastern and Southern African Trade and Development Bank (hereinafter called ‘the PTA Bank’).

(b) The Defendant's Debenture dated 2nd October 2008 was registered with the consent of the PTA Bank and subject to the priority rights therein.

(c) The material part of the consent specifically provided that the PTA Bank was the 1st secured creditor and had a 1st ranking All-Assets Debenture created in its favour by the company.

(d) The PTA Bank consented to Development Bank of Kenya Limited's (DBK) Debenture on the express condition and subject to the DBK Debenture being registered in respect of stocks and debtors as mentioned in the

Debenture, to rank pari passu, to the extent of the secured amount with the PTA Bank Debenture, as regards the stocks and debtors of the company, charged therein, provided that as long as any or all monies due to PTA Bank under the PTA Bank Debenture existing and payable by the company, the distribution of monies realized from the sale of all and any of the assets of the company, save for assets charged in the written Debenture, would without any exception or reservation, be applied to and towards the repayment of the PTA Bank loan, in preference and in priority to all creditors, including Development Bank of Kenya Limited other than creditors as are preferred by law.

(e) Under section 95 of the Companies Act, PTA Bank enjoyed priority in payment of the sums held in the fixed deposit account which in any event was money held in favour of the company. The deposit was an asset belonging to the company and secured by the PTA Bank All-Asset Debenture.

(f) Case law is very clear on this issue – PTA Bank enjoys priority by virtue of its prior registered Debenture.

(g) The Defendant should be ordered to immediately credit the Plaintiff's account or make payment to the plaintiff's receivership account forthwith and give credit for interest earned.

(h) The purported debiting of the company's account ostensibly to offset the defendant's debt was illegal and in contravention of statute, contract and common law".

3. The Application was supported by the Affidavit of one **Bernard Rop** sworn on 27th April 2010. He described himself therein as the duly appointed receiver and manager of the Plaintiff company, having been so appointed on 6th April 2009 pursuant to powers vested in a Debenture dated 31st January 2006 (hereinafter "the PTA Debenture"), in favour of the Eastern and Southern African Trade and Development Bank (hereinafter "the PTA Bank"). The deponent outlined the conditions of the said Debenture securing a sum of US dollars 1,800,000.00 being an all asset Debenture. He went on to say that the Defendant was aware of the mandatory provisions of the said PTA Debenture and that the PTA Bank was reluctant to exclude stocks and debtors from the PTA Debenture. Knowing that, the Defendant executed a Debenture with the Plaintiff on 2nd October 2008 (hereinafter "the DBK Debenture"). The deponent noted that the PTA Bank consented to the DBK Debenture on the express condition and subject to the DBK Debenture being registered in respect of stocks and debtors to rank *pari passu* to the extent of the secured amount with the PTA Debenture. However, there was the proviso that, as long as any or all monies due to the PTA Bank under its Debenture were still due and owing, the distribution of the monies realised from the sale of all or any of the assets of the Company (save for assets specifically charged in the PTA Debenture) would be applied to and towards the repayments of the monies owed to the PTA Bank in preference and in priority to all creditors including the Defendant bank.
4. Mr. Rop then recounted that, upon his appointment, he had communicated with the Defendant bank and obtained information as regards the Plaintiff's accounts with the Defendant. He confirmed that at the time of his appointment as receiver and manager, the Plaintiff's fixed deposit account number 3 200722 026 with the Defendant bank was in credit in the amount of Shs. 83,729,403.60. He had raised his concerns with the Defendant that such credit balance, as well as others in favour of the Plaintiff, was apparently off-set on or about 20th April 2009, after his appointment on 6th April 2009. He obtained confirmation from the Plaintiff's director that the Company had never given any written instructions to the Defendant bank to off-set such fixed deposits. By letter erroneously dated 1st January 2010 rather than 1st February 2010, the Defendant bank informed Mr. Rop that it would not reverse the entries in the Plaintiff's account as the deposits were also pledged as security with the Defendant bank and that the Company allegedly knew that such would be applied to off-set the loan with the Defendant bank. Thereafter, demand was made by the Plaintiff's advocates for the immediate repayment of the said sum of

- Shs. 83,729,403.60. Mr. Rop had also been advised, by the Plaintiff's advocates on record, that the PTA Bank enjoyed priority in the payment of the sums held in the fixed deposit account with the Defendant bank, such priority being by virtue of its pre-registered Debenture.
5. The Defendant filed a Notice of Preliminary Objection dated 5th May 2010. It detailed the following reasons in objection to the Plaintiff's Application dated 27th April 2010:

“1. THAT the said application contravenes the mandatory provisions of the Civil Procedure Act and the rules made thereunder.

2. THAT prayer 1 of the said application is already spent and cannot be argued anymore.

3. THAT prayer 2 of the said application is incapable of being granted since it merely seeks orders that will immediately lapse once the application is heard.

4. THAT prayer 3 of the said application does not seek an interlocutory order, but on the contrary, seeks a final order which is exactly similar to what is sought in prayer (a) of the plaint. Accordingly the same cannot be granted at an interlocutory stage.

5. THAT this court has no jurisdiction under order 39 of the Civil Procedure Act to grant mandatory orders, whether interim or final.

6. THAT neither Section 95 nor Section 96 of the Companies Act (Cap 486) vests this court with jurisdiction to grant the orders sought in the said application.

7. THAT the said application is fatally defective since it offends the mandatory provisions of Rules 3, 4 and 5 of the Companies (High Court) Rules”.

6. One **Celestine Otieno**, the Company Secretary of the Defendant bank swore a Replying Affidavit dated 20th May 2010. At paragraph 4 thereof, the deponent detailed the true and proper position at law as regards the two bank Debentures. He maintained that the PTA Debenture and the DBK Debenture rank *pari passu* to each other with neither taking priority over the other. He further maintained that it was the Plaintiff's intention that, other than the DBK Debenture, there could be no other security executed by either party that would rank *pari passu* with, or in priority to, the PTA Debenture. The deponent then went on to say that a fixed charge as per the said Debentures could only fasten on the Plaintiff's currently existing assets at the time of execution. Consequently, the PTA Debenture only secured those of the Plaintiff's assets prior to and as at 31st January 2006. Similarly, the DBK Debenture created a fixed charge over the Plaintiff's debtors and book debts as at its execution date - 2nd October 2008. Mr. Otieno then made two pertinent points from the Defendant Bank's point of view:
- a. He maintained that the sums held by a banker as secured deposits are the property of such institution and are not summarily payable to a depositor's receivers.
 - b. That vide a Letter of Set-off dated 18th January 2007, the Plaintiff Company had deposited and secured the said sum of Shs. 83,729,403.60 in favour of the Defendant bank in order to cover various and subsequent advances and overdraft facilities made by the Defendant bank available to the Plaintiff. The said Letter of Set-off constituted a contract between the Defendant bank and the Plaintiff which binds the receiver in his capacity as the agent of the Plaintiff Company.

The Replying Affidavit concluded that the Defendant bank enjoys the common law right to combine its accounts. Accordingly, and independently of the said Letter of Set-off, the Defendant bank reserved the right to combine the Plaintiff's loan account with its Deposit account.

7. On the 13th May 2010, Njagi J. (as he then was) recorded that the parties had agreed by consent to deal with the Plaintiff's said Application by way of written submissions. Unfortunately, the learned Judge's Ruling was never written or delivered and it has fallen upon this Court to determine the said Application. The Plaintiff filed its initial written Submissions on 3rd June 2010 following them up with Supplementary Submissions, with the consent of this Court, filed on 21st March 2013. The Defendant filed its written Submissions on 21st June 2010. The Plaintiff opened its submissions with a summary of facts as well as summarising the salient conditions of the PTA Debenture of which this Court considered the most relevant to the Application as follows:

“The charges created by the Debenture would rank as a first fixed charge on and over all the properties thereby charged and as regards all immovable properties of the Company... And the Company would not be at liberty to create any mortgage or charge or other encumbrance upon any property and assets thereby charged to rank either in priority to or *pari passu* with or subsequent to the charge thereby created and otherwise except as provided.... It being the intention that the Company would not have power without the consent of the Lender to part with dispose of or alienate any part of the property and assets thereby charged...”

8. The Plaintiff maintained that at all material times, the Defendant was aware of the mandatory provisions contained in the PTA Debenture. It was apparent that after some toing and froing as between the Plaintiff and the Defendant, the Plaintiff submitted the following conditions governing the consent by the Plaintiff which were accepted by the Defendant:

“(a) The PTA Bank was the first secured creditor under and pursuant to a first ranking all-Assets Debenture dated 31st January 2006 created in its favour by Palm Healthcare International Ltd.

(b) The PTA Bank consented to Development Bank's debenture on the express condition and subject to the DBK Debenture being registered in respect of stocks and debtors as mentioned in the debenture, to rank *pari passu*, to the extent of the secured amount with the PTA bank debenture, as regards the stocks and debtors of the company, charged therein, provided that as long as any or all monies due to PTA bank under the PTA bank debenture existing and payable by the company, the distribution of monies realized from the sale of all and any of the assets of the company, save for assets charged in the written debenture, would, without any exception or reservation, be applied to and towards the repayment of the PTA bank loan, in preference and in priority to all creditors, including Development Bank of Kenya Limited other than creditors as are preferred by law”.

9. The Plaintiff then identified what it considered to be the issues for determination by this Court at paragraph 16 of its submissions as follows:

“16.1 To who was the balance standing to the credit of the Plaintiff's fixed deposit accounts belong to as at 20th April 2009.

16.2 Can the Defendant exercise a right of set-off based on an unregistered Letter of Set-off dated 18th January 2007?

16.3 What is the effect of the appointment of a receiver and manager on the fixed deposit amounts?

16.4 Which debenture enjoys priority?

16.5 Do the respective debentures rank *pari passu*?

16.6 Can the receiver and manager apply for directions under section 348 of the Companies Act?

16.7 Can a mandatory injunction issue?

10. The Plaintiff then submitted as regards each of the issues that, firstly, the Defendant was contractually obliged to make payment to the Plaintiff upon demand by the Plaintiff's receiver/manager of the amount held to the Plaintiff's credit as such property was covered by the PTA Debenture. Further, the Plaintiff submitted that the Letter of Set-off relied upon by the Defendant was simply a banker's lien. To this end, the Plaintiff referred to the **Modern Law of Banking by E. P. Ellinger 1987 Edition** at page 9 of the Plaintiff's Lists of Authorities which detailed as follows:

“A lien does not attach to the balance outstanding to the credit of the customer's account with his bank. The reason is clear: the funds in question represent a debt due from the bank to the customer, and not ‘money’ or cash owed by him. The bank's right in such a case is to effect a set-off against the credit balance involved in respect of debts due to it from the customer.”

And later in that treatise, the Plaintiff quoted therefrom as follows:

“The bank's lien gives it an effective security against the interests of competing creditors. There are, however, some restrictions on its effect. First, the lien is ineffective in respect of property which is not owned by the customer, although this point may be doubted in respect of negotiable instruments. In this last case, the bank has the benefit of the lien if it obtained the instruments in good faith and for valuable consideration. The second limitation to the effect of the lien is that it fails to protect the bank in respect of advances made after notice that the instruments had been mortgaged or assigned in equity to a third party.”

Interestingly enough, the sentence that I have underlined as above was left out of the Plaintiff's submissions when quoting from **Ellinger** at page 9 of the Plaintiff's List and bundle of Authorities. However, to finish off its submissions in this connection, the Plaintiff noted that the said Letter of Set-off was a security by way of an equitable charge over the Plaintiff company's property and the same would be void if not registered under section 96 of the Companies Act. The Plaintiff referred to the authority of **Monolithic Building Co. Tacon v Monolithic Building Co. (1914-15) All ER 249** as well as referring to **Paget's Law of Banking, 10th Edition 1989 at P. 523.**

11. The Plaintiff then went on to consider the position as to the effect of the appointment of a receiver and manager as regards the fixed deposit accounts held with the Defendant bank. Some emphasis in relation to priority was placed upon the finding of **Chitty J.** in **Ward v Royal Exchange Shipping Co. Ltd, ex parte Harrison (1887) 58 LT 174 at P. 178**, in which the judge held:

“If at the time when he advanced his money a mortgagee of a chose in action has notice of an existing mortgage, he cannot by giving the first notice to the debtor obtain any priority.”

Further, the Plaintiff quoted from **Paget** (supra) at page 185:

“Money paid into a deposit account is a loan to the banker, not a specific fund held by him in a fiduciary capacity”.

The issue of priority was further considered and emphasised by the Plaintiff by reference to the well-known textbook of **Bank Security Documents** by **J. R. Lingard** at paragraph 9.11 on page 159 in which the learned author had detailed:

“Unless a debenture contains an express prohibition against the creation of subsequent charges ranking in priority to or *pari passu* with the floating charge and the subsequent chargee has notice of the restriction (see ch 1), any later fixed legal or equitable charge created by the company – even in favour of a person who has actual notice of the floating charge – will rank in priority unless the floating charge had crystallised and the later chargee had notice of crystallisation before the later charge was created (para 9.28). All properly-drawn modern debentures do contain such a prohibition, for without it, the floating charge is virtually worthless.”

The case of **Robert Stevenson and Co. Ltd In re Poole versus The Company (1913) 2 CH. 201** was further quoted by the Plaintiff in relation to the question of priority between competing debentures. In that case, it had been found that the security of debenture stockholders under the second deed of debenture was postponed to that of the stockholders secured by the first deed. As a consequence, it was the Plaintiff’s submission that the DBK Debenture ranked second to the PTA Debenture and as a result the issue of *pari passu* did not arise. The Plaintiff noted that even if it did arise, the PTA Debenture was restricted in respect to stocks and debtors only. As if anticipating the Defendant’s submissions on the point, the Plaintiff detailed that **section 348** of the Companies Act expressly provided for a receiver and manager to apply for directions to Court when faced with the situation where the fixed deposit account had been illegally raided by the Defendant. Further, under **section 95** of the *Companies Act*, the receiver and manager had a statutory duty to make payments of certain debts out of the assets subject to a floating charge in priority to other claims under the charge.

12.As regards as to whether a mandatory injunction could issue arising out of an interlocutory application, the Plaintiff put before court the following authorities – **Morris & Co. Ltd v Kenya Commercial Bank (2003) 2 EA 605, Florence Makotsi & Anor v Fortune Properties Ltd HCCC No. 353 of 2006 (unreported), Kenya Railways Corporation v Thomas Nguti & Ors Civil Appeal No. 210 of 2004, Shepherd Homes Ltd v Sandham (1971) 1 Ch.340, Charrington v Simons & Co. Ltd (1970) 1 WLR 725, Stephen Kipkebut t/a Riverside Lodge & Rooms v Ogola Civil Application No. 146 of 2008, Shariff A. Hassan v Adan Civil Appeal No. 121 of 2005 which follow the Court of Appeal’s decision in Kamau Mucuha v The Ripples Ltd Civil Application No. 186 of 1992 as well as Safaricom Ltd v Oceanview Beach Hotel Ltd & Ors Civil Application No. 327 of 2009.**

The Plaintiff concluded its submissions by detailing the following:

“(a) Under section 95 of the Companies Act, the PTA Bank enjoyed priority in payment of the sums held in the fixed deposit account which in any event was money held in favour of the company.

(b) PTA bank enjoys priority by virtue of its prior registered debenture.

(c) The Defendant should be ordered to immediately credit the Plaintiff’s account or make payments to the Plaintiff’s receivership account forthwith and give credit for interest earned.

(d) The purported debiting of the company’s account was effected after the appointment of a receiver and manager to offset the defendant’s debt was in contravention of statute, contract and common law. This warrants the granting of the injunction.”

13. The Defendant’s submissions were equally as impressive running into almost 22 pages. The Defendant also detailed a summary of facts quoting extensively from the relevant provisions of the PTA Debenture clauses 1, 4 (b) and 4(f), 5, 13, 14 (a), 15 and 37. The Defendant then laid out the written consent of the PTA Bank (the Plaintiff) which was attached to the DBK Debenture as follows:

“We ... PTA Bank ... being the first secured creditor under and pursuant to an All Assets Debenture dated 31st January 2006 created in favour of PTA Bank by PALM HEALTHCARE INTERNATIONAL LIMITED ... HEREBY CONSENT to the DBK Debenture on condition and subject to the DBK debenture being registered in respect of stocks and debtors as mentioned in the said debenture to rank pari passu to the extent of the secured amount with PTA Bank Debenture as regards the stocks and Debtors of the company, charged therein provided that as long as any or all the monies due to PTA Bank under the PTA Bank Debenture existing and payable by PALM HEALTHCARE INTERNATIONAL LIMITED, the distribution of monies realized from the “SALE” of all and any assets of PALM HEALTHCARE INTERNATIONAL LIMITED save for the assets charged in the herein written debenture, shall without any exception or reservation be applied to and towards the repayment of PTA Bank loan in preference to and in priority to all creditors including Development Bank of Kenya”.

The Defendant noted that the Plaintiff company had opened fixed deposit accounts with the Defendant bank as they were perfectly entitled to do in law and as permitted by the PTA Debenture. Later on, the Plaintiff company wrote a letter to the Defendant entitled: **“Letter of Set-off”** giving its undertaking not to call back the said deposits until certain overdrafts, which had been granted to the Plaintiff company by the Defendant bank, were repaid. The Defendant submitted that the particular Letter of Set-off did not give the Defendant anything to which it was not already entitled as the Plaintiff’s bankers, as it already had the common law right to combine accounts known as the right to set-off. As a result the Defendant maintained the following conclusion:

“(a) THAT the earlier debts incurred by the Plaintiff before the execution of the DBK debenture and in respect of which the plaintiff had previously written the aforesaid letters of set-off were incorporated into the DBK Debenture as Clause 1 thereof clearly and expressly confirms. From that point onwards all past and future indebtedness of the plaintiff to the defendant was secured by the DBK Debenture aforesaid.

(b) THAT the right to set-off any sums due to the plaintiff against any outstanding loans due to the defendant which had previously been granted vide the aforesaid letter of set off (and which, as already pointed out, did not give the defendants anything to which they were not already entitled) was expressly preserved by clause 13 of the DBK Debenture”.

14. The Defendant set out what it then considered to be the procedural law issues as well as the substantive law issues. It submitted that the Application was fatally defective and noted that prayer no. 2 sought orders pending the determination of the application. In the Defendant’s view this technically meant that the orders would lapse as soon as they were granted. I could not really understand what the Defendant was getting at by this submission which, in my opinion, has been overcome by events, bearing in mind that no interim orders were granted at the initial hearing of the Application under Certificate of Urgency. Thereafter, the Defendant submitted that the orders sought in prayer no. 3 could not be granted because they were the same orders as sought in the main suit. In the Defendant’s view such orders could not be granted vide an interlocutory application. I would have thought that the long list of authorities as quoted by the Plaintiff in this connection as well as the inherent powers of the Court were authority enough to allow such orders to be made at the interlocutory stage. Further, I have little understanding of the Defendant’s submission in relation to prayer 4 of the Application which is expressed in the alternative and which seeks the comparatively simple Order that the monies standing to the credit of the Plaintiff company held in deposit accounts with the Defendant bank should be removed therefrom and placed in an interest earning account in the names of the Advocates for the Plaintiff and the Defendant. To maintain that this Order cannot be granted by this Court, because the advocates are not parties to the suit, is laughable, for all that the prayer seeks is that the advocates do act as stakeholders pending the determination of the suit. Finally under this heading, the Defendant’s

submissions that prayer nos. 5 and 6 cannot be granted being merely consequential orders again have no merit. The Defendant then submitted that the Plaintiff, as a limited liability company, had no right to apply for directions of the Court under **section 348** of the Companies Act. That right lay with the receiver/manager. To my mind, it is quite clear that the receiver/manager is the agent of the Company hence it would seem to be logical that the receiver/manager brings the application under **section 348** in the name of the Company.

15. The Defendant then made the point that under **Rule 9** of the *Companies (High Court) Rules* made under **section 344** of the Companies Act, it was clearly provided that an application for directions by a receiver or manager under **section 348** of the Act should be made by summons. The Defendant maintained that as the Application before Court was made by Notice of Motion, the same was fatally defective. To this end, it referred to the cases of ***Namukasa v Bukya (1996) EA 433*** and ***Kigoya v Attorney General of Uganda (1996) EA 463***. In quoting these two cases, the Defendant would seem to have ignored the fact that they were both decisions of the High Court of Uganda determined some 47 years ago and are merely persuasive so far as this Court is concerned. The Defendant would not seem to have taken cognizance of Article 159 (2) (d) of the Kenya Constitution, 2010 to **‘administer justice without undue regard to procedural technicalities’** nor indeed the provisions of **sections 1A and 1B** of the *Civil Procedure Act* as well as **Order 51 rule 10 (2)** which reads:

“No application shall be defeated on a technicality or for want of form that does not affect the substance of the application.”

16. Thereafter, the Defendant submitted that this Court lacks jurisdiction to grant a perpetual mandatory injunction under the provisions of **section 63 (e)** of the *Civil Procedure Act* nor under **Order 39 rules 1, 2, 5 and 9** of the Civil Procedure Rules. In my view **section 63 (c)** of the *Civil Procedure Act* is quite clear that the Court may grant a temporary injunction. The subsection does not distinguish the sort of injunction that the Court may grant and in my view, the Court would have power to grant a temporary mandatory injunction. Similarly, I do not understand the Defendant’s reference to the court lacking jurisdiction under **Order 39** as that Order deals with arrest and attachment before judgement and not injunctions. If the Defendant has got it wrong and it should be referring to **Order 40**, I again do not see its problem. Under that Order, a Court may grant temporary injunctions and interlocutory orders. Again, in my opinion, a temporary injunction could as well be a mandatory one or a prohibitory one. Thereafter, the Defendant made the point that there was no power under **section 95 or 96** of the *Companies Act* for the Court to grant any of the Orders sought in the Application. The Defendant submitted that the Plaintiff had not denied that the DBK Debenture was duly registered under the provisions of the Companies Act and consequently these two sections were irrelevant to the Application before Court. That is as may be but here again, the Defendant would seem to have ignored the provisions of **Order 51 rule 10 (1)** which reads:

“Every order, rule or other statutory provision under or by virtue of which any application is made must ordinarily be stated, but no objection shall be made and no application shall be refused merely by reason of a failure to comply with this rule.”

17. Moving onto its submissions with regard to substantive law issues, the Defendant put forward a number of matters for the consideration of this Court. The first question raised was as to the nature of the security rights created by both Debentures. The charging clauses therein had been worded differently. The PTA Debenture referred to “a first fixed charge”. The DBK Debenture created “a first fixed charge on the company’s debtors and book debtors and a floating charge as regards the company’s stock in trade”. The Defendant maintained that it was trite law that the Court would not be bound by the language used by the parties but rather by the legal effect or implication of the intention of the parties. It referred to the English case of ***Agnew & Anor. v Commissioner of Inland Revenue (2001) 2 AL 710*** quoting from **McCarthy J** in ***Re Keenan Brothers Ltd (1986) BCLC 242*** as follows:

“It is not suggested that mere terminology itself, such as using the expression ‘fixed charge’, achieves the purpose; one must look, not within the narrow confines of such

term, not to the declared intention alone, but to the effect of the instruments whereby they purported to carry out that intention.....”

In referring to this passage as well as the case of **Re Brightlife Ltd (1987) Ch. D 200**, the Defendant submitted that the wording left the debtor with the liberty to deal with the book debts were held as to have created floating charges and not fixed charges contrary to the language used therein. From this rather jumbled reasoning, I gathered that what it meant was that the Defendant bank was at liberty to deal with the said book debts and other debts in the ordinary course of the Plaintiff Company’s business.

18. The Defendant then went on to say that the PTA Debenture, as well as the DBK Debenture, created a floating security over the Plaintiff Company’s book debts and other debts. It submitted that what this Court needed to determine is the question of whether it was legally possible to create a floating charge over credit balances with a bank. In agreeing with the Plaintiff’s position, that the balance standing to the credit of a customer’s interest-bearing account is a debt due to him from the bank, the Defendant maintained that it does not follow that a security interest, whether described as fixed or floating, can be created over such debt. It pointed to the definition of a “book debt” in **Goode’s** textbook entitled **Legal Problems of Credit and Security, 3rd Edition (2003)** detailing that a book debt is a debt arising in the course of a trader’s business which is of a kind that would be entered into the books of accounts of the trader. The passage quoted by the Defendant went on to say that it was generally considered that money deposited by a trader with his bank does not give rise to a book debt, since although the banker is the trader’s debtor, the debt does not arise by way of trade but is merely a consequence of the deposit of surplus funds. The Defendant submitted that in accordance with **Re Brightlife** (supra) the credit balance held in a customer’s account with its bankers could not be charged to a third party either as a book debt or as any other debt. In my opinion, the passage in **Hoffmann J’s** Judgement in that case is worth repeating here as follows:

“If clause 3 (A) (ii) (a) stood alone, I might have been left in some doubt over whether ‘debts’ were being used in a commercial or strictly legal sense. But in my judgement the ambiguity is resolved by the use of the same words in clause 5 (ii), which prohibits Brightlife from dealing with its ‘book or other debts’ without the prior consent in writing of Norandex ‘otherwise than in the ordinary course of getting in and realising the same’. A credit balance at the bank cannot sensibly be ‘got in’ or ‘realised’ and the proviso cannot therefore apply to it. If ‘book or other debts’ includes the bank balance, the consequence is that Brightlife could not have dealt with its bank account without the written consent of Norandex. It would have had to obtain such consent every time it issued a cheque. The extreme commercial improbability of such an arrangement satisfies me that the parties used ‘book debts and other debts’ in a sense which excludes the credit balance at the bank.”

As a consequence of the above, the Defendant submitted that that the credit balance in the Plaintiff’s Bank account with the Defendant could not be brought within the charge created in either Debenture, notwithstanding the specific language used in the said Debentures.

19. The next submission put forward by the Defendant was whether such security interest could invalidate the Defendant bank’s common law rights to combine accounts and set-off what was due to the Defendant as against such credit balances. It maintained that where such a conflict arises, the right or interest created by the law will always enjoy a priority. To this end, it referred to the cases of **Channel Airways Ltd v The Lord Mayor, Aldermen and Citizens of the City of Manchester (1974) 1 Lloyd’s Law Reports 456**, **The Emilie Millon (1905) 2KB 817** and **George Banker Transport Ltd v Eynom (1973) 1 WLR 1461**. As regards the Defendant’s common law rights as to combining accounts, the Defendant referred to the cases of **Garnett v McKewan (1972) LR 8 EX10**, **Halesowen Presswork and Assemblies Ltd v Westminster Bank Ltd (1972) AC 785**, **Barclays Bank Ltd v Okenarhe (1966) 2 Lloyd’s Reports 87** and **Re Cushla Ltd (1979) 3 All ER 415**. Indeed, with reference to **Wadsley & Penn’s** textbook entitled **The Law Relating to Banking, 2nd Edition**, the Defendant maintained that the right to

combine accounts was so inveterate that in certain circumstances the bank has a duty to combine accounts. The conclusion arrived at by the Defendant, in relation to this point, was that the credit balance standing in a customer's account with the bank, can only be determined after considering the bank's right to combine accounts. As regards as to which one of the two Debentures enjoyed priority over the other, the Defendant's fairly simplistic submission in that regard, was that the two Debentures ranked *pari passu* with each other.

20. The Defendant's next submission was to the effect that priority as between the two Debentures did not mean that the subsequent (DBK) Debenture could not crystallise before the prior (PTA) Debenture. It noted that the Defendant bank had taken action to enforce its Debenture sometime in February 2009. At that stage, the charge created by the DBK Debenture crystallised leaving the PTA Debenture undisturbed. It was the Defendant's submission that it then became entitled to appropriate the proceeds of the credit balances in the Plaintiff's accounts with it. According to the Defendant, this meant that even if the Plaintiff's advocates' arguments as regards the priority of the PTA Debenture and even if the Defendant's right to combine accounts was to be denied, the Orders as proposed by the Plaintiff would still be clearly untenable. The Defendant's submissions then concluded that the effect of clause 13 of the DBK Debenture, which preserved the Defendant bank's right to combine accounts, was independent of and separate from its common law right. Clause 13 made it clear that such was not an independent security. The Defendant concluded that by virtue of clause 13, it was empowered by the Debenture to combine the Plaintiff's accounts held with it, at any time.
21. As detailed above, the Plaintiff's Supplementary Submissions filed herein on 20 March 2013 confined themselves to and only referred this Court to the case of **Habib Bank AG Zürich v Niazone (K) Ltd (In Receivership) (2012) 2 EA 163**. In that case, after due notice of the appointment of the receiver, the bank went ahead and debited the company's account ostensibly pursuant to its unregistered lien. **Sitati J.** in that case found:

“By the time that the appellant purported to exercise the set off (albeit without a judgement of the court to do so) the balance of KShs. 700,000 which stood to the credit of the respondent was already secured by the Barclays' Bank debenture that had crystallised into a fixed charge. Consequently, the appellant had no legal right to set-off the account.

A floating charge is an incomplete assignment until it crystallises. The primary duty of a Receiver is to the debenture holder who appoints him. The appellant had no legal right to utilise the KShs. 700,000 as set-off after the appointment of the Receiver and Manager. The credit balances in the account of the respondent with the appellant were security for the debt to Barclays Bank and was therefore not available for set-off by the appellant (*Re B Johnson and Co. (Builders) Ltd (1995) 2 All ER 775 applied*).

The appellant's lien which was created after a duly registered debenture could not be given priority over the debenture. In any event, the said Lien was never registered with the Registrar of Companies, thereby making the position of the appellant even more precarious and it remained an unsecured creditor (*Robert Stephenson and Co. Ltd In re Poole v The Company (1913) 2Ch 201; Security Trust Co. v The Royal Bank of Canada (1976) 1 All ER 381 applied*).”

The Plaintiff requested the Court to grant the Orders sought in the Application together with costs.

22. As detailed above, the Receiver and Manager of the Plaintiff company was appointed under the PTA Debenture on the 6th April 2009. The Letter of Set-off was exhibited to the Replying Affidavit as “CO 1” and was dated 18 January 2007. The same is in standard format, typewritten. The blanks in the document have been completed in longhand. It commits a Security of Fixed Deposit in the amount of US\$303,927.65 as against an overdraft for the Plaintiff Company in the amount of Shs. 18 million. The US\$ coverage was approximately one third more than the

overdraft amount. The reminder notices sent by the Defendant to the Plaintiff are dated respectively 18th August 2008, 27th November 2008 and 9th February 2009. By that latter date, the approved limits on the overdraft had stretched to Shs. 25 million and the amount allegedly of the outstanding balance was Shs. 29,791,906.81, according to the heading of the final reminder but was Shs. 30,435,532.55 as detailed in the body of that letter. Where the Replying Affidavit was silent was just when the Defendant combined the Plaintiff's Loan account with the Deposit account. However, the Affidavit in support of the Application sworn by the Receiver and Manager quite clearly details that, after enquiry, he had established that the accounts were combined on or about 20th April 2009, 14 days after his appointment. It seems to me that if the accounts had been combined prior to the 6th April 2009, the Defendant bank would be in a different position than it now is.

23. In this regard, I find that the matter before me reflects a similar situation as the case of **Habib Bank AG Zürich** (supra). In that case the court considered if an unregistered lien had priority over a debenture and **Sitati J.** found as follows:

“At page 150 of Kerr on the Law and Practice as to Receivers, (16 ed) by Raymond Walton, the learned author says the following regarding Crystallization of floating charges:

“The appointment of a receiver is one of the events which causes the floating charge to crystallize. The order operates from when the appointment becomes effective. The receiver becomes entitled to possession of the company's assets, and any interference with his possession is a contempt of court”.

It was submitted that a floating charge is an incomplete assignment until it crystallizes. In Re B Johnson and Co. (Builders) Ltd [1955] 2 All ER 775, the court held that the primary duty of a Receiver is to the debenture holder who appoints him. This is what Lord Evershed MR said with regard to the duty of the Receiver:

“it is quite plain that a person appointed as receiver and manager is concerned, not for the benefit of the company, but for the benefit of the mortgagee bank to realize the security, that is the whole purpose of the appointment”.

It is for the above reasons that the respondent submitted that the appellant had no legal right to set-off its debt after notification of the appointment of the receiver as the floating charge had already crystallized into a fixed charge and the money in the account now belonged to the respondent and secured the debt of Barclays Bank. After weighing and considering the judgment of the lower court, I am satisfied that the interpretation taken by the respondent was the correct one. There was therefore no error on the part of the trial court in reaching the conclusion that the appellant had no legal right to utilize the Kshs.700,000 as set-off after the appointment of the Receiver and Manager. The credit balance in the account of the respondent with the appellant was security for the debt to Barclays Bank and was therefore not available for set-off by the appellant.

On whether or not the debentures took priority over the appellant's lien, counsel for the appellant argued that this was not the case since the respondent had already issued authority to the appellant concerning the Fixed Deposit and as such, the appellant's lien took priority over the debentures. The respondent was of a different view and referred the court to paragraph 9.11 of Bank Security Documents by JR Lingard, 1993 in which the learned author says the following:

“Unless a debenture contains an express prohibition against the creation of subsequent charge ranking in priority to or *pari passu* with the floating charge and the subsequent charge has notice of the restriction – any later fixed legal or equitable charge created by the company even in favour of a person who has actual notice of

the floating charge – will rank in priority unless the floating charge has crystallized before the later charge was created. All properly-drawn modern debentures do contain such a prohibition; for without it, the floating charge is virtually worthless”.

And *Paget’s Law of Banking* (10 ed) 1989 at pages 524 to 525 says that “where a mortgage or charge is taken without notice of a prior encumbrance, the priorities between competing mortgages and charges over book debts appear to be governed by the date on which notice of the mortgage or charge is given to the debtor”.

In the case of *Robert Stephenson and Co. limited In re Poole v the Company* [1913] 2 Ch 201 the question that arose was the priority of competing debentures. The first debenture had restrictive clauses which prevented the company from creating subsequent debentures that would rank *pari passu* or in priority to the first debenture. Upon crystallization of the first security constituted by the first deed the question of priorities arose. It was held that the security of the debenture stockholders under the second deed was postponed to that of the stock holders secured by the first deed. This was also the case in *Security Trust Co. v The Royal Bank of Canada* [1976] 1 All ER 381.

In the instance case, it is clear that the appellant’s lien which was created after a duly registered debenture could not be given priority over the debenture. In any event, the said lien was never registered with the Registrar of Companies, thereby making the position of the appellant even more precarious and it remained an unsecured creditor”.

24. I ask myself whether the fact that the Defendant held the DBK Debenture made any difference to the lien position. That Debenture detailed that it ranked *pari passu* with the PTA Debenture but only in respect of the Plaintiff’s stocks and debtors. To this end, the finding in the **Brightlife** case as approved in **Agnew v Commissioner of Inland Revenue** (supra) that the credit balance held on the customer’s account with its bankers could not be charged to a third party either as book debts or as other debts, must be distinguished. A close examination of the charging clause of the PTA Debenture dated 31 January 2006 shows that it is an all asset Debenture even though clause 4 (b) *inter alia* details a first and fixed charge over all the Company’s goodwill, assets, book debts, income and property whatsoever and wheresoever both present and future. In the **Brightlife** case, the debenture therein specifically detailed a charge as against the company’s book and other debts.
25. The outcome of all the above is that I allow the Plaintiff’s Notice of Motion dated 27th April 2010 as regards prayer 3 thereof. The Plaintiff will also have the costs of this Application.

DATED and delivered at Nairobi this 31st day of July, 2013.

J. B. HAVELOCK

JUDGE