



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI

COMMERCIAL AND ADMIRALTY DIVISION

CIVIL SUIT NO. 37 OF 2003 (FORMERLY HCCC NO 6868 OF 1992)

ANDREW GREGORY (Suing as LIQUIDATOR of and on behalf of EAST AFRICAN ROAD SERVICES LTD [in liquidation].....PLAINTIFF

- VERSUS -

AMERALLY RAHEMTULLA KASSIM-LAKHA.....1ST DEFENDANT
ABDULAZIZ GADRUDIN HARJI.....2ND DEFENDANT
HARISCHANDRA RAICHAND SHAH.....3RD DEFENDANT
SHELUFU LIMITED.....4TH DEFENDANT

JUDGMENT

1. The plaintiff is the liquidator of East African Road Services Limited. On or about 18th October 1990, the company issued a debenture in favour of the 4th defendant to secure repayment of Kshs 15,000,000 advanced to the company. That debenture appears as document number 23 in the agreed bundle of document. In addition, and according to the terms of the debenture the company executed and delivered to the 4th defendant legal charges over immoveable properties.
2. On 14th December 1990, the 4th defendant appointed the 1st, 2nd and 3rd defendants as receivers and managers of the company. On 16th April 1991, Kenya Shell Limited presented a winding up petition against the company in Nairobi winding up Cause No 11 of 1991. On 7th November 1991 the High court issued a winding up order against the plaintiff company.
3. Granted those facts, the plaintiff pleaded in a plaint dated 23rd December 1992 and as amended on 20th January 1993 that those securities constituted a fraudulent preference in favour of the 4th defendant. The plaintiff also sought a declaration that the appointment of the receivers was invalid; an order for delivery of the plaintiff's assets, monies, interest thereon and for a full account.
4. The parties entered into a formal consent that the matter be determined by way of case stated for the opinion of the court. The consent is set out in a letter dated 21st October 2010 and filed in court on 22nd October 2010. The letter is under the hand of the plaintiff's and defendants' counsels and provides as follows;
 - a) That the plaintiff's suit against the Defendants, being Milimani HCCC No. 37 of 2003 (formerly HCCC No.6868 of 1992) do proceed for hearing by way of case stated for the opinion of the Court.

b) That the issues to be determined by the Court should be:

“Whether there was a fraudulent preference in favour of the 4th Defendant in terms of section 312(1) of the Companies Act by the issuing of the securities to the said 4th Defendant on 18th October 1990 in view of the fact that a winding up petition was presented against the company on 16th April 1991 and subsequently, a winding up order issued on 7th November, 1991”.

If the court makes a finding that there was a fraudulent preference in favour of the 4th Defendant in terms of S.312 (1) of the Company’s Act then whether the Defendants are jointly and severally liable to account and pay together with interest thereon from the date of filing suit until payment in full to the Plaintiff in respect of all their dealings with the assets of the company and the proceeds of sale of the same which they have disposed of since the 14th December 1990.

“Whether the debenture issued on 18th October 1990 to the 4th Defendant is invalid in terms of section 314 of the Companies Act as to render the appointment of the 1st, 2nd and 3rd Defendants invalid and as to require the 1st, 2nd and 3rd Defendants to account for and pay to the Plaintiff together with interest thereon all funds realized during their tenure as receivers”.

c) That Parties to file their agreed bundle of documents and statements facts within 30 days from the date hereof.

d) That Parties to file and serve their respective written submissions on or before the 31st January 2011.

The parties have also filed an agreed bundle of documents dated 26th November 2010 admitted in evidence.

5. The entire rubric of the plaintiff’s case turns on the validity of the securities and whether they constituted a fraudulent preference. The plaintiffs position is that the charges and debentures are void having been made on 18th October 1990 which was within 6 months of commencement of the winding up proceedings as per section 312 (1) of the Companies Act.

6. The defendants’ case on the other hand is that on the date of creation of the securities, the plaintiff company was not insolvent. The defendant concedes that in the years 1989 and 1990 the company was experiencing “temporary” financial difficulties. The 4th defendant, at the request of the company and in conjunction with the latter’s bankers Standard Chartered Bank agreed to lend the company Kshs 15,000,000. The defendant submitted that a valid resolution of the company dated 15th August 1989 was executed authorizing the borrowing. As a result of negotiations between the company, the bank and the 4th defendant, there was delay in transfer of the securities to the 4th defendant. The bank eventually agreed to alter its securities which paved the way for the 4th defendant to create the securities in issue on 18th October 1990. It is thus the defendants’ case that the lending was made in 1989 and the securities were prepared way back on 22nd August 1990. They were not in any way prompted in any manner by the winding up notice or petition.

7. Before delving further into the facts or issues, it is instructive that the parties are proceeding by way of a case stated. At the time the parties entered into the consent of 21st October 2010, the operational provision was order XIV rule 6 of the old civil procedure rules which provides;

“Where the parties to a suit are agreed as to the question of fact or of law to be decided between them, they may state the same in the form of an issue and enter into an agreement in writing that, upon the finding of the court in the affirmative or the negative of such issue –

(a) a sum of money specified in the agreement, or to be ascertained by the court or in such manner as the court may direct, shall be paid by one of the parties to the other of them, or that one of them be declared entitled to some right or subject to some liability specified in the agreement; or

(b) Some property specified in the agreement and in dispute in the suit shall be delivered by one of the parties to the other of them, or as that other may direct; or

(c) One or more of the parties shall do or abstain from doing some particular act in the agreement and relating to the matter in dispute”.

That provision is to a large extent *pari material* with order 35 of the Civil Procedure Rules 2010. This court is thus proceeding upon the agreed statement of issues captured in the consent, the agreed bundle of documents and the written submissions of the parties in its judgment.

8. The starting point is section 312 (1) of the Companies Act which provides;

“312. (1) Any transfer, conveyance, mortgage, charge, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding up which, had it been made or done by or against an individual within six months before the presentation of a bankruptcy petition on which he is adjudged bankrupt, would be deemed in his bankruptcy a fraudulent preference shall in the event of the company being wound up be deemed a fraudulent preference of its creditors and be void accordingly”.

The section is in simple English and its natural or ordinary meaning does not call for detailed use of the canons of statutory interpretation.

9. The next point is the meaning and test of a fraudulent preference. In short, was there an intent on the part of the plaintiff company to prefer the 4th defendant over all its other creditors and was that preference fraudulent? The meaning and test of a fraudulent preference are well settled. In Re Modern Retreading Company Limited [1967] E.A 182 at 190 the court stated;

“It is well established that the test of a fraudulent preference is the intent to prefer one creditor over other creditors”.

A more detailed definition is found in Halsbury’s Laws of England 3rd edition Volume 6 paragraph 1354;

“Any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding up which, had it been made or done by or against an individual within six months before the presentation of a bankruptcy petition on which he is adjudged bankrupt, would be deemed in his bankruptcy a fraudulent preference, is, in the event of the company being wound up, to be deemed a fraudulent preference of its creditors, and is invalid accordingly”.

Paragraph 1355 of the same treatise states that the preference “is deemed fraudulent when the substantial and dominant motive in the mind of the debtor was to prefer one creditor or particular creditors”.

10. Palmer’s Company Law 22nd edition volume 1 Stevens & Sons, London, at page 929 has a similar definitions at paragraphs 81 – 79;

“For a transaction to constitute a fraudulent preference. It must appear that the transaction took place within six months of the commencement of the winding up, and that the dominant motive in the mind of the company acting by its directors, was to prefer the creditor. If these requirements are satisfied, the transaction is deemed to be fraudulent; it is necessary to prove that any moral blame attaches to the company. If the payment, etc was made by the directors with a view to shielding themselves from civil or criminal proceedings, or otherwise under pressure from the creditor this is not a fraudulent preference; and the same principle has been held to apply where the dominant intention of the company is not to confer an advantage on the creditor, but to benefit the company by keeping on good terms with the creditor”.

The plaintiff’s key evidence is that the 4th defendant, at the time of creating the debenture on 18th October 1990 was a substantial shareholder of the chargor and a creditor.

11. Now, it is a cardinal precept of law of evidence that he who alleges a fact must prove it. See Koinange and 13 others Vs Koinange [1986] KLR 23. See also Peat Vs Gresham Trust Limited [1934] ALLER 82 at 87. The plaintiff needs to satisfy the court that there was a fraudulent preference here containing the key elements of a fraudulent preference laid down by the statutes and law above. Those elements are well summarized by H.Picarda in The Law Relating to Receivers and Managers (1984) Butterworth's, London page 140;

“The burden of establishing that a particular charge constitutes a fraudulent preference voidable in the winding up falls on the liquidator. It is for him to demonstrate that the relevant conditions prescribed by section 44 are satisfied. There are six such conditions. These are (1) that the charge was executed within the objectionable period (2) that the charge is or satisfies the description of one of the types of transactions specified in the section (3) that it occurred at a time when the company was insolvent in the sense specified in the section (4) that the charge stood in relation of creditor to the company (5) that the effect of the transaction was to give the charge a preference priority or other advantage over the other creditors (6) that the company acted with the view of giving the charge a preference priority or other advantage over the other creditors. The last of these conditions places upon a liquidator a heavy burden. For this reason receivers are less frequently faced with impeachment of their receivership on the ground of fraudulent preference”.

I would now examine the evidence in relation to the parameters of the law set out above. It is common ground that some time in 1989, the 4th defendant advanced to the plaintiff company a sum of Kshs 15,000,000. Document number 19 in the agreed bundle confirms, and there is an admission by E.H Malik in the letter dated 24th January 1990 that the 4th defendant had advanced those sums. Those amounts were not formally secured until 18th October 1990 by the creation of the debentures and charges aforementioned. The 4th defendant states that the debentures and charges were supported by the resolution of the company dated 25th August 1989 and were lying in the company's lawyers offices as far back as 22nd August 1990.

The 4th defendant submits that at that time and even as late as 18th October 1990 the company was solvent. The defendant relies on the audit report of Price Waterhouse Coopers (pages 19 – 25 of agreed bundle indicating that as at 31st March 1990 the company's assets exceeded its liabilities by Kenya 1,302,062. At page 26 and 27 of that report the assets were Kshs.74,380,000 while liabilities were Kshs 69,380,000 as per the statement of affair. The plaintiff's view is that a company can only be said to be solvent if it is able to pay its debts as and when they fall due. I prefer the definition of solvency at section 220 of the Companies Act which provides;

“220. A company shall be deemed to be unable to pay its debts:-

- (a) If a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding one thousand shillings then due has served on the company, by leaving it at the registered office of the company, a demand under his hand requiring the company to pay the sum so due and the company has for three weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor; or
- (b) If execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or
- (c) If it is proved to the satisfaction of the court that the company is unable to pay its debts, and in determining whether a company is unable to pay its debts the court shall take into account the contingent and prospective liabilities of the company”.

12. I find on the evidence that the 4th defendant held 49 % equity in the plaintiff company. I say so in view of the minutes of the board dated 25th August 1989 (page 5 and 6 of agreed bundle) and a letter of its lawyers to Standard Bank dated 23rd February 1989 (page 33 of agreed bundle). It was to be paid a technical and advisory fee of 2 ½ % of the gross revenues of the company and interest on loans advanced. The 4th defendant says it waived both the fee and interest in good faith and that all monies

received by it from its receivers were utilized to pay off the debts. This is evidenced by receipts exhibited at pages 28 to 32 of the agreed bundle of documents. From the documents at page 73 of the bundle it seems that some directors of the chargor were also directors of the 4th defendant.

13. I have stated, in agreement with the authorities, that the onus of proving a fraudulent preference is on the plaintiff. This must be demonstrated by cogent evidence or must be clearly inferred from a set of circumstances. I would go back to the holding in Peat Vs Gresham Trust Limited [1934] AC 252 at 262;

“It is contended on the appellant’s behalf that once given the withdrawal and the consequences of the withdrawal, then in the absence of any other explanation the intent to prefer must be inferred, because a man is presumed to intend the natural consequences of his act. My Lords, I do not accept this contention. In my opinion in these cases the onus is on those who claim to avoid the transaction to establish what the debtor really intended, and that the real intention was to prefer. The onus is only discharged when the court upon a review of all the circumstances is satisfied that the dominant intent to prefer was present. That may be a matter of direct evidence or of inference, but where there is not direct evidence and there is room for more than one explanation it is not enough to say there being no direct evidence the intent to prefer must be inferred”.

14. The plaintiff submitted that it has fulfilled the preconditions set by section 312 (1) of the Companies Act. The plaintiff also says that it has met the 6 conditions I mentioned earlier by H. Picarda in The law Relating to Receivers and Managers (Supra) at page 140. I think it is important to reflect further on the plaintiff’s views in that regard. First, the company created the charges and debentures on 18th October 1990, within 6 months of commencement of winding up on 16th April 1991. Section 226 (1) and (2) of the Companies Act provides;

“226. (1) Where, before the presentation of a petition for the winding up of a company by the court, a resolution has been passed by the company for voluntary winding up, the winding up of the company shall be deemed to have commenced at the time of the passing of the resolution, and unless the court, on proof of fraud or mistake, thinks fit otherwise to direct, all proceedings taken in the voluntary winding up shall be deemed to have been validity taken.

(2) In any other case, the winding up of a company by the court shall be deemed to commence at the time of the presentation of the petition for the winding up”.

The plaintiff also placed reliance on documents numbered 1 in its supplementary bundle, documents 5, 6 and 7 at pages 18, 26 and 33 respectively of the agreed bundle to show that the company was not solvent. It also made reference to the letter of E.H. Malik of 24th January 1990 that I have dealt with earlier. The question is whether that evidence discloses a fraudulent preference or whether one can be inferred in the circumstances. To answer that question, it is important to look at the key terms of the debenture and charges. It was an express term of the debenture of 18th October 1990 that the plaintiff charged all its property, undertaking, goodwill, book debts and assets then and in the future the 4th defendant (page 55 of agreed bundle). The charge created by the debenture over the immovable assets was a first fixed charge extending to the moveable assets to constitute a ranking floating charge (document 23 of agreed bundle). There is evidence that the company was indebted to other creditors from the statement of affairs at page 26 of the bundle. That is why the plaintiff claims that the debenture and charges of 18th October 1990 amounted to a fraudulent preference.

15. In my mind, what is central is whether the company in acting that way had a dominant or real motive of preferring the 4th defendant over the other creditors. The plaintiff says this should be inferred from the fact that the 4th defendant appointed the 1st, 2nd and 3rd defendants as its receivers barely 2 months after creating the debenture. I think that is a strained construction from the evidence and the law. I have already referred to the audit report of Price Waterhouse Coopers (pages 19 – 25 in the bundle) stating that as at 31st March 1990 the company’s assets exceeded its liabilities. Secondly, the lending had taken place in 1989.

This is clear from the letter of E.H. Malik of 24th January 1990. Clearly the debentures and charges of 18th October 1990 were to secure a pre-existing lending or condition. It is from this set of circumstances that the dominant intention of the company must be measured to determine whether there was a fraudulent preference. To the earlier holding in *Peat Vs Gresham Trust Limited* [1934] AC 252, I would add Words and phrases, legally defined 3rd edition, London, Butterworths at page 282;

“I have always understood that to ascertain whether there has been a fraudulent preference, it is necessary to consider what the dominant or real motive of the person making the preference was, whether it was to defraud some creditors by preferring others, or for some other motive’. *New, Prance & Gerrard’s Trustees Vs Hunting* [1897] 2 QB 19 at 29, per Smith LJ”.

On the evidence, I am satisfied that in the year 1989, there were negotiations between the 4th defendant and the plaintiff bankers Standard Chartered Bank (pages 33 – 54 of bundle). It is also evident from the bank’s letter to the lawyers of the company dated 16th October 1989 (pages 16 – 18 of agreed bundle) and the banks letter to E.H. Malik, the company’s general manager of 29th August 1989 (pages 14 and 15 of bundle). From the minutes of the plaintiff’s board of directors (pages 5 to 12 of bundle) the company resolved to borrow Kshs 15,000,000 from the 4th defendant on 25th August 1989. I have already made reference to pages 19 – 25 of the bundle containing the audit report for that period stating the company was solvent. I find that the negotiations between the bankers, the company and the 4th defendant held up the registration or perfection of the securities. I would find that the securities were thus securing a pre-existing debt or condition on 18th October 1990. If that is the intention, guidance is found in *Re William Hall (contractors) Limited* [1967] 2 ALL ER 1150 in the final paragraph;

“Counsel for the liquidators submitted that if (contrary to my opinion) the bank were wrong on the first point, the provision contained in cl. 8, proviso (ii) of the legal charges amounted to a fraudulent preference of the bank and is accordingly void under section 320 of the Companies Act, 1948. I reject this submission and find as a fact that the benefit of that provision was not given to the bank with a view to giving it a preference. In my judgment the company’s intention in executing the legal charges was simply to carry out its pre-existing obligation under the memoranda of deposit. In these circumstances, I make an order in the terms of the summons”.

I would also refer to *Re F & Stanton Limited* 1929 1 ch 180 at 192;

“It has long been held, commencing with the case of *Bills vs. Smith* (1), a case of great authority, that if moneys are advanced on an actual obligation by the debtor to give security, the giving of that security on the verge of bankruptcy does not constitute a fraudulent preference: and such cases as *Ex parte Hodgkin* (2) recognize that to be law”.

I am then unable to say that when the 4th defendant created the securities on 18th October 1990, notwithstanding that winding proceeding commenced within 6 months thereafter, that its dominant intention was to create a fraudulent preference. In reaching that conclusion, I am guided further by the holding in *Re Modern Retreading Company Limited* [1967] E A 182 at 190.

“It is well established that the test of a fraudulent preference is the intent to prefer one creditor over other creditors. (See *Re Stenotyper Ltd., Hastings Brothers v. Stenotyper Ltd* a preference did, in fact, materialize but as it was held that the purpose of the company was to safeguard its chairman and not to prefer a creditor, the transaction was not void as a fraudulent preference. As I have said, I think the facts show that the directors concerned;

“Thought that their company was about to enter better days with the quarrels with the petitioner apparently settled and the company beginning to make a trading profit. In these circumstances, they decided to vote themselves a share of the profits without any thought that the company would be wound-up or that other creditors would not, in due course, be paid. For these reasons, I think the rejection of the claim as a fraudulent preference was not well-founded and the application on those grounds succeeds”.

16. I have not seen direct evidence of that intention. And the totality of all those circumstances do not lead me to infer that the dominant intention of the company was to create a fraudulent preference in favour of the 4th defendant. It then follows that the liquidator has not discharged his onus fully to establish the intention of the debtor was to fraudulently prefer the defendants. My answer to issue number 1 is thus in the negative. From the analysis, and particularly the audit reports aforementioned, I find the securities were not voided by section 314 of the Companies Act.

17. I am satisfied that the debenture and charges of 18th October 1990 were to secure prior borrowings of 1989. The plaintiff submitted that no equitable charge had been created as no title documents had been deposited with the 4th defendant. I note title number Kisumu/Block/2/13 had been so deposited. It was however a title registered under the Registered Land Act. The plaintiff relies on a passage in PL Onalo *Land Law and Conveyancing in Kenya* (1986) at pages 133 – 134 that an RLA title cannot be the basis of creation of an equitable mortgage. I do not find that argument entirely persuasive. But in the event I am wrong, I am fortified by the evidence that one of the legal charges of 18th October 1990 created was over that title Kisumu/Block 2/13 earlier deposited with the 4th defendant. I do accept the legal proposition that no charge or debenture was created in September 1989 for want of formalities and registration. Here I am guided well by the decisions in *Manchester Outfitters Suiting Division Ltd and another Vs Standard Chartered Financial Services Ltd and another* [2002] 2 KLR 590 and *Ganijee Glass Mart Limited & others Vs First American Bank of Kenya Limited* Nairobi HCCC 1821 of 1999 (High Court, unreported) as well as sections 20 and 32 of the Registration of Titles Act and section 109 of the Registered Land Act. What I have found is that there was no fraudulent preference in terms of section 312 of the Companies Act.

18. Having so found, it follows that the second limb of issue number 2 has no platform to lie on. Since I have not found that the company made a fraudulent preference in favour of the 4th defendant, the appointment of the 1st, 2nd and 3rd defendants as receivers cannot be impeached. I have not seen a rebuttal of the receipts and payments at pages 28 to 32 in the bundle. Those receipts and payments show that the monies received by the 4th defendant from the 1st to 3rd defendants (receivers) under the securities were employed by the 4th defendant to pay the plaintiff's debt. So that if the 4th defendant was endeavouring to keep the company afloat, and had waived its interest on loans as well as technical and advisory fees of 2 ½ % aforementioned, it would be inconsistent to say in the same breath that it had a dominant intention to create a fraudulent preference. For the same reason, I would find that the 4th defendant is not liable for an account to the liquidator or for interest claimed for dealings with the assets of the company from 14th December 1990.

I have already found that the securities were not voided by section 314 of the Companies Act as to render invalid the appointment of the 1st to 3rd defendants as receivers. It would then follow that I cannot order for an account to the plaintiff in the terms proposed by the plaintiff at issue numbered 2 in the letter of consent aforementioned. Having so found, the plaintiffs prayers for declarations and orders numbered (a) (1 – viii), (b) (i – viii) and (c) in the amended plaint have not been proved on a balance of probabilities. It follows that the substratum for prayers for general and special damages have collapsed. I find that the defendants are not liable to the plaintiff for general or special damages.

19. The plaintiff prayed in the amended plaint and in its submissions for an order for general damages. But this matter is proceeding by way of a case stated for the opinion of the court. The parameters for the case stated under order XIV rule 6 and 7 of the old Civil Procedure Rules and the specific agreement of issues put to the court are well laid out in the letter of consent dated 21st October 2010. The way the issues for the case stated for the court's opinion were drawn were limited and specific. Once a finding was made that the debenture and charges were valid and that there was no fraudulent preference, the other prayers by the plaintiff fell by the way side. The case stated for the opinion of the court did not specifically call for assessment of general damages.

And having found earlier that such damages do not lie, I would decline the prayer for general and special damages. I accept as a general proposition that the net worth of the company including the immoveable

assets charged to the 4th defendant and as per the valuations by C.P Robertson-Dunn and Lloyd Masika Limited were about Kshs 38,050,880 in 1991. They would have formed a fair basis for general damages in the event that the securities or appointment of receivers were voided. Lastly, I note that no claim for special damages was specifically and particularly pleaded in the amended plaint. That became fatal to the claim for special damages. I would thus in the result dismiss the plaintiffs suit.

20. Costs would normally follow the event. In this case, I do note that the plaintiff company was wound up on 7th November 1991. The 4th defendant was a substantial shareholder of the plaintiff company. The 4th defendant had appointed the 1st to 3rd defendants as receivers of the plaintiff company under an instrument of debenture in its favour. Granted all of those circumstances, the age of the suit and the competing claims by the parties that were the subject of the suit, I order that each party shall bear its own costs.

DATED and **DELIVERED** at **NAIROBI** this 20th day of December 2011.

G.K. KIMONDO
JUDGE

Judgment read in open court in the presence of

Ms Dar for the plaintiff.

Mr. Wetangula for Nyaoga for the Defendants.