



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI (MILIMANI COMMERCIAL COURTS)

Civil Suit 336 of 2000

COMMERCE BANK LIMITED.....PLAINTIFF

VERSUS

KUKOPESHA LIMITED.....DEFENDANT

J U D G M E N T

The Plaintiff, COMMERCE BANK LIMITED, has sued the Defendants, KUKOPESHA LIMITED as acceptor of Promissory Bills discounted by it to MUSICRAFT MANUFACTURING LIMITED (hereinafter referred to as Musicraft) in 1995. The Plaintiff's case is that on various dates between November, 1996 and January, 1997 the Defendant drew nine Promissory Notes in favour of Musicraft (In Receivership) in the sum of Kshs.4,230,560/-. The Plaintiff claims that it discounted the said Promissory Notes to the benefit of Musicraft and that Musicraft endorsed the Promissory Notes in favour of the Plaintiff who became holder for value. The Plaintiff claims that the Defendant became the acceptor pursuant to Section 90(2) of the Bills of Exchange Act (hereinafter referred to as the Act).

The Plaintiff's case is that the Bills were not honoured in full on their due dates, in breach of the agreement between the parties and that it automatically converted the debt into a loan account as per the said accommodation. The Plaintiff claims against the Defendant, the acceptor of the said Bills, the sum of Kshs. 5,618,219.45 as at 30th June, 1999, with interest from that date at 30% p.a. until payment in full.

The Defendant has denied the claim in the amended statement of defence. The Defendant admits that it drew certain Promissory Notes in favour of Musicraft, and that they were made solely for the accommodation of Musicraft without any consideration, and that therefore the Defendant was not liable to pay. The Defendant denies that it endorsed the Promissory Notes to the Plaintiff or that the notes were negotiated for the Plaintiff, and avers that therefore it was not the acceptor of the Notes. The Defendant denies that the said Bills were discounted by the Plaintiff to the benefit of Musicraft or that there was any endorsement or valid endorsement of the Notes by the Defendant.

The Defendant invokes section 45 of the Act and claims that the Defendant's liability if any was discharged under that provision. The Defendant challenges the Plaintiffs' claim for lack of particulars regarding the terms of the agreement pleaded in paragraph 5 of the plaint and which the Plaintiff alleged was breached. The Defendant pleads further that if the bills were dishonoured, the Defendant was never notified of the said dishonour and that therefore it was fully discharged from liability.

The Defendants has also pleaded that the Plaintiff changed the terms of the agreement and made a new

agreement with Musicraft whereby it converted the total aggregate amount due on the Agreement to a long term loan and that therefore, by virtue of novation, the Defendant was fully discharged of any liability there under.

Each party called a witness to testify on its behalf. The Plaintiff called James Nyanjui Nyingi one of its employees. The gist of his evidence was that the Plaintiff company sold its business to Giro Commerce Bank and that the Plaintiff is no longer in existence. Ms. Kirimi for the Plaintiff contradicted Mr. Nyingi's evidence and submitted that the Plaintiff company was still in existence but that it no longer provided Banking services.

Regarding the Plaintiff's claim, Mr. Nyingi testified that Musicraft was offered Kshs. 5 million at its request for working capital at the rate of 22% interest per annum. Mr. Nyingi testified that it was also agreed that the Plaintiff would discount genuine third party bills in favour of Musicraft but reserved the right to recourse to Musicraft in the case of default by third parties. Mr. Nyingi stated that pursuant to their agreement the Plaintiff received seven Promissory Bills, (which he produced as exhibits) and discounted them to Musicraft. He produced the application from Musicraft as Plaintiff exhibit. Mr. Nyingi testified that on their due date, only part payment was made on Bill No. 090. He stated that the rest of the Bills were dishonoured. Mr. Nyingi testified that the dishonoured Bills were transferred, as part of normal banking practice, to Unpaid Bills Discounting Account. He denied that the bills were converted to a loan account. Mr. Nyingi concluded by stating that no notice of dishonour was served on the Defendant as it was not necessary, but that a demand notice was however served. Mr. Nyingi stated that as per the Musicraft Statement of Account and as per the Bills they produced in court, their aggregate sum was Kshs.3,334,410/- and that the Plaintiff was seeking judgment for that sum.

The Defendant called the Managing Director of the Defendant Company Mr. NAJU JIWA. Mr. Jiwa admitted that he agreed to sign Promissory Notes for the accommodation of Musicraft Limited, owned by his brother in law now deceased. Mr. Jiwa testified that verbally the agreement between them was that the Promissory Notes would not be discounted and that no consideration was payable. Mr. Jiwa testified that in his understanding, Credit and Commerce Finance Limited was to hold the Promissory Notes as accommodation bills. That was in 1995. Mr. Jiwa said that after endorsing the Bills he never heard from either Musicraft or the bank until 1997 when Musicraft Limited went into Receivership. Mr. Jiwa testified that on 20th November, 1998, 1 ¾ years after the due date on the last Promissory Note (the due date was 9th April, 1997) the Defendant received a letter of demand from Commerce Bank, demanding Kshs.5,224,216/75 within 5 days. That he immediately contacted his brother in law who assured him not to worry as everything was in control. That it was not until 16th February, 1999, two weeks after his brother in law, Mr. Karan, had passed on, that the Bank wrote to Musicraft Limited, then under receivership for 2 years, copied to the Defendant company saying that since Musicraft failed to pay, Kukopesha Limited would be enjoined in a suit to pay the Bills.

Mr. Jiwa drew the courts attention to the Musicraft Statement of Account to the fact that Mr. Karan had been servicing the loan account through regular payments until his death. Mr. Jiwa finalized by stating that the Defendant was never given any notice of dishonour of the promissory notes as the law required.

The Plaintiff's Advocate filed a statement of Agreed issues dated 26th February, 2003. In it four issues are raised as follows:

1. Did the Plaintiff grant financial accommodation to MUSICRAFT (K) LTD (now in Receivership) by way of Bills Discount Facility?
2. Did the Defendant draw Bills in favour of MUSICRAFT?
3. Is the Defendant liable to the Plaintiff on account of the said Bills?
4. Who is to pay the costs of the suit?

Before considering these issues, there is a preliminary point which the Defendant has raised and I propose to begin with it. It is the Defendant's contention that the Plaintiff had no capacity to bring forth this claim for the reason that the initial Agreement, which is the subject matter of the suit, and which is found at pages 1 to 4 of P. exhibit 1, was between the Defendant Messrs Musicraft Manufacturing (K) Ltd. and Credit & Commerce Finance Limited. It was the Defendant's contention that the Plaintiff's witness, an employee of Giro Commercial Bank, did not produce any document to show the nexus between Giro Commercial Bank and the Plaintiff.

The Plaintiff has challenged the Defendant's issue with the Plaintiff's capacity to bring this suit. The Plaintiff contends that the description of the Plaintiff and its capacity to bring the suit was spelt out in the plaint. Under the plaint the Plaintiff was described as previously known as Credit & Commerce Finance Limited and that it was while known in that name that it offered to a company known as Musicraft Manufacturing (K) Limited a Bills discounting facility which is in issue in this case. The witness who testified for the Plaintiff stated that the Plaintiff took over Credit & Commerce Finance Limited together with all its liabilities and assets and that is how it brought the instant suit.

Perhaps the most important point is that the capacity of the Plaintiff was not made an issue in the Defendant's statement of defence and it cannot raise it at this point. Having not raised it in the pleadings, and having not made it an issue for determination by the court, I do find that it is an afterthought for the Defendant to raise the issue at the stage of the hearing of the case. I will dismiss that issue for that reason.

Regarding the issue whether the Plaintiff granted financial accommodation to Musicraft (K) Limited by way of Bills Discount Facility and; the second issue whether the Defendant drew Bills in favour of Musicraft. The Defendant contends that the Promissory Notes which are the subject of the suit, were not Bills of Discount but were what it referred to as Favour Bills. Mr. Jiwa for the Defendant contended that the Promissory Bills were merely for the accommodation of Musicraft as holding notes and were never meant for a Discounting Facility. The Defendant contends that on the face of the Promissory Notes the column indicating value received for the Promissory Note was blank and that therefore, they could not have been a Bill for a Discounting Facility as they did not comply with section 27(1) of Bills of Exchange Act. That section stipulates as follows:

"27(1) Valuable consideration for a bill may be constituted by –

(a) any consideration sufficient to support a simple contract."

The Plaintiff on the other hand relied on the definition of a Promissory note as provided under section 84 of the Act. The section provides:

"An unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand at a fixed or determinable future time a sum certain in money to, or to the order of a specified person or to the bearer."

Miss Kirimi for the Plaintiff submitted that as provided under section 89 of the Act, the maker of a Promissory Note engages that he will pay it according to its tenure and is therefore precluded from denying to a holder in due course the existence of the payee and of the makers capacity to endorse.

Regarding the issue for consideration stated above, Miss Kirimi for the Plaintiff submitted that under section 3(4) of the Act, a Bill is not invalid by reason that it does not specify the value given, or that any value has been given therefore. Miss Kirimi continued to submit that having signed the Bill the Defendant company was the drawer or acceptor or endorser for the purpose of lending his name to Musicraft so as to accommodate the later party for the value of the Bill. Miss Kirimi therefore submitted that Musicraft having endorsed the Promissory Note in favour of the Plaintiff the plaintiff became a holder for value. Section 31(1) and (3) of the Act provides:

"31. (1) A bill is negotiated when it is transferred from one person to another in such a manner as to

constitute the transferee the holder of the bill.

(3) A bill payable to order is negotiated by the endorsement of the holder, completed by delivery.”

I have considered this issues and I do find that the Defendant was an acceptor of the Promissory Note having lend his name to Musicraft to enable Musicraft obtain the accommodation stated in the Bill. I do find that the Promissory Notes were promissory notes for the purposes of section 84 of the Act. In that regard, I am satisfied that the Plaintiff was a holder for value of the Bills and was entitled to claim either from the drawer i.e. Musicraft or from the Defendant company as the acceptor of the Bill. I am also satisfied that the Promissory Notes were negotiated within the meaning of section 31(1) and that it was payable to order for its value. Section 3(4) of the Act is very clear that a bill is not invalid for failure to specify the value given as consideration thereof or for failure to give any value. It is therefore not a defence for the Defendant’s to contend that it received no consideration on these Bills and that therefore it is entitled to avoid the payment.

The Defendant contends that it was discharged from honouring the Bills when they were dishonoured by Musicraft on the due date and the Plaintiff failed to give it notice of the said dishonour. There is no dispute that the Bills in question were dishonoured by reason of non payment and therefore, as stipulated under section 47 (1) (b) of the Act, they meet the criteria for being considered as dishonoured. There is also no dispute that under the same section the Plaintiffs’ right of recourse accrued against the drawer when the Bill was dishonoured for non payment.

Regarding presentment of the Promissory Notes and the requirement that notice of dishonour should have been made to the Defendant, section 88(1) of the Act gives the circumstance under which notice of dishonour should be given. It stipulates as follows:

“88. (1) Where a promissory note in the body of it is made payable at a particular place, it must be presented at that place in order to render the maker liable; but in any other case, presentment of payment is not necessary in order to render the maker liable.”

I agree with Miss Kirimi’s observation that the Promissory Notes did not provide for their presentment for payment at a designated place. There was therefore no requirement for any presentment of the Bills in order to render the maker liable and as provided under section 88(1), presentment was therefore not required.

In regard to the notice of dishonour being given to the Defendant, my attention has been drawn to the provisions of section 50(2) (c) (iii) of the Act which stipulates that notice of dishonour is dispensed with where the drawer is the same person to whom the bill is presented for payment. In the instant case, the Defendant was the drawer and was also the same person who was to make payment upon it. In those circumstances, the notice of dishonour is dispensed with as provided under that section. Furthermore, section 51(1) of the Act gives the holder of a Bill the option to note non-acceptance or non-payment as the case may be, but provides that it is not necessary to do so in order to preserve the recourse against the drawer or endorser. Clearly under section 51(1) and section 52(3) of the Act, the lack of notice of dishonour to the Defendant did not affect the Plaintiff’s recourse against him and therefore the failure to give notice of dishonour does not afford the Defendant any defence. In the case of **Pan African Credit & Finance Limited vs. Fricsmills International Limited [1989]** KLR 405, Pall, J. dealing with the issue of whether notice of honour of the Promissory Notes is mandatory prior to filing of the suit held:

“In order to render an acceptor liable, it is not necessary to protest a promissory note or that notice of dishonour should be given to him.”

I am persuaded by the holding of the learned judge. I find and hold that the Promissory Notes in question did not specify the place of presentment and presentment was therefore waived as provided under section 88(1) of the Act. I also find and hold that in order to render an acceptor of the Promissory Notes liable, it was not necessary to protest them or to give notice of dishonour. I conclude my consideration of the first two agreed issues by answering them in the affirmative.

I will take the last two issues together. Whether the Defendant is liable to the Plaintiff on account of the Bills and who is to pay the cost of the suit.

The answer to these two issues rotates around the Defendant's defence that there was novation on the contract the subject matter of this case, and that therefore the Defendant was not liable to pay.

Both counsels have relied on the Halsbury's Laws of England, 4th ed. vol. 9 (1) page 778 for the definition of the meaning of novation. The meaning of novation is provided therein as follows:

“Novation has been judicially defined as being where there is a contract in existence and some new contract is substituted for it, either between the same parties or different parties, the consideration usually being the discharge of the old contract. However, where the new contract modifies the old contract between the same parties, this has come to be termed a variation; and the expression ‘novation’ has more recently tended to be used rather for the situation where the acts to be performed under the old contract remain the same, but are to be performed by different parties. Hence, novation requires a subsequent binding contract and the consent of all parties.”

The Plaintiff's contention is that the effect of the novation was not to assign or transfer a right or a liability but rather to extinguish the original contract and replace it with another. Miss Kirimi contended that since there was no consent by the parties, and since there was no consideration provided for the new contract, it cannot be said that there was novation of contract in this case. Miss Kirimi continued to submit that there was substitution of an old debt with a new one and that the act of creating an account for the unpaid Promissory Notes did not create a new contract.

Mr. Nyaoga for the Defendant does not agree with Miss Kirimi's view. The Defendant's contention was that the Plaintiff converted the Promissory Notes into a long term loan and that this brought about a new contractual relationship which replaced the old contract between the parties. Miss Kirimi denied that there was any conversion of the Promissory Notes or of the contract created by those notes with a new contract. Counsel submitted that the act of creating an account for the said Promissory Notes did not create a new contract.

It did not escape my attention that the evidence adduced by Mr. Nyingi for the Plaintiff contradicted certain averments in the plaint. Under paragraph 5 of the amended plaint, the Plaintiff avers:

“In breach of the said agreement, the said Bills were not honoured in full on their due dates or at all and the same were automatically converted into a loan account as per the said accommodation.”

Mr. Nyingi in his evidence at the initial stage when he testified stated that the moment the Bills were dishonoured, they were transferred from the normal running Bills Account to the Unpaid Bills Discounting Account. When his attention was drawn to paragraph 5 of the amended plaint, Mr. Nyingi testified that the one who drafted that paragraph of the plaint used the wrong term and that the words 'automatic conversion' should not have been used. He denied that there was any conversion into a loan account. What Mr. Nyingi was explaining was contradicted further by a statement he produced. Mr. Nyingi was recalled to produce a statement as P. ex. 2. Mr. Nyingi described the document as a statement of accounts of the loan account with Musicraft and he explained that as shown in that account, the Plaintiff applied interest on the unpaid balance from the date the account was created, which on the Statement is shown as 1st March, 1998. That interest was applied throughout the life of that account is evident on the Statement. The last date on the account is 30th June, 1999. I agree with Mr. Nyaoga for the Defendant that the act by the Plaintiff of creating this account resulted in a conversion of the agreement between the parties. The Promissory Notes did not provide for the creation of such an account upon dishonour of the Bills. The contract agreement between the parties gave the terms and conditions of the discount account facility offered to Musicraft in the following terms:

“We will discount genuine third party Bills of Exchange/Promissory Notes representing genuine trade transactions, subject to the availability of funds from time to time and at our sole discretion at usances not exceeding 90 days. We reserve the right of recourse to yourselves, in the event of default by the

third parties.”

It is clear that under the contract no provision was made for the provision of an account. Instead, the Plaintiffs' right under that contract was to require payment of the Bills from Musicraft in the event of default by the third parties. In the instant case, Musicraft would be required to pay the Bills in the event of default by the Defendant. The conversion into the account, whether referred to as Unpaid Discount Account Facility or Loan Account, was not part of the Agreement between the parties.

Under section 57 of the Act it is clear that what the Plaintiff could change was the amount of the Bill with interest from the time of presentment for payment or from the date of maturity of the Bill. The proper interpretation of this section clearly shows that interest could not be applied on the amount of the Bill contrary to the terms agreed upon by the parties. Under the contract, the Plaintiff reserved the right to charge a discount rate of 22% per annum, a commission of 1% per quarter or part thereof, and penal interest/collection surcharge at 3% per month or any part thereof, from the due date to the actual date of payment. There was no provision for any other interest. By creating the Unpaid Discount Account Facility the Plaintiff was creating a Loan Account in the terms pleaded under paragraph 5 of the amended plaint, which resulted to a conversion and the creation of a new contract. Upon creating the new contract, the Plaintiff imposed interest at the rate between 30% and 35%. I do find that the creation of this account created a new contract which substituted the old one which the parties had signed on the 19th June, 1995. As Mr. Nyingi explained in his evidence, under this new contract, it was Musicraft which was liable to pay the Plaintiff for the sums due in that Statement. In other words, there was a rescission of the initial contract in which the Defendant was liable to pay the Plaintiff, with the substituted one where the Defendant was not a party.

The Defendant has raised issue with a contradiction in the sum claimed by the Plaintiff. Under paragraph 3(a) of the amended plaint the plaintiff claims that the sum owed is Kshs.4,230,560/-. Under paragraph 6 of the same plaint the Plaintiff prays for Kshs.5,618,219.41/-. Mr. Nyingi in his evidence stated that the Plaintiff was seeking to recover a sum of Kshs.3,334,410/- being, according to him, the aggregate total sum of the six Bills he produced in court. He explained that he was unable to trace one Bill.

The Plaintiff has not explained the reason for all these differences, neither has it tried to explain why the same claim varied from time to time. I think the explanation for this contradiction in the Plaintiff's claim is the fact that the Plaintiff converted the dishonoured Bills into a Loan Account on which it loaded interest at the rate of 30% as is evident from the Statement of Account produced before this court. Mr. Nyingi did not want to admit that the reason why the sums claimed by the Plaintiff varied was because it created a Loan Account on the dishonoured Bills and applied interest on sums due. Having applied interest, the sum claimed by the Plaintiff had of necessity to be more than the aggregate of the Promissory Notes. The Plaintiff cannot deny that it converted the original contract between the parties.

I do find and hold that there was indeed a novation which altered the original contract between the parties and substituted it with a new one in which the Defendant was not a party and was not liable to pay. As the author of Chitty on Contracts 28th Ed. Vol. 1 General Principles at para 23-031”

“A novation denotes the rescission of one contract and the substitution of another in which the same acts are to be performed by different parties. A novation cannot be forced on a new party without his agreement.”

The Plaintiff has not shown that the Defendant was party to the creation of the new contract nor that it agreed to the rescission of the new one. Therefore the new contract cannot be forced on the Defendant. I do find and hold that the Plaintiff has failed to prove its case on a balance of probabilities and therefore the prayers sought in the plaint are not merited.

If I came to the conclusion that the Plaintiff was deserving of a judgment in this case, I would have found that the only sum recoverable by the Plaintiff was the amount of the Bills produced in court as exhibits with interest from the date of filing of this suit until the payment in full applying the provisions of section 57 of the Act. Since I have found against the Plaintiff I dismiss the suit with costs to the Defendant.

Dated at Nairobi this 17th day of October, 2008.

LESIIT, J.

JUDGE

Read, signed and delivered, in the presence of:

Miss Lubalwa for Miss Kirimi for the Plaintiffs

N/A for Mr. Nyaoga for the Defendant

LESIIT, J.

JUDGE