REPUBLIC OF KENYA
IN THE HIGH COURT OF KENYA
AT KISUMU
Civil Suit 413 of 2001

KISUMU PAPER MILLS LTD ..... PLAINTIFF

-VERSUS-

NATIONAL BANK OF KENYA ..... 1ST DEFENDANT

GRAHAM J. G. SILCOCK ..... 2ND DEFENDANT

NAVAL J. N. G. SOOD ..... 3RD DEFENDANT

R U L I N G

In my ruling of 24th January 2003, I made a finding that there are some issues of Law in this case which would in pursuant to Order XIV rule 2 of Civil Procedure Rules be convenient to have decided before any evidence or issues of fact are tried. Following that finding, I directed the advocates on record for both parties to frame and file what each party considered to be relevant issues of Law in the case for determination of the Court at this state. The following were issues which were filed on behalf of M/s Paper Mills Ltd, the plaintiff, in compliance with the said directive:-

1. Is the first legal charge registered by M/s National Bank of Kenya Ltd, the 1st defendant on the plaintiff's property KISUMU/KORANDO/4189 valid in Law?

2. If the said charge is valid in Law, has the plaintiff been discharged from its obligations thereunder by reason of breach by the 1st defendant of the terms thereof and has the 1st defendant become liable to discharge the same?

3. If questions (1) and (2) above are answered in the negative and in any event has the 1st defendant's statutory right to realize the security created by the charge arisen?

4. Has the plaintiff become discharged from its obligations under the Debenture date 30th December 1989 for Kshs 100,000,000/= and has it been rendered unenforceable by the 1st defendant due to breach of a fundamental term or other terms thereof by the 1st defendant?

5. Was there any or any valuable and legal consideration for the Supplemental Debenture of 16th February 1993?

6. Is the Supplemental Debenture dated 16/2/1993 valid and enforceable in Law?

7. Was the appointment of the 2nd and 3rd defendants as Receivers and Managers of the plaintiff lawful in the circumstances of the charge Debenture and Supplemental Debenture?

8. Should the 2nd and 3rd defendants be removed as Receivers and Managers of the plaintiff?

9. Should the District Land Registrar Kisumu, register a discharge of charge of the charge dated 26/1/1990 on the property KISUMU/KORANDO/4189 and given by the plaintiff to the 1st defendant?

10. Should therefore the 1st defendant be ordered to execute a discharge of the charge creating the Debenture and in default of its executing such discharge within the time prescribed by the Court should the Deputy Registrar of this court be permitted to execute such discharged?

On behalf of the defendants M/s Otieno Ragot & Co. Advocates filed a list of issues of Law which they considered relevant for determination along with those filed by the plaintiff. These were as follows:-

1. Were the breaches committed by the plaintiff of the terms of the charge, Debenture and Supplemental Debenture entitle the 1st defendant to appoint the 2nd and 3rd defendants as Receivers and Managers of the plaintiff's business and what are the overall legal and contractual effects of those breaches?

2. If the Court finds that the Charge, Debenture or Supplemental Debenture are not valid in Law, is the plaintiff estopped from raising the issue of such validity at this stage?

3. Does the plaintiff have the locus standi to advance the case of its shareholders not parties to this suit?

4. Is the verifying affidavit of Dipak Parachand Shah filed with the plaint, a verifying affidavit for the purposes of Order VII rule 1(2) of the Civil Procedure Rules?

5. If the Court makes a negative finding on issue (4) is the plaint valid and should it be struck out?

6. Are the Directors of the plaintiff entitled to bring this suit in the name of the plaintiff which is under receivership except through the Receivers?

7. What is the relationship between the plaintiff and the 2nd and 3rd defendants and is the plaintiff entitled to maintain the suit against them?

8. In this suit unprocedurally brought, it bad in Law and does this Court have jurisdiction to hear and determine the same?

The first issue raised on behalf of the plaintiff is whether the charge in favour of the 1st defendant over property No. KISUMU/KORANDO/4189 is valid in Law?. It is contended on behalf of the plaintiff that it was pleaded in the amended plaint and not denied in the defence that the charge which was prepared, drawn and registered at the instructions of the 1st defendant was over the property NO. KISUMU/KORANDO/4152 but subsequently, only page one of that charge document was amended to read KISUMU/KORANDO/4189 but page 2 of it under clause C, the property charged remained no. KISUMU/KORANDO/4152. It was therefore concluded that as there was inconsistency as regard the identity of the property charged the said charge was not a binding document between the plaintiff and the 1st defendant which was capable of being relied on to enforce the rights of parties. It was also submitted that as the charge had become inoperative, the parties have been discharged from their obligations under it and that if there was money owing by the plaintiff to the 1st defendant, the same had become unsecured debt. In reply to the said contentions, it was submitted that it was clear from the correspondence exchanged between the plaintiff and the 1st defendant that the parties had infact intended that the charge in favour of the 1st defendant was to be over property NO. KISUMU/KORANDO/4189 and that the reference to property NO. KISUMU/KORANDO/4152 was a mutual mistake. It was further submitted that there was no evidence of an intention of the parties to create a charge over property NO. KISUMU/KORANDO/4152 and as there was no explanation of how that property NO. KISUMU/KORANDO/4152 came into the contract between the 1st defendant and the plaintiff was an indication that there was an attempt by the plaintiff to defraud the 1st defendant.

I have had a close look at a copy of the charge document which was registered on 12th February 1990. It is correct as claimed that on the first page of it the property which was charged is indicated as NO. KISUMU/KORANDO/4189 but the last two figures of the number of the said title i.e 89 had been written by hand after erasure of numbers 52 and there is a signature appended next to the writing similar to that of the advocate who attested the execution of the document. It is also true that on page 2 of the document under clause C, the property over which a legal charge was created was shown as NO. KISUMU/KORANDO/4152. I further note that the cover of the said document it is shown that it was made by the plaintiff in favour of the 1st defendant over L. R. NO. KISUMU/KORANDO/4152. I therefore agree that the property charged by the plaintiff in favour of the 1st defendant is not clearly stated in the charge. As the said charge document is not sufficiently explicit as to the identity of the property over which a charge was created in favour of the 1st defendant there is no legal requirement or justification at all on my part to accept any extraneous evidence so as to show that the intention of the parties had originally been to create a charge over property NO. KISUMU/KORANDO/4189. I find support in Section 97 of the Evidence Act. The document itself should be able to express the intention of the parties to it. In any case, if there had been a discovery of any error on it which was not in conformity with intentions of parties, the 1st defendant should have demanded that the plaintiff should have executed another charge. The admission that the advocate who had drawn the said charge document had amended the number of the title of the property charged without endorsement of the owner of the property endorsing the amendment further reduced the validity of the document in that the amendment was not made by the maker. There is also no evidence that the plaintiff was involved in respect to using title NO. KISUMU/KORANDO/4152 in the said document so as to warrant the claim that the use of it was an indication of an attempt to defraud the 1st defendant. In the result, I agree that the charge document executed by the parties in this case is not a valid document upon which the parties herein can enforce their rights in that it is inoperative due to its uncertainty as to the identity of the property charged in favour of the 1st defendant.

The second and fourth issues were argued together. These issues are as follows:-

2. If the said charge is valid in Law, has the plaintiff been discharged from its obligations thereunder by reasons of breach by the 1st defendant of the terms thereof and has the 1st defendant become liable to discharge the same? And,

4. Has the plaintiff become discharged from its obligations under the Debenture dated 30th December 1989 for Ksh 100,000,000/= and has it been rendered unenforceable by the 1st defendant due to the breach of a fundamental term or other terms thereof by the 1st defendant?

These two issues of Law could be summarized as whether the plaintiff has been discharged from its obligations under both the charge and the 1st Debenture. It was contended that under both the charge and 1st Debenture, the agreed rate of interest which the 1st plaintiff for the facility accorded it was to be was between 15.5% and 18% per annum. It was however submitted that despite those clear provisions in the said documents on the rate of interest under both the charge and the 1st Debenture, the 1st defendant had consistently charged exorbitant and illegal rates of interests which were a breach of a fundamental term of the said contracts and which entitled the plaintiff to consider itself discharged from its obligations under the said documents. It was also contended that the charge is governed by the provisions of the Land Registered Act which under Section 71 stipulates that any variation of an interest from that agreed parties has to be made by a document of variation executed by the parties to the charge and registered. It is common ground in this case that there was no such instrument of variation executed and registered in respect to changes of interest rates imposed by the 1st defendant under the said charge in this case and that by charging an interest of 35% as admitted in the letter dated 9th June 1998, the 1st defendant had committed not only unlawful act under the said Act but also a breach of a fundamental term of the contracts. It was submitted that the said charge had become null and void and the statutory notice issued on 9th June 1998 in which unlawful rate of interest had been charged was also null and void. It was contended that the 1st defendant cannot enforce its rights under the said charge. As regards the variation of interest by the 1st defendant to the extent of about 100% over the maximum rate agreed in the 1st Debenture, it was also contended that that was a fundamental breach, which has rendered it void at the intense of the plaintiff, consequently as the plaintiff has come to Court to avoid it the 1st defendant cannot enforce the said 1st Debenture by an appointment of a Receiver Manager or by selling the assets charged under the Debenture. Mr. Wasuna for the plaintiff relied on the Halsburry's Laws of England, 4th Edition, volume 9, paragraph 545, 546 and 547.

In response to the above submissions, Mr Otieno for the defendants contended that while both the charge and the 1st Debenture had specified the rates of interest which was to be applied, subsequent dealings between the plaintiff and the 1st defendant had demonstrated that those rates had been varied by consent. It was Mr. Otieno's contention that documents executed by the parties were the Debenture of 30/11/89, the charge of 21/1/90 and the Supplemental Debenture of 16/2/93, and that in his views there was a clear evidence in the Supplemental Debenture that the parties had agreed to erase the rates of interest agreed in the 1st Debenture and the Charge. According to Mr. Otieno, the ultimate rates of interest in respect to the charge. Debenture and Supplemental Debenture were those spelt out in the Supplemental Debenture. It was also submitted that as the plaintiff had all along not shown that it was opposed to the variation of the rates of interest it would now be estopped by Section 120 of the Evidence Act from coming to Court and claiming that the interest is unlawful. He added that it matters not that there is a statute governing the rate of interest. It was further contended that if there is a dispute as to the rates of interest that did not discharge the borrower from paying the principal debt which is not challenged. On the 1st defendant's rights to exercise its powers it was submitted that once a demand had been made and there is a failure to comply with it, the rights under the charge accrued to the 1st defendant either to sell the charged property or to appoint a Receiver/Manager. It was claimed that as the plaintiff had failed to pay the 1st defendant had gone ahead and had appointed Receiver Manager under clause 12 of the charge.

The charge registered on 12th January 1990 and the 1st Debenture which was executed on 30th December 1989 appear to have secured one and the same facility of Kshs 100,000,000/= which was advanced to the plaintiff by the 1st defendant. It appears that the 1st debenture was the first one to be drawn and executed and the charge was prepared, executed and registered later on. The agreed interest on both these documents was that provided under clause 1 of the charge and 2 of the 1st Debenture which was indicated to be between a minimum of 15.5% and maximum of 18%. It is not denied that the registration of these documents, the 1st defendant varied the rate of interest above the maximum provided and by its letter of 9th June 1998 the 1st defendant claimed that the operative rate of interest was 35%. However, it was not admitted that the Registered Land Act governed these transactions stipulates that the agreed rate of interest may only be varied by an instrument of variation executed by the parties to the charge and registered in terms of Section 71 of the Registered Land Act. It is not denied that in this case that there was no such instrument of variation executed by the plaintiff and the 1st defendant, consequently the decision by the 1st defendant to raise the rate of interest for beyond the agreed range was a breach of a fundamental term of the contract which went to the root of the contract which entitled the plaintiff to avoid it. It is clear to me that the 1st defendant having committed the said breach it could not enforce the said 1st Debenture by appointing a Receiver or sell the charged property. There is no evidence to support the suggestion that the subsequent dealings between the parties had demonstrated that there had been a consent of the parties to charge and vary the rate of interest especially as the provision of Section 71 of Registered Land Act is mandatory and there is no room for any such consents by parties. The suggestion that if the interest charged was challenged, the plaintiff was bound to pay the principal debt is also doomed as the contract governing both the principal debt and rate of interest is one and the same and some parts cannot be void and some invalid.

It was also submitted that the Supplemental Debenture erased earlier provisions in respect to the rate of interest charged by the 1st defendant. I have had a look at a copy of the Supplemental Debenture and I notice from the 1st page that it was a debenture to secure a facility of Kshs 400,000,000/= and not the existing facility. In clause 1 of the debenture the following clause

" --------- all liabilities of the Company to the lender as in the existing security more particularly set out together with interest calculated at the rates and in the manner specified in the existing security ---------- "

In clause 5, it was provided that:-

" further monies are required by the Company in connection with its business and the lender has agreed to allow the Company further banking facilities ----------"

It becomes clear to me after reading this document that the allegation that the rate of interest laid down in the 1st debenture and

adopted in the charge was not urged out by the Supplemental Debenture.

There was also a submission that for a long time the plaintiff did not show that it was opposed to the charge of rate of interest and that it was therefore estopped under Section 120 of the Evidence Act from raising this objection. There was no evidence in support of this claim. It was not shown how after the plaintiff has been told that the interest charged had been raised except in the statutory notice issued in 1999 which clearly indicated the rate of interest as 35%.

I am therefore satisfied that the 1st defendant had violated the provisions of 2 of the 1st debenture and clause 1 of the charge and had charged a rate of interest which was far above the agreed amount. In doing so, the 1st debenture committed a fundamental breach of the said 1st debenture and the charge as indicated above rendering them unenforceable.

In my view, the plaintiff has become discharged from his obligations under the two documents, the 1st debenture and the charge. I find support in this holding from the English case of ***Hain Steamship Co. Ltd -vs- Tate and Hyle Ltd [1936] 2 all ER 597*** at 600 at 601 where it was held that however slight a deviation might be the other party may consider that he is not bound by the contract anymore. In this case, there was a considerable deviation from the charge and debenture which entitled the plaintiff to be discharged from its obligations.

The next legal issue canvassed by the plaintiff's counsel was no 5 which was in the following terms:-

5. Was there any or any valuable and legal consideration for the Supplemental Debenture of 16th February 1993?

It appears to me that that issue can be conveniently considered together with issue no. 6. It was submitted on behalf of the plaintiff that the intention of the parties in entering into a consent and executing and registering the Supplemental Debenture was that the 1st defendant was to grant the plaintiff a further facility of Kshs 400,000,000/=, but the 1st defendant did not grant the plaintiff any other facility following the execution and registration of that further debenture. It was contended that the facility of Kshs 100,000,000/= which had earlier on been advanced to the plaintiff was secured by the 1st Debenture and the Charge, but the Supplemental Debenture was not meant to secure it being a past consideration without clear provisions in it. It was urged that clause 5 of the Supplemental Debenture clearly stated that what the plaintiff wanted was an advance of further monies and that the 1st defendant has agreed to lend it. It was however submitted that the 1st defendant did not give and disburse further monies as had been agreed, after execution of this document. It was contended that there was total failure of consideration in it and the same was now void. It was claimed that as the Supplemental Debenture had become void the 1st defendant could act on by appointing receivers. The plaintiff relied on Halsburys Laws of England, 4th Edition Volume 9 at page 372 and paragraphs 541, where it is stated that a failure to perform part of the contract constitutes a failure to perform the whole. The plaintiff also relied on 26th Edition of Clutty on contract at pages 1090 to 1091 paragraph 1730, and the cases of ***Swisse Atlantique Societe D'Armanient Maritime SA -vs- N. V. Rotterdam Schekolem Centrale [1962] 2 All ER 61*** in respect to efficacy of the contract.

In response to the above submissions, Mr Otieno for the defendants contended that in paragraph 24(k) of the Amended Defence, it was pleaded that the Supplemental Debenture was intended to secure the existing debt and that there was no intention to grant to the plaintiff further or additional facility under that Debenture. It was also claimed that the fact that the plaintiff had later on submitted a valuation report proved that the Supplemental Debenture was to secure the existing debt.

I have carefully read the Supplemental Debenture which was executed by the parties on 16th February 1993, with a view to finding out what was the intention of the parties when they executed it. On the first page of this document it is clearly stated that the Debenture was to secure a facility of a sum of Kshs 400,000,000/=. That provision flies in the face of the contention that the Debenture was intended to secure the then existing debt. I also note that under clause 5 of it was clearly agreed that the plaintiff required further moneys in connection with its business and the 1st defendant had agreed to advance the same subject to the execution of the said Supplemental Debenture. In my view that statement does not also support the claim that the supplemental Debenture was meant to secure an existing debt. I agree that if in fact the Supplemental Debenture was to secure and cover the then existing debt the earlier Debenture and the charge should have been mentioned in it and just as was done in the charge where the consideration was stated as forbearance to call for an immediate repayment of the debt. That was conspicuously absent in this Supplemental Debenture. It is also noted that in the Supplemental Debenture the then existing debt was clearly stipulated in the schedule as Kshs 100,000,000/= and the existing securities were acknowledged. There was no intention that there was any short fall in the said existing securities which called for additional one. Having carefully considered all these issues, I find that the Supplemental Debenture had been intended to secure a fresh facility of Ksh 400,000,000/= and not the then existing debt as claimed. However, it is admitted by the 1st defendant that Kshs 400,000,000/= was not disbursed. The consideration for the said Supplemental Debenture thereby failed rendering it void for all purposes.

The first issue raised on behalf of defendants is whether the breaches committed by the plaintiff of the terms of the charge, the 1st Debenture and the Supplemental Debenture entitled the 1st defendant to appoint the 2nd and 3rd defendant as Receivers and Managers of the plaintiff. According to Mr Otieno, the answer to the issue was affirmative in that the plaintiff had failed to repay the facilities as agreed. He added that under clause 2 of the charge, it had been agreed that the plaintiff was to pay the principal debt and interest on demand and that as that had been done and the plaintiff had failed to do so the 1st defendant became entitled under clause 10 of the charge and clause 12 of the 1st Debenture to appoint receivers and it did. On perusing the charge, I note that clause 10 of it purported to amend Section 74 of the Registered Land Act by removing the mandatory 3 months notice accorded the chargors to redeem their properties before either sale of the charged properties is commenced or appointment of the receivers by the chargee is made. I find that the said charge is also incompetent and irregular for abolishing or getting rid of statutory rights given by the Act of Parliament to the chargor in form of 3 months notice. While the 1st defendant which is stated as a chargee in the charge registered on 12/2/90, but indicated in the 1st Debenture as the bank was entitled to

appoint receivers under clause 12 of the 1st Debenture and/or sell the charged property under clause 13 of the charge, I have held above that both these documents are incompetent and they cannot be enforced by any of the parties. I stated above that the charge is incompetent for its uncertainty as to the identity of the property charged in favour of the 1st defendant and that due to the variation of interest charged by the 1st defendant in contravention of Section 71 of Registered Land Act, the 1st Debenture was also void. In the circumstances, the 1st defendant could not exercise its rights reserved to it in the two documents so as to appoint the 2nd and 3rd defendants, as Receivers and Managers of the plaintiff.

The other issue raised by the defendants is that the verifying affidavit of Depak Shah which accompanied the plaint did not verify the plaint. It is true that the said verifying affidavit indicated in paragraphs 2 and 3 that deponent had read and understood the contents of an affidavit filed and that the contents were true. The deponent's error was to refer to the plaint as an affidavit. Under Order XVIII rule 7 that irregularity being that of form is admissible. As the plaint in this case was accompanied by a verifying affidavit in terms of Order VII rule 1(2) of Civil Procedure Rules but the error was that the deponent referred to the plaint in paragraph 2 of it as an affidavit instead of the plaint. As the plaint was accompanied by a verifying affidavit the irregularity cannot result in the striking out of the plaint under Order VII rule 1(3) of Civil Procedure Rules. The deponent has clearly stated that he was a director of the plaintiff who brought this suit as he was therefore with an authority to swear the affidavit.

The next issue raised on behalf of the defendants was whether the Directors of the plaintiff were entitled to bring this suit in the name of the plaintiff's Company which is under receivership and whether such a suit is maintainable against Receivers. Mr Otieno for the defendants contended that it was irregular for the plaintiff in their own names and in their individual capacity to bring such a case. He added that a receiver is a mere agent who has no interest on the property and cannot sue and be sued on his own name. It was further contended that the only time an action may be brought against a receiver is under Section 354 of the Companies Act which relates to filing returns where a Chamber Summons has to be invoked under rule 9(g) of the Company High Court Rules. It was Mr Otieno's further submission that this Court has no jurisdiction to determine the issues raised by the plaintiff. It is true that the plaintiff is under receivership and that the 2nd and 3rd defendants were by a deed of appointment of 4th September 1998 appointed Receivers and Managers by the 1st defendant. They are therefore agents of the 1st defendant. They could not therefore bring a suit against the 1st defendant. The plaintiff who challenges the validity of the debenture under which the Receivers and Managers were appointed are in effect questioning their appointment. I am therefore satisfied that the Directors of a Company which is under receivership and who are challenging the validity of the appointment of such receivers may bring a suit in the name of the Company as was done in the case of ***Multi Holdings Ltd & Ano. -vs- Uganda Commercial Bank [1971] EA 238.*** I do not agree with Mr. Otieno that this Court has no jurisdiction to entertain and to determine the legal issues raised by the plaintiff. The fact that some prayers of the plaint may not be available to the plaintiff does not affect the jurisdiction of this Court especially as the plaintiff's main trust in the suit appears to have been a challenge to the validity of the Charge and Debentures.

In item eight of the issues raised by the defendants, it was contended that as the plaintiff was seeking Orders against the 2nd and 3rd defendants under Section 354 of the Companies Act, the proper procedure was by way of a Chamber Summons under rule 9(g) of the Companies (High Court) Rules. It was therefore submitted that it was improper for the plaintiff to demand accounts by a plaint. If the plaintiff's prayer in this suit had been for account only then the proper procedure for it would have been to come to this Court by a Chamber Summons under rule 9(g) of the Companies (High Court) Rules. However, as there many reliefs sought both against the 1st defendant separately and the 2nd and 3rd defendants together, the proper procedure is by a plaint as was adopted in this case. The defendants' complaint that the procedure adopted by the plaintiff in coming to this Court was irregular is no valid.

Having considered and determined all the issues of Law raised and canvassed as indicated above, the parties may now fix the suit for hearing and final determination.

Dated and delivered this 18th day of January 2006.

B. K. TANUI

JUDGE

In the presence of; Mr. Oanda for Wasuna for plaintiff

N/A for defendant.

B. K. TANUI

JUDGE

BK/hao