Kenya Commercial Bank Limited v Izaak Walton Inn & 2 others (Civil Case 710 of 2010) [2024] KEHC 11180 (KLR) (Commercial and Tax) (16 September 2024) (Judgment)

Neutral citation: [2024] KEHC 11180 (KLR)

REPUBLIC OF KENYA

IN THE HIGH COURT AT NAIROBI (MILIMANI COMMERCIAL COURTS)

COMMERCIAL AND TAX

CIVIL CASE 710 OF 2010

JWW MONG'ARE, J

SEPTEMBER 16, 2024

BETWEEN

KENYA COMMERCIAL BANK LIMITED ..... PLAINTIFF

AND

IZAAK WALTON INN ..... 1ST DEFENDANT

MARYANN MUKAMI LEOGEAIS ..... 2ND DEFENDANT

JAMES WACHIRA LEOGEAIS ..... 3RD DEFENDANT

JUDGMENT

Introduction And Background

1. The Plaintiff is a banking institution ("the Bank") whereas the 1st Defendant is a hotel establishment situated in Embu Town of Embu County and is engaged in the hospitality industry offering various services to its guests. By a plaint dated 22nd October 2010, the Bank filed suit stating that sometime in September 2007, the 2nd Defendant opened a bank account in the Bank's Mwea branch and was allocated with account number 048-102 XX0 and a Quickserve debit card number 6016 8250 *7 to enable her operate the bank account ("the Card"). That the maximum floor limit that could be utilized per day using the Card was set at Kshs. 20,000.00/= and that the 2nd Defendant failed to fund her account with the Bank as required leading to the closure of the account by the Bank on or about 31st December 2007.

2. Sometime in November 1995, the parties entered into an Establishment Agreement ("the Establishment Agreement") for the 1st Defendant to operate a PDQ machine at its premises. The Agreement provided that the Bank was to pay the amount of all sales vouchers issued less 5% of the total price shown on the sales vouchers and that the floor limit for any sales voucher upon presentation

of a card was to be notified to the 1st Defendant from time to time by the Bank in writing and that the floor limit at the time was set at Kshs. 7,500.00/=. The Bank claimed that on diverse between 9th April 2008 and 10th January 2009, the 1st Defendant's servant and or agent in complete breach of contract intentionally and/or negligently and fraudulently colluded with the 2nd and 3rd Defendants to carry out fraudulent transactions using the Card thereby causing the Bank to incur substantial loss amounting to Kshs. 13,403,084.90/=.

3. The Bank contended that the 1st Defendant was negligent in its operation of the PDQ machine by allowing transactions above the said floor limit of Kshs.20,000.00/= per day, allowing transactions above the said floor limit of Kshs.7,500.00/= per sales voucher, allowing transactions through the Card beyond the limit set in the PDQs which was a limit of Kshs. 500,000.00/= per transaction, that all transactions linked to the Card applied the same authorization code "020" which was a fictitious and/or fraudulent authorization code and that it allowed the 3rd Defendant to use the Card at its establishment knowing that he was not the Card holder. The Bank further accused the 2nd and 3rd Defendants of fraud and in sum holds the Defendants jointly and severally liable. Accordingly, the Bank prays for the court to order against the Defendants jointly and severally for inter alia the payment of the sum of Kshs.13,403,084.90/=.

4. The suit was opposed by the 1st Defendant's through the statement of defence and counterclaim dated and filed on 2nd March 2011. It admitted to signing the Establishment Agreement with the Bank but denied breaching any of the obligations therein. It averred that the PDQ machine was installed at its premises at the request of the Bank, that the same was a manual franking machine which was operated manually and that before running of the Card, the 1st Defendant claimed that it would always call the Bank to obtain an authorization code. That the Bank also had an obligation to circulate to the 1st Defendant a list of lost, cancelled or unacceptable cards and that at all times, the 1st Defendant always called the Bank before accepting any credit or debit card. It claimed that at the end of every month the Bank would verify all the transactions and issue a statement and it was a term of the contract that the Bank would pay to the 1st Defendant for the total transactions for each month less the agreed commission of 4%.

5. It was the 1st Defendant's further contention that after some time, the Bank replaced the manual Franking Machine with an automatic PBQ machine which would accept both credit and debit cards. The 1st Defendant explained that a debit card is a card issued to an account holder who is allowed to access the funds in his or her bank account and that as a merchant, the 1st Defendant would first get the necessary authorization from the Bank's Card Centre before allowing a card holder to use the card for payment. If the account had no money or was cancelled, the debit card would be rejected. The 1st Defendant avers that control of the entire process of the approval was solely on the part of the Bank.

6. The 1st Defendant stated that during the subject period, the Bank did not at any one time circulate information that the 2nd and 3rd Defendant's card was lost, cancelled or as a closed account. That if the 2nd Defendant's account was closed as alleged by the Bank, the Bank has not explained how such a card was allowed to be in use between 9th April 2008 and 15th January 2009. The 1st Defendant asserted that at all material times, it had obtained the necessary approvals when the Card was being used and if the account was closed as alleged by the Bank, the Card would have been automatically rejected. The 1st Defendant contended that the Bank generated a transaction statement for all cards that were used in the 1st Defendant's establishment, that the Bank paid the 1st Defendant as per the statement, and deducted its commission as per the Agreement. The 1st Defendant reiterates that the Bank did not reject the Card and it issued the necessary approvals which act was not within the control of the 1st Defendant.

7. The 1st Defendant denied all the particulars of negligence stated in the Plaint and stated that all the transactions were within the set floor limit, all the transactions were duly approved by the Bank and 1st Defendant was not in control of the approval process, the approval of the transactions were done at the Bank's Card Centre and that no transaction could be done using the debit card without the knowledge of the Bank.

8. The 1st Defendant admitted that the 2nd Defendant was the holder of the Card issued by the Bank and that she was a regular customer at the 1st Defendant's establishment and she used to patronize the hotel with the 3rd Defendant who she introduced as her son. That on several occasions, the 2nd and 3rd Defendants patronized the 1st Defendant's establishment and used the Card and that at all the times the necessary authorization was given by the Bank and once the necessary approval was issued by the Bank, the 1st Defendant had no way of establishing the status or position of the 2nd Defendant's Account. The 1st Defendant states that the Bank paid the amount due to the 1st Defendant as per the transactions statement and it retained 4% sales commission as per the Agreement.

9. Without prejudice to the foregoing, the 1st Defendant stated that if there was any fraud by the 2nd and 3rd Defendants, the said fraud could only have been done with the knowledge or participation of the Bank's staff, employees or agents and therefore the Bank was solely to blame for any loss it suffered. That the use of the Card could only have been caused by an act of serious negligence or collusion on the part of the Bank, employees or agents. The 1st Defendant accused the Bank of negligence for allowing the use of the 2nd Defendant's card after 31st December 2007 when it had allegedly closed the account, failing to circulate a bulletin or notify the 1st Defendant that the 2nd Defendant's card was not valid, issuing authorization codes to the 1st Defendant allowing use of the Card, authorizing and allowing the use of the 2nd Defendant's card for almost one year without detecting any fraud and failure by the Bank's Card Centre which is fully automated to detect or capture the 2nd Defendant's card as a fraudulent or cancelled card.

10. The 1st Defendant stated that that further evidence of the negligence on the part of the Bank was disclosed by the following facts; That in late December 2008 the 2nd Defendant and her son the 3rd Defendant indicated to the 1st Defendant that they wished to hold a party, which the estimated costs would be about Kshs.2,000,000.00/=. That upon informing the 1st Defendant to make the necessary arrangements, the 1st Defendant was concerned to learn that the bill would be settled by way of the credit card. As the 1st Defendant had no mandate to impose a limit on a cardholder, since that was the responsibility of the issuing Bank, the 1st Defendant stated that as a matter of courtesy and caution, it wrote to the Bank on 30th December 2008. That the 1st Defendant informed the Bank that the cardholder had indicated it would incur a huge expenditure using the Card and requested the Bank to confirm whether that was in order. That the Bank did not reply to the said letter until the 14th January 2009. In the meantime, the Card was used on 31st December 2008 and the necessary authorization was issued by the Bank.

11. The 1st Defendant further avers that in the said letter dated 14th January 2009, the Bank did not even state that the 2nd Defendant's account was closed and/or that it was suspending the Card and therefore all the averments in the Plaint are false and contradictory. The 1st Defendant further contended that the Bank paid the amount due to the 1st Defendant as per the Agreement after deducting its commission.

12. For the above reasons, the 1st Defendant denied that it was liable severally or jointly for the alleged loss suffered by the Bank. In its counterclaim, the 1st Defendant argued that the Bank had engaged in a malicious and vicious campaign to destroy the 1st Defendant's business. That the Bank spread false

and malicious information to other card issuing banks that the 1st Defendant was a risky establishment and as a result, all the major card issuing Banks cancelled the establishment agreements with the 1st Defendant. That failure to have the facility for accepting credit and debit card that was caused by the Bank has caused the 1st Defendant substantial loss and as such, the 1st Defendant seeks general damages from the Bank for the circulation of false information and the subsequent loss of business.

13. The Bank filed a reply to the 1st Defendant's defence and defence to the counterclaim dated 16th April 2012. It reiterated the contents of its plaint by stating that it is the 1st Defendant's agents, servants and/or employees who failed and/or neglected to seek authorizations from the Bank's agents, servants and or employees before running the 2nd Defendant's card and that the 1st Defendant's agents, servants and or employees colluded and or connived with the 2nd and 3rd Defendants to repeatedly run the Card contrary to the terms and conditions of the Establishment Agreement. That the 1st Defendant failed and neglected to exercise any or any due care and that had the 1st Defendant duly performed its obligations under the Establishment Agreement then the huge loss sustained by the Bank would not have arisen.

14. The Bank further stated that the 1st Defendant originated the fraud by allowing the 3rd Defendant to swap the Card when it belonged to the 2nd Defendant and allowing him to use of the Card for sums above the daily limit of Kshs.20,000.00/= and/or for significant and/or illogically huge sums of money. That the 1st Defendant's director one Mr. Joe Kaviu, facilitated the fraud by using the 2nd Defendant's Card to pay himself for a motor vehicle purportedly sold to the 3rd Defendant and that due to the connivance and collusion in the fraud involving the 1st Defendant's directors and other staff, all authorizations procured by the 1st Defendant from the Bank were induced by fraud and were allowed by the Bank as a result of a mistake of fact. That the approvals of the Defendants' fraudulent transactions were further induced by mistake due to a computer system breakdown caused by conversion of the Bank's software to T24 which was unable to reconcile Quick Serve transactions done through the POS (Point of Service Machine) undertaken manually and not online. That as a result of this, the Defendants received payments in the sum of Kshs. 13,403,084.90/= and became unjustly enriched and the Bank is thus entitled to refund of the sums paid to the 1st Defendant fraudulently and or by mistake.

15. The Bank stated that its investigations established that it was the 3rd Defendant, who was never a card holder of the 2nd Defendant's Card, who utilized the Card and not the 2nd Defendant. It thus reiterated that the Defendants committed fraud against the Bank and it denied the blame and negligence alleged by the 1st Defendant. The Bank admitted to receiving the 1st Defendant's letter dated 30th December 2008 but denied that it authorized the 1st Defendant to allow usage of the 3rd Defendant's Card to cater for a hotel bill of Kshs. 2 million. It stated that upon receipt of this letter, it commenced investigations which unearthed the Defendants' massive fraud against the Bank.

16. In its defence to the counterclaim, the Bank stated that the 1st Defendant's establishment was in truth responsible directly and indirectly for the Bank's huge loss perpetrated for a period of approximately one (1) year and that it was under contractual duty to disclose the 1st Defendant's role in the loss. The Bank claimed that the 2nd and 3rd Defendants admitted to the fraud, collusion and connivance with the 1st Defendant's director(s), employees and servants and that the 1st Defendant's staff and former employees had admitted to the 1st Defendant's fraudulent actions, omissions and misrepresentations. That in view of the express admissions by the 1° Defendant's employees and ex-employees as well as by the 2nd and 3rd Defendants, the Defendants had no valid and bonafide Defences to the Bank's suit. As such, the Bank prayed for judgment as sought in the plaint and further that the 1st Defendant's counterclaim be dismissed with costs.

17. The 2nd and 3rd Defendants neither entered appearance nor filed a filed a defence and as such upon application by the Bank, default judgment was entered against them on 2nd April 2012. The suit against the 1st Defendant proceeded for hearing where the Bank presented one witness, Juma Amimo, its Senior Manager Forensic Services (PW 1) who adopted his witness statement dated 3rd August 2023 and produced the Bank's List and Bundle of Documents dated 7th March 2017(Plaintiff Exhibits Nos. 1-28). The 1st Defendant called its director, Kaviu Mugo, who adopted his witness statement dated 31st October 2023 and produced the 1st Defendant's Bundle of Documents of the same date (Defence Exhibits Nos. 1-5). At the conclusion of the hearing, the parties were directed to file written submissions which are now on record. Since the evidence and submissions of the parties mirror the positions highlighted above, I will not summarize the same but I will make relevant references in my analysis and determination below.

Analysis and Determination

18. In determining this suit, I am guided by the fact that the standard of proof in civil cases is on a balance of probability and that the burden of proof is on the party alleging the existence of a fact which he wants the Court to believe. This is anchored in section 107 (1) and (2) of the *Evidence Act*(Chapter 80 of the Laws of Kenya) which provides that "whoever desires any Court to give Judgment as to any legal right or liability dependent on the existence of facts which he asserts must prove that those facts exist" and that "When a person is bound to prove the existence of any fact it is said that he burden of proof lies on that person". In Miller .V. Minister Of Pensions 1947 ALL E.R 372, Lord Denning aptly summarised the application of the standard in the following terms:-

> " That degree is well settled. It must carry a reasonable degree of probability, but not so high as is required in criminal cases. If the evidence is such that the tribunal can say: We think it more probable than not; the burden is discharged, but, if the probabilities are equal, it is not. Thus, proof on a balance or preponderance of probabilities means a win, however narrow. A draw is not enough. So, in any case is which the tribunal cannot decide one way or the other which evidence to accept, where both parties' explanations are equally (un) convincing, the party bearing the burden of proof will lose because the requisite standard will not have been attained."

19. The Court of Appeal in James Muniu Mucheru v National Bank of Kenya Ltd CA Civil Appeal No 365 of 2017 [2019] eKLR simply put it that 'Courts will make a finding based on which party's version of the story is more believable.'

20. From the parties' submissions, I find that the following are the abridged issues falling for the court's determination and I will deal with each of them sequentially:-

    a. Whether there was a Merchant Agreement for the Acceptance of Cards between the Bank and the 1st Defendant

    b. Whether there was breach of the Establishment Agreement regarding the particulars pleaded in the plaint.

    c. Whether the Bank was negligent

    d. Whether the 1st Defendant unjustly enriched itself by way of fraud.

    e. Whether the Bank is entitled to the reliefs sought in the suit

    f. Whether the Counterclaim contained in the reply to the Plaint is merited?

g. Who bears the cost of the proceedings?

Whether there was a Merchant Agreement for the Acceptance of Cards between the Bank and the 1st Defendant

21. In its evidence, (Plaintiff Exhibit No.6), the Bank produced the Establishment Agreement and a "Merchant Agreement for the Acceptance of Cards". The Bank stated that this was one document that was signed by the 1st Defendant and was within the knowledge of the 1st Defendant. The 1st Defendant disputed this Merchant Agreement for the Acceptance of Cards by stating that the same was not signed by the parties and that PW 1 in his evidence admitted that as per the statement of one Fredrick Achila (Plaintiff Exhibit No.17), there was no merchant agreement signed by the parties. Although the 1st Defendant denies knowledge of the impugned Merchant Agreement for the Acceptance of Cards, I note that at para. 4 of its statement of defence, "....the 1st Defendant admits that it signed a Merchant agreement between it and the Plaintiff..."

22. DW 1 in his testimony also admitted that the PDQ machine was governed by the Merchant Agreement. This lends credence to the Bank's position that the Establishment Agreement and the Merchant Agreement for the Acceptance of Cards was one document that was signed by the 1st Defendant (Pg. 14 of Plaintiff Exhibit 6). DW 1 further made reference to said Merchant Agreement in stating that there was no floor limit for PDQ transactions. I therefore find in the affirmative that there was a Merchant Agreement for the Acceptance of Cards between the Bank and the 1st Defendant.

Whether there was breach of the Establishment Agreement regarding the particulars pleaded in the plaint.

23. From the evidence, I find that there was indeed a breach of the Establishment Agreement and that the same was breached by the 1st Defendant for a number of reasons. First, there was no evidence presented by the 1st Defendant to demonstrate that it sought authorization for the subject card transactions contrary to Clause 1.1 of the Merchant Agreement for the Acceptance of Cards. The only evidence of authorization sought was the Kshs. 2,000,000.00/= the 3rd Defendant allegedly intended to spend at the 1st Defendant's premises. Other than that, the 1st Defendant admitted in its testimony that it allowed and encouraged the 3rd Defendant to swipe his debit card over the PDQ machine between 9th April 2008 and 12th January 2009. I am guided by the decision of this court in, Barclays Bank Plc Vs Arts "680" Limited ML Comm HCCC No. 435 of 1996 [2001] eKLR held that such unauthorized transactions constitute a breach of the Merchant Agreement.

24. Second, the 1st Defendant admitted that it allowed transactions over the PDQ machine way above the floor limit of Kshs. 7,500.00/= set out in the Establishment Agreement. Third, I note that the 1st Defendant did not verify the identity of the 3rd Defendant or confirm that of the 2nd Defendant as the cardholder, it did not seek authorization immediately it was suspicious or doubtful of the 2nd Defendant's use of the Card nor ensure that the cardholder, that is the 3rd Defendant, signed the 3 copies of the sales vouchers or receipts as per the Merchant Agreement. This lends credence to the Plaintiff's argument that these were all violations of Clauses 4.2, 6.5 and 11.1.6 of the Merchant Agreement.

25. The 1st Defendant, while becoming aware that the 3rd Defendant was not the cardholder did not immediately seek authorization from the Bank or confirm whether the Card was stolen, lost or being misused. It only sought indemnity from the cardholder, the 2nd Defendant, 4 days after the use of

the Card by the 2nd Defendant and then allowed the 2nd Defendant to make over-the-floor limit transactions knowing very well this was irregular and unauthorized.

26. I therefore find that the there was breach of the Establishment Agreement by the 1st Defendant regarding the particulars pleaded in the Plaint.

Whether the Bank was negligent

27. From the evidence availed to the court, I note that the Bank admitted to software or system glitches that allowed the processing of the subject transactions and failure by its Card Centre to carry out reconciliations as expected. I find that the Bank was a victim of the Defendants exploiting the weaknesses of its system, either knowingly or unknowingly, to carry out the card transactions when the 2nd Defendant's account had already been closed and had a debit balance. Considering the manual nature of the PDQ transactions at the time and given that the 1st Defendant as the merchant did not seek authorizations from the Bank before the card transactions, it was difficult for the Bank to immediately detect that they were being defrauded. In any case, PW 1 admitted in its Forensic Investigation Report dated 16th March 2009 (Plaintiff's Exhibit No. 1) that some of the Bank's officers failed to effectively coordinate and/or facilitate reconciliation activities at the Card Center thus exposing the Bank to loss. This was an implied admission of liability and negligence and I thus find that the Bank should also be held equally liable for the loss as was held by the court in Kenya Commercial Bank Ltd v Fredrick Mallya [2016] eKLR that has been cited by the Bank.

Whether the 1st Defendant unjustly enriched itself by way of fraud

28. The 1st Defendant admitted that it was paid the entire amount of the subject transactions by the Bank, that is Kshs. 13,403,084.90/=. These sums, I have already found, were not to be paid as the 2nd Defendant's account had been closed at the time and had a debit balance. The 2nd Defendant also received these sums while outrightly breaching the Establishment Agreement and the Merchant Agreement and therefore expressly facilitated the fraud. It knew that these transactions were doubtful and unauthorized owing to the sums that were being swiped but still went ahead to encourage and facilitate the same. The 1st Defendant thus benefited from sums that were fraudulently spent by the 3rd Defendant and as such enriched itself by way of fraud.

Whether the Bank is entitled to the reliefs sought in the suit

29. Having found that the 1st Defendant fraudulently received the sum of Kshs.13,403,084.90/=, it follows that the Bank is entitled to the reliefs sought for in the suit which include judgment for the Kshs. 13,403,084.90/=, costs of the suit and interest. However, I am equally persuaded that the bank through negligence and or failure by its staff to spot the fraud in a timely manner also contributed to the loss and hence should be made to contribute to the loss suffered by the Bank. I am therefore satisfied that the above sum of Kshs.13,403,084.90/= is subject to apportionment of liability at 50% as I have found that the Bank was also equally liable and negligent for the loss incurred by it.

Whether the Counterclaim contained in the reply to the Plaint is merited

30. Having carefully considered and analyzed the evidence availed by the 1st Defendant, I find that the 1st Defendant's counterclaim is not merited. In my view, the 1st Defendant did provide any evidential material to substantiate the allegations found in the counterclaim and I am therefore persuaded that the same was not substantiated and or proved to the required standard on a balance of probability. For instance, I find that there was no evidence provided by the 1st Defendant to establish the allegations that the Bank spread false and malicious information to other card issuing banks that the 1st Defendant

was a risky establishment. In addition, I also find that there was no evidence of any loss suffered by the 1st Defendant as alleged or at all. I find therefore that in totality that the counterclaim was not proved or at all to the required legal standard and is therefore not sustainable.

Who bears the costs of the suit and counterclaim?

31. Since the Bank's suit has largely succeeded and the 1st Defendant's counterclaim has failed, I find that the Bank is entitled to costs of both the suit and counterclaim.

Conclusion and Disposition

32. In conclusion, it is my finding that although the Plaintiff's claim as set out in its Plaint dated 2nd October 2010 is merited, the Plaintiff to large extent contributed to the loss herein by failure of its staff to act diligently and spot the fraud before the loss occurred or at its early stages. I find therefore that the Plaintiff should partly bear part of the blame for the loss it suffered. Liability for the loss shall be apportioned at 50% against the Plaintiff. On the hand, the court is satisfied that the 1st Defendant's counterclaim dated 2nd March 2011 is not merited and the same is dismissed forthwith. Subsequently, the court makes the following dispositive orders:

    a. Judgment be and is hereby entered in favour of the Plaintiff in the sum of Kshs. 6,705, 542.45/ = after apportionment of liability at in the ratio of 50%.

    b. The Plaintiff is awarded interest at court rates in (a) above from the date of the judgment till payment in full.

    c. Costs of this suit and the counterclaim be and are hereby awarded to the Plaintiff.

    It is so ordered.

DATED, SIGNED AND DELIVERED VIRTUALLY AT NAIROBI THIS 16TH DAY OF SEPTEMBER, 2024.

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J.W.W. MONG'ARE

JUDGE

In the Presence of:-

Ms. Njagi holding brief for Mr. Mwangi for the Plaintiff.

N/A for the 1st Defendant.

N/A for the 2nd and 3rd Defendants.

Amos - Court Assistant