



**REPUBLIC OF KENYA**

**IN THE HIGH COURT OF KENYA AT NAIROBI**

**COMMERCIAL & TAX DIVISION**

**MILIMANI LAW COURTS**

**HCCC NO. 384 OF 2016**

**YOUTH ENTERPRISE DEVELOPMENT FUND BOARD..... PLAINTIFF**

**-VERSUS-**

**RAFIKI MICRO FINANCE BANK LIMITED.....DEFENDANT**

**JUDGMENT**

1. The controversy in this dispute revolves around a Deed of Guarantee dated 26<sup>th</sup> November 2012 (the Deed of Guarantee) entered between Youth Enterprise Development Fund Board (the Plaintiff or Youth Fund or YEDFB) and Rafiki Deposit Taking Microfinance (K) Limited (the Defendant or Rafiki).

2. YEDFB is a body corporate established under the State Corporations Act (Chapter 446 Laws of Kenya) pursuant to Legal Notice No. 63 of 2007. In the Notice establishing the corporation, one of the objects and purposes of the fund is to provide loans to existing micro-finance institutions, registered non-governmental organizations involved in micro financing, and savings and credit cooperative organizations for onward lending to youth enterprises (Paragraph 4(c) of the Youth Enterprise Development Fund Order 2007).

3. It would be in carrying out that object that the Board entered the Deed in which it granted Rafiki a loan of Kshs.100,000,000/= for onward lending to persons and institutions in accordance with the Credit Guarantee Scheme Operational Policies and Procedures which formed part of the Deed.

4. One of the terms of the Deed was that Rafiki, as the participating financial institution, was to provide a Bank Guarantee equivalent to Kshs.100,000,000/=. In pursuance of that covenant, Rafiki provided a Bank Guarantee (the Chase Bank Guarantee) issued by Chase Bank Limited (Chase Bank).

5. In a sad twist of events, Chase Bank was placed under receivership by Central Bank of Kenya forcing the Youth Fund to demand that Rafiki furnishes a fresh Bank Guarantee from a financially sound institution. One aspect of the case by the Youth Fund is that Rafiki has failed, refused and/or ignored the demand and is in breach of the contract.

6. The Youth Fund alleges that Rafiki is also in breach of other covenants as it:-

*a) Failed to provide support and cooperation during evaluation of the utilization fee and claim verification.*

*b) Granted loans to persons above the age provided for under the Credit Guarantee Scheme Operational Policies and Procedures.*

*c) Made very little disbursements so that only 40% (Kshs.40,000,000) of the amount granted to it has been utilized.*

7. On 30<sup>th</sup> June 2016, the Youth Fund issued a Notice of termination of the Guarantee and recalled the entire loan of Kshs.100,000,000/= and utilization fee. The Youth Fund asserts that it was a further term of the Deed that the sum due and owing would become payable to the Plaintiff within seven (7) days of the termination taking effect, failure to which the same would attract penalty interest at the rate of 6% per annum above the Central Bank of Kenya rate until payment in full.

8. It is upon those premises that the Fund seeks Judgment against the Rafiki as follows:-

*a) Kshs.100,342,693/=.*

b) Interest on (a) above at the rate of 6% p.a above the prevailing Central Bank of Kenya Prime Lending Rate as at 8<sup>th</sup> August 2016 till payment in full.

c) Costs of the suit.

9. On its part Rafiki, states that the Chase Bank guarantee was to remain in force up to and including 1<sup>st</sup> January 2018 and that on 6<sup>th</sup> June 2016 Rafiki wrote to the Fund confirming the validity and legality of the Bank Guarantee. Again, in respect to the Bank Guarantee, Rafiki makes reference to the letter written by Chase Bank Ltd (In Receivership) on 22<sup>nd</sup> November 2016 to the Youth Fund indicating that the Bank Guarantee continued to be valid upto the date of its intended expiry subject to conditions of receivership under Section 45(5) (b) of the KDI Act.

10. Regarding another breach, Rafiki states that at the time evaluation was done on it, it was undergoing operational constraints but which it worked out and advised the Youth Fund of their capacity and willingness to comply with the evaluation procedures. That the Fund failed to respond to the Defendant's proposal and proceeded to terminate the contract.

11. As to the amount of disbursements made, Rafiki denies the allegations of the Youth Fund that they were dismal and states that it had utilized more than 90% of the funds invested by the Fund, both in loans and guarantees.

12. Ultimately, Rafiki argues that the termination of the Deed was premature and impulsive, as it has been and continues to be in compliance with the terms of the contract. That aside, Rafiki asserts that if the termination is found to be valid, still the Youth Fund is not entitled to the amount demanded as the Deed provides that the Youth Fund shall provide covers on defaults of start-ups at 70% and for established premises at 50%. Rafiki urges for a reconciliation to be done so as to determine the liability attached to the Fund.

13. This Court was asked by the parties to determine this matter on the basis of witness statements, documents and written submissions. The parties proposed different issues but I accept those framed by the Youth Fund as truly capturing all issues raised for determination as the issue of breach is not just in respect to the Bank Guarantee.

14. The issues for determination are:-

- a) Whether the Defendant breached the terms and conditions of the loan granted to it by the Plaintiff.
- b) Whether the Defendant is liable to repay the loan sum of Kshs.100,000,000/= together with accrued interest.
- c) Which party is liable to the costs of the case?

15. The Youth Fund pleads three types of breach which I examine in turn.

16. The Security clause of the Deed reads:-

“To secure the Kshs.100,000,000 (Kenya Shillings One Hundred Million) invested by the Guarantor in this Guarantee Scheme, the participating Financial Institution has agreed to provide a bank guarantee equivalent to the said amount to cover the period of this Deed of Guarantee. Where the Bank Guarantee does not cover the full period, the renewal of the bank guarantee shall be done at least 30 days before its expiry to avoid the automatic termination of this Deed of Guarantee and call up on the bank guarantee as envisaged herein above.”

17. It is common ground that at the time material to the dispute, Chase Bank which had provided the Bank Guarantee was placed under receivership. Because of this, the Youth Fund demanded for a fresh guarantee but Rafiki insisted that the guarantee it was holding was still valid.

18. At the center of this first issue is a letter of 22<sup>nd</sup> November 2016 from Chase Bank (in receivership) to the Youth Fund assuring the latter as to the validity of the Guarantee. It reads:-

“CHASE BANK

(IN RECEIVERSHIP)

22<sup>ND</sup> November 2016

Dear Sir/Madam

RE: CONFIRMATION OF AUTHENTICITY AND VALIDITY OF

BANK GUARANTEE

We have been requested by our client, Rafiki Microfinance Bank Limited, to confirm to you the authenticity and validity of our bank guarantees.

As such this is to confirm that the Guarantees whose details are as below indeed originated from Chase Bank Kenya Ltd and are binding with the signatures appended thereof and realizable on demand.

GUARANTEE REFERENCE	AMOUNT (KES)	APPLICANT	BENEFICIARY
CB/CR/LG/ RDTMKL/ 1543-12	100,000,000.00	Rafiki Microfinance Bank Limited	Youth Enterprise Development Fund

However, please take note that Chase Bank Limited is currently in Receivership and conditions of Receivership apply pursuant to Section 45(5) (b) of Receivership Law (KDI Act).

Any assistance accorded to them will be highly appreciated.

Yours faithfully,

FOR AND ON BEHALF OF CHASE BANK (IN RECEIVERSHIP)

Authorized signatory (Signed) Authorized signatory (Signed)”

19. This Court has read submissions by counsel for the Youth Fund and reflected on its entire case and it is not apparent that the Guarantee was any less efficacious simply because Chase Bank was under receivership. Breach in this regard has not been proved.

20. In any event when Chase Bank gave the Guarantee, it was approved by the Youth Fund. Nowhere in the contract was Rafiki obligated to provide a fresh Guarantee in the event that the Guaranteeing Bank was placed under receivership. I would think that having approved the Guarantee by Chase Bank, the Youth Fund, just as Rafiki, had signed up to live with any consequences of Chase Bank being in a position of inability to carry out its obligation.

21. Rafiki is also assailed for failing to provide support and cooperation during the evaluation of the utilization fee and claims verification. Under the provisions of the Deed, the Credit Guarantee Scheme Operational Policies and Procedures are read to form part of the Deed. On reports and inspections, the policies and procedures manual reads:-

“(7.3) Reports and Inspections

a) The Financial Institutions shall submit such statements and furnish such information as the YEDFB may require in connection with any credit facilities provided under the Scheme ( *a general format is hereby annexed, (Annex 1”*);

b) The Financial Institution shall also furnish to the YEDFB all such documents, receipts, certificates and other writings as the latter may require and shall be deemed to have affirmed that the contents of such documents, receipts, certificates and other writings are true, provided that no claim shall be rejected and no liability shall attach to the Financial Institution or any officer thereof for anything done in good faith;

c) The YEDFB shall, insofar as it may be necessary for the purposes of the Scheme, have the right to inspect or call for copies of the books of account and other accounts records (including any book of instructions or manual circulars covering relevant general instructions regarding conduct of advances) of the Financial Institution, and of any borrower from the Financial Institution. Such inspection may be carried out either through the officers of the YEDFB or any other person appointed by the YEDFB for the purpose of inspection. Every officer or other employee of the Financial Institution or the borrower, who is in a position to do so, shall make available to the officers of the YEDFB or Central Bank of Kenya or the person appointed for the inspection as the case may be, the books of account and other records and information which are in his possession. Such communication or requirement shall originate from the Chief Executive Officer or the Manager in-Charge of the Scheme and to the Chief Executive Officer or the Managing Director of the Participating Financial Institution.”

22. In the letter of 30<sup>th</sup> June 2016, the Youth Fund complains that it lacked the support and cooperation of Rafiki during the evaluation of utilization fee and claims verification and cites this as one of the breaches. In response to this letter Rafiki reacts as follows to this specific complaint:-

“We were operating under stress at the time of your visit, in May 2016, as you are aware and this may have resulted in our “apparent lack of support”. For this, kindly accept our apologies. We have since stabilized our operations and are now in a better position to give the attention you deserve to complete your evaluation and verification exercise.”

23. In this letter Rafiki does not deny the breach. To the contrary it apologizes for the apparent lack of support. This is also the tone of paragraph 6 of the statement of defence.

24. In its submissions, counsel for Rafiki introduces an unpleaded issue after citing clause 6.6.1.2 of the deed which reads:-

“Either party (a Terminator) shall be entitled to terminate this Deed of Guarantee forthwith by notice in writing (a “Terminating Notice”) if any of the following events shall occur:

(a) The Terminatee committing any breach of any of its obligations under this Deed of Guarantee and the Terminatee failing to remedy such breach (if capable of remedy) within 30 days after having been given notice to do so by the Terminator; and,

(b) The Terminatee entering into bankruptcy whether compulsory or voluntary (except for the purposes of a *bona fide* reconstruction or amalgamation with the consent of the other party, such a consent not to be unreasonably withheld) or the Terminatee having an administrator appointed or a receiver, administrative receiver, or manager being appointed over any part of the assets or undertaking of the Terminatee.

(c) The Loan Portfolio guaranteed is exhausted and the Participating Financial Institution fails to renew within a period of 60 days.

(d) In the absence of the events (a-c) but upon giving the other party a written notice of not less than 60 days, either party may terminate this agreement and the parties shall honour any obligations outstanding prior to the termination.”

25. Counsel makes the argument that the Youth Fund ought to have issued a Terminating Notice with a Notification period of 30 days within which Rafiki would cure the alleged breach. It argues that had the proper notice been issued then, compliance and remedies would have been conducted within the contractual timelines.

26. This line of defence is new and unpleaded. Other than alleging that the Notice was premature and “impulsive”, Rafiki does not plead impropriety in any other way. To entertain this defence would be to allow the Defendant to traverse outside its pleaded defence and this Court is reluctant to do so.

27. Yet even if the matter was properly before Court then a wholesome reading of the Notice demonstrates that it is a proper Notice. It reads:-

“Youth Enterprise Development Fund Board

30<sup>th</sup> June 2016

Chief Executive Officer

Rafiki Microfinance Bank,

NAIROBI

Dear Sir,

RE: CALL FOR THE PRINCIPAL OF KSHS.100,000,000/=

Reference is made to the above matter and your letter dated 6<sup>th</sup> June 2016.

We have had numerous challenges in regards to the administration of the loan facility advanced to yourselves courtesy of the Deed of Guarantee entered on 20<sup>th</sup> November 2012 between YEDF and yourselves. The said challenge are as hereunder:-

1. Lack of support and co-operation during evaluation of utilization fee and claim verification;
2. Ignoring and/or refusing to have the bank guarantee substituted as per the Fund’s request;
3. Less disbursements of less than Kshs.40,000,000/= meaning that Kshs.60,000,000/= has never been utilized since the inception of the Credit Guarantee Scheme as reflected in the quarterly reports.

It is apparent that working under the prevailing circumstances has been difficult and as such the Deed of Guarantee has been breached. Consequently, we hereby do issue yourselves with a thirty (30) days termination notice as per the provisions of *Clause 6 (6.1.2) on “Amendment and Termination”* which says, ..... *Either party (a Terminator) shall be entitled to terminate this Deed of Guarantee forthwith by notice in writing (a “Terminating Notice”) if any of the following events shall occur:*

*(e) The Terminatee committing any breach of any of its obligations under this Deed of Guarantee and the Terminatee failing to remedy such breach (if capable of remedy) within 30 days after having been given notice to do so by the Terminator.....”*

Arising from the above, we demand repayment of the outstanding balances of Kshs.100,000,000/= and utilization fee being the amount due and owing to the Fund from yourselves within the next thirty (30) days.”

28. The Notice cites Clause 6.6.1.2 which gives a Notice to remedy within 30 days. There is no evidence that Rafiki remedied the said breach within 30 days. What it talks about in its letter of 22<sup>nd</sup> July 2016 is that:

“We have since stabilized our operations and are now in a better position to give you the attention you deserve to complete your evaluation and verification exercise.”

The breach alleged was lack of support and cooperation during the evaluation process, the Defendant does not demonstrate that it had in fact extended that support and cooperation within 30 days of the demand. This Court accepts the grievance by the Youth Fund that there was breach of the Deed and it was entitled to terminate the contract.

29. Upon termination, Rafiki was under an obligation to repay the sum guaranteed within 7 days from the date of earlier termination or face a sanction. The sanction was as follows;

**“Where the said amount is not repaid on the date it is due, then the Participating Financial Institution shall pay a penalty interest of 6% per annum above the prevailing Central Bank of Kenya’s prime lending rate until payment in full.”**

30. It is common ground that Rafiki is still in default and would have to suffer the penal interest ascribed under the contract. But before the Court can possibly make that final call, it has to consider one other defence invoked by Rafiki. Rafiki asserts that under the terms of the Deed, the Youth Fund would provide cover on default of 70% on start-ups and 50% for established premises. In paragraph 9 of the Defence Rafiki argues that a reconciliation is necessary to determine the liability attached to the Youth Fund.

31. But Rafiki does not follow through that argument. First, it does not provide any evidence of the extent of default of the defaulters, if any. Second, it does not bespeak an order for the taking of accounts and the Court has no basis to grant it. The line of Defence then collapses.

32. Ultimately the Plaintiff has proved its case and I enter judgment in its favour against the Defendant for Ksh.100,342,693.00 plus interest thereon at 6% per annum above the prevailing Central Bank of Kenya lending rate as at 8<sup>th</sup> August 2016 until payment in full. Costs as well to the Plaintiff.

**Dated, Signed and Delivered in Court at Nairobi this 5<sup>th</sup> Day of October 2020**

**F. TUIYOTT**

**JUDGE**

**ORDER**

In view of the declaration of measures restricting Court operations due to the COVID-19 pandemic and in light of the directions issued by his Lordship, the Chief Justice on 17<sup>th</sup> April 2020, this Judgment has been delivered to the parties through virtual platform.

**F. TUIYOTT**

**JUDGE**

**PRESENT:**

Muruiki holding brief for Mwaura for the Plaintiff.

Njoroge for the Defendant