REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

CIVIL CASE NO 3102 OF 1988

WATSON MOGERE .....PLAINTIFF

BENJAMIN OMWANWA.....PLAINTIFF

FRANCIS KIBORE.....PLAINTIFF

VERSUS

EAST AFRICAN BUILDING SOCIETY.....DEFENDANT

JUDGMENT

In this suit brought by originating summons several prayers were made. However, at the time of hearing of the suit the issues agreed upon and on which this Court was asked to pronounce judgment on are only two.

They are:

1) Under the contract entered into between the parties when was the defendant entitled to commence charging interest on the sum of Kshs 700,000.

2) Was the defendant entitled in law to charge the plaintiffs interest on annual rates on the said sum of Kshs 700,000.

First the background facts.

The three plaintiffs, Watson Mogere, Benjamin Omwanwa and Francis Kibore, are the registered owners of land known as LR 36/1/791, situated at Eastleigh Section II, Nairobi. By a letter of offer dated 20th March, 1984, the defendant, East African Building Society agreed to advance to them a sum of Kshs 700,000 on the security of a legal charge over the property, repayable over a period of 15 years, by monthly instalments of Kshs 10,465/=. The loan would attract interest at the rate of 16 per cent "From the date of acceptance of the offer" to be calculated "on annual rates." Although that was so, the letter of offer had a clause to the effect that the amount of the loan would not be paid over to the plaintiffs until "after the receipt by the Society's advocates of the instrument of security duly registered at the appropriate registries."

The letter of offer contained other terms. I wish however to allude to only two of those. Clause 9 stipulated that if the agreement to advance "is not completed within 3 months of the acceptance of the offer or within such time for acceptance as may be extended by the Society, then the agreement to advance may be terminated by the Society without any prejudice to all rights accrued to the Society as at the date of termination.

Clause 11 provided that the letter of offer to advance and representations contained in plaintiffs' application from which they had lodged with Society would constitute the terms and conditions of the agreement to advance.

On 2.4.84 the plaintiffs accepted the offer by the defendant to advance them the Kshs 700,000 on terms which were set out in the letter of offer to advance dated 20th March, 1984. The security documents were, however, not made ready until 19th September 1984. The plaintiffs executed the same and returned them to the defendant's advocates on 23rd October, 1984. That was about seven months from the date of acceptance of the offer to advance money. For some reason the charge was not registered until 6th June, 1985. Even then the amount of the advance was not released to the plaintiffs until 28th August 1985.

The sums advanced became due on 1st August 1985, according to the charge document. So that the 1st instalment became due and payable on 1st September 1985. It is in evidence, that the plaintiffs have been paying the agreed instalments on due dates and have not at any time defaulted. That notwithstanding the first statement they received from the defendant dated 1st January, 1986, reflected the balance outstanding as being Kshs 905,456.50 that figure included the sum of Kshs 127,655.50 interest for the period 2nd April 1984 to 31st December, 1985. The second statement covered the period ending 31st December, 1986. The balance then outstanding was Kshs 924,749.55, up from Kshs 905,456.50 which was shown as outstanding a year earlier. The plaintiffs had regularly paid the contractual instalments on due dates.

The balance as at the 31st December, 1987, was Kshs 949,649.45. The trend was that the balances were increasing instead of decreasing. This trend appears to have provoked this suit.

There are some aspects of the charge document which are significant and merit special mention. The charge provides that the date of appropriation of the sums advanced was 2nd April, 1984. It should be recalled that that was the date the plaintiffs accepted the offer to advance money to them. Then there is clause 1 (c) of the charge. It provides:

> "(c) To pay interest at the rate specified in the schedule hereto:
>
> (i) from the date of appropriation specified in the said schedule until the thirty – first day of December next following upon the whole of the principal sum; and
>
> (ii) thereafter in each succeeding year on the aggregate amount of all sums owing by the borrower to the Society on the last day of the preceding calender year such interest to be debited to and became payable by the borrower on the first day of the said succeeding year provided that if the principal sum or any part thereof shall not be advanced by the Society to the borrower until the calender year following that which the date of appropriation falls the principal sum shall be deemed to have been advanced in full on the last day of the calender year in which such date of appropriation falls;"

Those are the basic facts. The defendant did not dispute them. So although by directions given by the Court on 8th November, 1988, the parties were at liberty to call witnesses, no witnesses were called. The learned counsels for the parties were content with facts disclosed by affidavits filed and their annextures, which facts I have substantially set out above.

Mr Ngobi appeared for the plaintiffs, while Mr Oyatsi appeared for the defendant Society. The main thrust of Mr Ngobi's submissions was that the manner in which the defendant charged interest offended both public policy and Central Bank of Kenya regulations, was unconscionable and not in accordance with the proviso to clause 1(c) (ii) of the charge document. In his view the charge supercedes the letter of offer, and that clause 10 of the letter of offer was clear on that. The clause states, *inter alia* that the advance would be secured by a legal charge which would be prepared by the Society's advocates embracing such terms and conditions "as the society in its absolute discretion shall think fit." Mr Ngobi construed that clause to mean that the letter of offer did not create a binding contractual relationship.

Mr Oyatsi, on the other hand did not think there was any ambiguity in the terms of the letter of offer of advance. In his view it was the document which created a binding contractual relationship between the parties. In his view that document is clear that interest would be chargeable with effect from 2nd April, 1984, the date the defendant allegedly made available or rather set aside Kshs 700,000 for the plaintiffs' appropriation upon satisfaction of the pre-conditions. Consequently, he said, the money was not available for the defendant's use and therefore interest was properly charged and claimed by them. He was also of the view that the plaintiffs read the terms of the letter of offer, understood them and endorsed on the letter of offer accepting that they would be bound by them. Consenquently, he said, the parties having freely contracted the Court has no business interfering.

On the submission by Mr Ngobi, that the manner in which the defendant charged interest offended public policy Mr Oyatsi's response was simple and short. The plaintiffs did not state which public policy was infringed. Furthermore, that the plaintiffs were responsible for delay in the registration of the charge, and therefore they should not be heard to complain with regard to the delay by the defendant releasing funds to them. He further submitted that there was no default on the part of the defendant which would disentitle it from enforcing any or all of the terms of the letter of offer.

Mr Oyatsi's submission with regard to compound interest was that the defendant was entitled to charge compound interest under the contract between the parties. He cited various gazette notices to show that the defendant was not caught up by the various Central Bank of Kenya circulars which had been issued from time to time fixing the maximum interest rates banks and financial institutions were not to exceed. He submitted that none of those circulars, covered building societies and therefore interest chargeable by them is governed by contract.

With regard to clause 1 (c) (ii) of the charge, Mr Oyatsi submitted that the plaintiffs were in effect relying on their own default to refuse to pay the money they had contracted to pay.

In his reply Mr Ngobi submitted that, by agreement 20th March, 1985 was given as the date of completion of the agreement to advance. The time passed. The agreement had not been completed. Nonetheless the defendant continued with the deal. Mr Ngobi argued that by doing so, it acquiesced to the delay. Consequently it is estopped from raising it. He further submitted that the letter of offer was an invitation to treat because before the charge was registered the plaintiffs could withdraw from the deal. So in his view, the charge was and is the contract document with the result that interest should be charged according to its terms.

I now propose to deal with the agreed issues.

The first of those issues entails a minute scrutiny of the letter of offer of advance, and the charge.

The letter of offer of advance fixes the 2nd April 1984, as the commencement date for charging interest. It was the date the plaintiffs endorsed their acceptance of the offer of advance. It is also the date of appropriation stated in the schedule to the charge.

The date of appropriation as I understood it from the evidence before me, is the date when the defendant says it set aside the principal amount of the loan for use by the plaintiffs. Although that may have been so, the money could not possibly be paid over to the plaintiffs then. They had to execute the charge before that. The charge had not been drawn by the defendant's advocates. The plaintiffs had to surrender the documents of title to their property known as LR No 36/1/791 – Galole Rd, Eastleigh Section II, Nairobi, to the defendant's advocates, for purpose of drawing the charge. The advocates would also require time for that purpose. So that although the appropriation date was fixed to be 2nd April, 1984, the defendant knew the money to be advanced would not be released then or soon thereafter.

The effect of fixing 2nd April, 1984, as the appropriation date was that interest would be charged for money which had not been advanced and which would not be advanced until the charge would have been executed by the plaintiffs and duly registered as required by law.

Could the acceptance by the plaintiffs of the terms of the letter of offer of advance *per se* entitle the defendants to part with the Kshs 700,000 they agreed to advance to the plaintiffs? That question has in a way been answered above. The money could not be paid over before the charge was executed and registered. The charge has its own independent terms and conditions for the grant of the advance without recourse to the letter of offer.

That then means that the letter of offer did not contain all the terms and conditions for the advance of money to the plaintiffs by the defendant. The letter of offer in effect, contains, terms and conditions which had to be satisfied before the loan could be given. It does not however contain all the terms and conditions governing the whole of the contractual relationship between the parties. For example there are no terms and conditions spelled out therein with regard to default in the payment of agreed instalments by the plaintiffs. For those and other rights of the parties under the contract one has to look at the charge. So to my mind the letter of offer was merely an agreement to enter into a loan agreement.

The charge sets out, *inter alia*, how interest would be worked out. That is contained in clause 1 (c) of the charge. It states that interest would be chargeable with effect from the date of appropriation which is shown in the schedule as 2nd April 1984 (paragraph 1 (c) (i)). Clause 1 (c) (ii) is not clearly worded. However, a careful reading of it appears to suggest to me that the defendant recognises that circumstances could set in to make it impossible for it to pay over the principal sum to the plaintiffs on the appropriation date or soon thereafter. So that in the words of that clause if the advance would be made timeously, then interest for the year 1984 would accrue and be compounded and, itself attract interest in the following year. However, if the principal sum was not paid over in the course of 1984, then for purposes of working out interest, the advance would be deemed to have been made on 31st December, 1984.

The defendant, however, seems to construe the clause differently. It was contended on its behalf, or so I think, that interest would accrue from 2nd April, 1984, whether or not the principal sum was paid over to the plaintiffs during 1984, and that it would be compounded at the end of each year including 1984. If such construction were to be given to clause 1 (c) of the charge, then the proviso in clause 1 (c) (ii) will be rendered meaningless. The deeming clause, to my mind, was included so that the plaintiffs could not be required to pay interest for money they had not received. That conclusion appears to receive support from authorities.

In *Holder v Inland Revenue Commissioners* [1932] AC 624, Viscount Dunedin, described "interest" as money payable for an advance made by say a bank to the person paying. So that in his view there must be an advance made before interest becomes payable.

In *Words and Phrases Legally Defined,* Vol 3 p 79, "interest" is defined as:

> "…….. the return or compensation for the use or retention by one person of a sum of money belonging to or owed to another."

Here "use" or "retention" is used to imply that the money loaned or owed must be in the custody of the person liable to pay interest.

According to *"Dictonary of English Law,* 1923 Edition" "Interest" is "calculated at a rate propotionate to the amount of the principal and to the time during which non-payment continues ……"

In light of those authorities, which are based on the common law, it is contrary to common law to charge interest for money which has not been advanced. The construction given to the charge by the defendant on the question of the effective date for paying interest is, therefore, untenable.

Assuming I am wrong and they are right, are the plaintiffs obliged to pay interest from 2nd April, 1984? Mr Ngobi for the plaintiffs submitted that it will be contrary to public policy to require them to do so. Mr Oyatsi, did not think there is any public policy prohibiting that.

A contract may, under the common law, be rendered unenforceable either wholly or in part for being

contrary to public policy. Is there a rule of public policy prohibiting the charging of interest before money on which the interest is charged passes over to the person to pay the interest? Mr Oyatsi, seemed to introduce a new angle to the concept of interest. In his view once a lending institution agrees to appropriate a designated sum of money for the use of a prospective borrower, that money becomes unavailable to it for appropriation for any other use or purpose. It is set aside to await satisfaction by the intending borrower of the conditions attached to the loan. Delay by him to satisfy those conditions should not be held against the institution. Instead the institution should be compensated for setting aside that money. The compensation is in the form of interest.

The argument raises fundamental questions. Firstly, suppose the intending borrower does not satisfy the conditions for the grant of the loan, will the lending institution sue him for interest for the period the money was "set aside'? Secondly, is the lending institution able to demonstrate by evidence that actually money was set aside to await the intending borrower to come for it? Doesn't the fact that an institution is licensed as a lending institution presuppose that it is able and capable of maintaining a fund from which to draw money to lend to prospective borrowers? If interest is compensation for use or retention of money belonging to another, can one properly describe money claimed or paid for money yet to be advanced as interest? Possible answers to the foregoing questions will cast grave doubts as to the reasonableness of the argument.

I had earlier posed the question whether there is any public policy against claiming interest for monies agreed to be lent but which has not actually been advanced. My earlier enunciation of what interest is, a principle of common law. Common law is a body of laws or principles of law which have gradually grown up with growth of the nation in which they apply. It is also a principle of commerce that interest is the price a person pays for using or keeping another's money. To maintain those principles practices which undermine them must of necessity be suppressed on the basis that they are contrary to public policy.

What is contrary to public policy with regard to contracts. G H Treitel, in his book, *The Law of Contract,* Third Ed, at p 364 says:

> "A contract which does not involve the commission of a legal wrong may be illegal because its tendency is to bring about a state of affairs which the law disapproves on grounds of public policy. A contract is only illegal for this reason if its harmful tendency is clear, that is, if injury to the public is its probable and not merely its possible consequence." (Emphasis supplied).

In our case and adopting the words of the learned author, above, charging of interest for money yet to be advanced is clearly a harmful tendency of the contract under consideration. It offends the generally accepted principle that interest is payable for the use of or continued retention of another's money. To my mind, therefore, and indeference to Mr Ngobi's submission, it is unconscionable, oppressive as it is unjust enrichment to claim or pay interest for money not yet advanced. It is an affront to common sense and public policy. Courts are not obliged to enforce such contracts, unless the clause requiring such payment is severable.

In my judgment, therefore, the effective date for charging interest cannot possibly be 2nd April, 1984. Considering the facts and circumstances of the case and regard being had of clause 1 (c) of the charge the effective date is 31st December, 1984. Why? The clause is clear that the 2nd April, 1984, was initially deemed as the date the loan amount would be paid over to the plaintiffs. However, the money was not paid over. Nor was it paid over within the three months duration the loan deal was supposed to be completed. Therefore under clause 1 (c) (ii) of the charge, the date money would be advanced was deemed to be the last day of the year in which the appropriation date fell, *viz*, 31st December, 1984.

But money was not paid over to the plaintiffs until August, 1985. So although public policy favours the upholding of contracts, freely entered into between parties, by 31st December, 1984, money had not been advanced to the plaintiffs. The doctrine of illegality will not permit the upholding of contracts which are illegal by reason of being contrary to another rule of public policy. The contract under consideration was freely entered into by men of full age. However it contains a clause which offends against common sense

and public policy as to payment of interest to the extent that it requires interest to be paid by the plaintiffs for a designated period when the principal sum had not been paid over to them. The Court is not obliged to enforce that part of the contract even though the plaintiffs had freely consented to it. It is illegal. The result is that although to my mind, interest was chargeable from 31st December, 1984, as per the document of charge, the plaintiffs are not obliged to pay any interest raised before the loan amount was paid over to them.

I now turn to the second issue. It relates to charging of compound interest. Clause 1 (c) (ii) of the charge permits the charging of what in effect is compound interest. So that under the charge the defendant was entitled to charge interest on annual rates on the Kshs 700,000. However, whether that was legally permissible is another issue. Both counsels submitted at length on the matter. They produced various gazette notices and Central Bank circulars, but I found none which barred the defendants from charging compound interest of the loaned sums of money. I will therefore, answer the second issue in the affirmative.

The result is that any interest charged for the period preceding the date the principal sum was paid over to the plaintiffs offends public policy and the plaintiffs are not obliged to pay it. The defendants are however, entitled to charge interest on annual rates or compound interest if and as far as it does not offend the law and Central Bank regulations

Costs of the suit to the plaintiffs. Order accordingly.

Dated and delivered at Nairobi this 24th day of June , 1992

S.E.O BOSIRE

JUDGE