



REPUBLIC OF KENYA
IN THE COURT OF APPEAL FOR EAST AFRICA
AT NAIROBI
(Coram: Spry, Ag.P., Law, Ag. V.P., & Lutta, J.A.)
CIVIL APPEAL NO. 54 OF 1972

BETWEEN

THE STANDARD BANK LIMITED.....APPELLANT

AND

1. MEHOTORO FARM LIMITED

2. HON. WAIRA KAMA

3. WATHAIYA W/O WAIRA KAMAU.....RESPONDENTS

(Appeal from a judgment and decree of the High Court of Kenya at Nairobi (Madan, J.) dated 10th December,

1971 in Civil Case No. 354 of 1970)

JUDGMENT OF LUTTA, J.A.

This is an appeal from a judgment of the High Court relating to a claim made by the appellant against the respondents Mehotoro Farm Limited (to whom, for convenience, I shall refer hereinafter as "the Company") and Mr. and Mrs Kamau - for the recovery of Shs.841,051/85 alleged to be due from the Company to the appellant; Shs.660,000/- severally from Mr. and Mrs Kamau under guarantees and indemnities signed by them in favour of the appellant; a declaration that two farms - being L.R. Numbers 1713/3 and 7538 are severally mortgaged and charged to the appellant in the sum of Shs.660,000/- each; and for an order, in default of payment by the company and Mr. and Mrs Kamau of the total amount due, for sale of the two farms. The learned judge dismissed the claim against the Company and Mr and Mrs Kamau and held that the memorandum of equitable mortgage by deposit of titles relating to the two farms - L.R. Numbers 1713/3 and 7538 dated 25th January, 1964 and the instruments of variation thereto dated the 1st November, 1968 were void. He declared the two farms freed and discharged from the said memorandum and the instruments of variation.

The company was incorporated with limited liability under the Companies Act - Cap.486 - having changed its name on 5th December, 1967 from "Julietta Company Limited" to "Mehotoro Farm Limited"; its share capital was Shs.400,000/- divided into 20,000 ordinary shares of Shs.20/- each. It owned the two

farms and on 25th January, 1964 by two memoranda of charge by deposit of title documents it charged its immovable properties - the two farms - in favour of the appellant by way of equitable mortgage each to secure an unspecified sum. However, each of the memoranda was stamped for revenue as security for Shs.320,000/-. On 5th September, 1967 Mr. and Mrs Kamau agreed with the directors of the Company to purchase the shareholding at the price of Shs.660,000/- on the terms and conditions set out in a letter dated 4th September, 1967 from Mr. and Mrs Kamau's advocates to the advocates of the Company. The following parts of the said letter are relevant -

"1.the price to be paid for the total shareholding will be the balance of Kenya shillings six hundred and sixty thousand (K.Shs.660,000/-) after deducting therefrom the liability of the Company to the Standard Bank Limited as at the date of completion.

The price will be payable as follows:-

(a)The sum of shillings sixty six thousand (Shs.66,000/-) forthwith by way of deposit to you as shareholders and you shall release the same to the vendor on receipt of Divisional Board consent to the transaction.

(b)the balance on completion.

2.It is an implied warranty of the agreement that the company owns L.R. Nos. 1713/3 and 7538 Ruiru Township (hereinafter referred to as `Kowina Estate') for a freehold estate or for a leasehold estate and will deduce good titles thereto free from encumbrances (other than a charge to the Standard Bank Limited) and that there are no outstanding breaches of the terms and conditions of the titles or of any bylaws, agricultural orders or other legal, government or local government instructions or regulations."

According to the statement of Agreed Facts, the liability of the company to the appellant as at the date of completion was Shs.203,309/95 which was the amount of overdraft in the Company's account at Nakuru. Mr. and Mrs Kamau were advanced Shs.66,000/- by the appellant on or about 11th November, 1967 for the purpose of paying the deposit on account of the purchase price of the shares. The appellant then closed Mr. kamau's account, which had a debit of Shs.66,000/- by transferring it to the Company's account in the Kiambu branch, which was indebted to the appellant, by way of an overdraft, in the sum of shs.203,309/95; the latter was secured by the two memoranda of charge and the guarantees of the directors of the Company. Mr. and Mrs Kamau were advanced Shs.660,000/= through this account for the purchase of the company's shares' this amount was secured by upstamping the two memoranda of charge by two instruments of variation under which the Company agreed that the amount so secured was to be increased to shs.660,000/- in each case.Mr and Mrs Kamau each executed guarantees and indemnities dated 20th November, 1967 and 5th January, 1968 respectively in favour of the appellant to secure the said sum of shs.660,000/-. In the statement of Agreed Facts, paragraphs 12, 13, 14 and 15 read as follows-

"12.To enable the second and the Third Defendants to purchase the shareholdings on the said terms and conditions the plaintiff advanced to the Company a sum of money (hereinafter called `the loan') to the intent and with prior consent and knowledge of the Plaintiff that the Company applies the loan directly towards payment of the said purchase price for the purchase of the shareholding by the Second and Third Defendants. It was further agreed between the Plaintiff on the one hand and the Company the Second and the Third Defendant on the other that the re-payment of the loan together with interest thereon was to be safeguarded by the securities and guarantees referred to in clauses 14 and 15 below.

13.The Plaintiff advanced the loan to the Company so that the same may be utilised by the Company towards payment of the said purchase price as agreed for the purchase of the shareholding by the Second and Third Defendants and loan was so utilised. The Company opened a new account with the Plaintiff in Kiambu, in which it was debited with monies lent and to which the outstanding debt in Nakuru was transferred.

14. In performance of the agreement referred to in Clause 12 above the Charges were upstamped by two instruments of variation each dated 1st day of November 1968 to secure as therein stated the repayment of the total liabilities not exceeding shs.660,000/- with interest thereon.

15. In further performance of the agreement referred to in clause 12 above the Second and the Third Defendants each executed in favour of the Plaintiff the two Instruments of Guarantee respectively dated the 20th November 1967 and the 5th January 1968 to secure the repayment of the liabilities of the company not exceeding shs.660,000/- together with interest thereon."

The learned judge held that the transaction was one for the sale and purchase of shares at the agreed price of shs.660,000/- and that the existing debt, that is, shs.203,309/95, was incorporated in the purchase price and indirectly paid notionally by releasing the previous guarantees by the directors of the Company, for which Mr. and Mrs. Kamau were substituted and thus the existing debt became tainted by being merged in the total purchase price and therefore irrecoverable. He further held that there was no consideration for Mr. and Mrs Kamau to guarantee repayment of the existing overdraft and in that context, the guarantees executed by them were, unenforceable to the extent of the existing overdraft.

The appellant, at the trial of the suit in the High Court, conceded that it had no valid claim against the Company for money which was lent to the latter for the purpose of assisting Mr. and Mrs Kamau to buy shares on the ground that it was rendered void by section 56 of the Companies Act and consequently the guarantees executed by Mr and Mrs Kamau to secure the existing overdraft were to that extent also invalid. However, Mr. Slade, for the appellant, argued before us, as he did in the High Court, that the old debt, that is, shs.203,309/95, and securities thereof could not be invalidated by any subsequent illegality of the loan to the Company for the purpose of assisting Mr and Mrs Kamau to purchase shares in the Company. He submitted firstly, that it was not illegal for the appellant to allow the old debt to continue or to accept Mr. and Mrs Kamau as new guarantors in respect of the old debt. Secondly, he submitted that the old debt was not extraneous to the transaction as it was directly brought in to calculate the purchase did not represent assistance by the Company to mr and Mrs Kamau and therefore there was no contravention of section 56 of the Companies Act. Mr da Gama Rose, for the Company and Mr and Mrs Kamau, contended that the old debt formed part of the overdraft and an integral part of the transaction for the purchase of the shares at the agreed price of shs.660,000/-, the price having been agreed between the directors of the Company and Mr and Mrs Kamau with the knowledge of the appellant. He submitted that as the directors of the Company were paid shs.660,000/- through the Company, the cash price of shs.456,690/05 directly as cash payment and the balance of the purchase price being paid by releasing the directors from their joint and several liability from the guarantees of the old debt, the transaction offended section 56. Mr. da Gama Rose further contended that there was no consideration for Mr. and Mrs Kamau to pay the old debt. He submitted that if the old debt did not form an integral part of the transaction, the consideration pleaded in the plaint was not proved. he also contended that the cause of action in respect of the old debt was not pleaded in the plaint and that it arose from the reply to the defence and that this constituted a departure from the practice governing pleadings and amendment thereof; thus the appellant would not in this case, be entitled to succeed because of the inconsistency between the reply and the plaint. he submitted also that if the old debt does not form an integral part of the transaction then the charges as well as the guarantees are severable. Mr. Slade objected to the latter point being raised in support of the judgment on the ground that there was no cross-appeal. We heard argument de bene esse on the appeal. As regards pleadings, shs.841,051/85 is claimed in the plaint as the total amount owing as at 27th February, 1970, to the appellant by the Company which the appellant had advanced to the Company from time to time. The reply to the defence alleged in paragraphs 3(b) and (c) and 4(a) that -

"3(b) the amount owing to the Plaintiff by the First Defendant on the security of the said Charges at that date was shs.203,309/95;

(c) no payment made by the First Defendant to the Plaintiff after that date was ever appropriated by either party towards payment of that debt of shs.203,309/95.

4(a)the advance which the Plaintiff agreed to make the Second and Third Defendants was shs.456,690/05 only, being the difference between the sum of shs.660,000/- and shs.203,309/95 then owing by the First Defendant as aforesaid."

The essence of Mr da Gama Rose's contention is that there is no cause of action pleaded in the plaint on which the claim for shs.203,309/95 can be grounded. The cause of action in respect of this amount, that is, the old debt, was raised in the reply to the defence and since there are a series of causes of action or a series of contracts, each cause of action or contract must be separately pleaded. As I understand it the plaint alleges that the cause of action is advances amounting to shs.841,051/85, made to the Company over a number of years. In other words, the amount in respect of financial assistance given to the Company over a period of years (that is, since 1964 up to 1968), including that relating to the purchase of shares of the Company by Mr and Mrs Kamau. In my view, it is not necessary to plead separately each advance as a separate cause of action. In any event, the Court has power under Order 6 rule 18 of the Civil Procedure (Revised) Rules 1948 to allow a party, at any stage of the proceedings, to alter or amend his pleadings in such manner and on such terms as may be just. This rule also requires that "all such amendments shall be made as may be necessary for the purpose of determining the real question in controversy between the parties". There is also the inherent jurisdiction of the court to allow such amendments to the pleadings as may be necessary for the ends of justice - see section 97 of the Civil Procedure Act. In my view there is no reason why the inherent jurisdiction of the court would not be invoked in this case or why this practice would not be followed if the appellant were to apply to amend his pleadings. I think that it is open to the court to hold, in a claim of this kind, that only so much of the claim is proved or conversely, so much of the claim is void by reason of prohibition by statute. I do not see any inconsistency between the plaint and the reply to the defence.

The question in this appeal is whether the old debt, that is shs.203,309/95, was tainted by section 56 of the Companies Act. Section 56 provides as follows:-

"56. (1) Subject as provided in this section, it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connexion with a purchase of subscription made or to be made by any person of or for any share in the company, or, where the company is a subsidiary company, in its holding company: Provided that nothing in this section shall be taken to prohibit -

(i) where the lending of money is part of the ordinary business of a company, the lending of money by the company in the ordinary course of its business.

(ii) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase of, or subscription for, fully paid shares in the company or its holding company, being a purchase or subscription by trustee of or for shares to be held by or for the benefit of employees of the company, including any director holding a salaries employment or office in the company.

(iii) the making by a company of loans to persons, other than directors, bona fide in the employment of the company with a view to enabling those person to purchase or subscribe for fully paid shares in the company or its holding company to be held by themselves by way of beneficial ownership.

(2) If a company acts in contravention of this section, the company and every officer of the company who is in default shall be liable to a fine not exceeding twenty thousand shillings."

The kind of transaction this section is aimed at is the one whereby a company provides financial assistance for the purchase of its shares. Mr Slade argued that financial assistance provided by the company to Mr and Mrs Kamau was in the sum of shs.456,690/05 and that the guarantees of the old debt and the release of the directors from the previous guarantees by obtaining fresh guarantees from Mr and Mrs Kamau did not involve financial assistance from the Company. The question that arises is, what is

the meaning of the expression "financial assistance"? It seems to me that it covers any transaction where not only money but also security or guarantee and indemnity, is provided by a company in order to enable a person to purchase or acquire its shares. Mr Slade submitted that the old debt was unrelated to the new one, presumably he meant that the old debt was not included or involved in the purchase price of Shs.660,000/-. The nature of the transaction was essentially the provision of financial assistance to Mr and Mrs Kamau to purchase or acquire the Company's shareholding, whose value was shs.660,000/-. According to paragraphs 12, 13, 14 and 15 of the statement of agreed facts, set out above, a loan of shs.660,000/- was provided by the appellant to the Company in order to enable Mr and Mrs Kamau to purchase the Company's shares. This was done by the payment of the cash price, that is, shs.456,690/05 to the directors through the Company and by the release of the directors from their joint and several guarantees in respect of shs.203,309/95, which is the difference between shs.660,000/- and the cash price, that is, the old debt, and obtaining from Mr. and Mrs. Kamau guarantees in respect of the consolidated figure of shs.660,000/= and upstamping the charges by instruments of variation to secure the repayment of that amount. Thus the old debt, in my view, was merged in the purchase price of the shareholding of the Company as the Company charged its immovable assets to secure the loan of shs.660,000/= by upstamping the charges to that extent, in my opinion, the conclusion that it provided financial assistance in the sum of shs.660,000/= to Mr. and Mrs Kamau to purchase its shares is inescapable. Mr. and Mrs. Kamau's guarantee extended to shs.203,309/95 because this amount formed part of the total purchase price of the Company's shares otherwise they would not have been connected with it in any way nor would the directors have been released from their guarantees in respect of that amount unless some arrangement by them was made to repay it. Similarly, the Company, as at the date of completion, became liable for shs.203,309/95 because this amount formed part of the value of the total shareholding, which was being purchased or acquired by Mr. and Mrs. Kamau otherwise the guarantees of the directors would have continued. In my view the Company gave financial assistance within the meaning of section 56 of the Companies Act and therefore the charges upstamped by the two instruments of variation each dated 1st November, 1968 to secure the repayment of shs.660,000/= (which includes shs.203,309/95) and the instruments of guarantee executed by Mr. and Mrs. Kamau on 20th November, 1967 and 5 January, 1968, respectively, are void for illegality. Whether or not the parties were innocent is not material because public policy requires that a company shall not provide any form of financial assistance for the purpose of the purchase of its shares. I have no doubt that the parties here were all acting innocently and in good faith. However, the Act has prohibited this kind of transaction and I am unable to see how the courts can fail to enforce the prohibition even though the transaction was innocent. As regards the question whether or not there was consideration for guarantees executed by Mr. and Mrs. Kamau, Mr. Slade submitted that there was the consideration of forbearance to sue, that is, the appellant forbore to call in the old debt. I am unable to agree. The sum of shs.203, 309/95 was preexisting debt and it was not incurred by reason of executing the guarantees. There was no undertaking to forbear nor was there an actual forbearance. In my view there was no consideration for the guarantees executed by Mr. and Mrs. Kamau. In the circumstances I would dismiss the appeal.

Dated at Nairobi this 20th day of December, 1972.

B.C.W. LUTTA

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JUSTICE OF APPEAL