IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: WAKI, NAMBUYE, K. M'INOTI -JJA)

CIVIL APPEAL NO. 22 OF 2013

BETWEEN

RUPA COTTON MILLS (EPZ) LTD.....APPELLANT

VERSUS

BANK OF BARODA (K) LIMITED.....RESPONDENT

(Appeal to strike out Records of Appeal from the Ruling and Order of the High Court of Kenya at Nairobi (Mutava, J.) Dated 15th March, 2012

in

Winding up Cause No. 40 of 2011)

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JUDGMENT OF THE COURT

The appeal arises from the Judgment of **J.M. Mutava, J** (as he then was) dated the 15th day of March, 2012.

The background to the appeal is that, vide a letter dated 4th January, 2010 (the letter of request), the appellant (the Company), requested for various banking facilities from the respondent (the bank) and provided the necessary documentation to facilitate the opening of bank accounts and for urgent disbursement of the requested sums.

Acting on representations and assurances by the Company, the bank sanctioned the release of the sums of money forming the financial accommodation, and also permitted the company to draw down on all the approved financial facilities before registration of the charge and debenture security documents in its favour as required by law.

The company defaulted on all the financial facilities accorded to it by the Bank, prompting the bank to instruct its advocate to issue a statutory winding up notice upon the company. It is this action on the part of the bank that prompted the company to file HCCC No. 526 of 2011, on which the company anchored an interim application for injunction. The court granted a conditional interim injunction, whose terms the Company failed to meet. The interim orders therefore lapsed paving the way for the bank to file a Winding Up Petition No. 40 of 2011. The Company in turn filed a Notice of Motion in the said petition dated 21st December, 2011 seeking to restrain the bank, its agents or servants, from advertising the Winding –up petition pending hearing and determination of that application. It was supported by affidavits sworn by a Director of the Company and opposed by a replying affidavit sworn by the Branch Manager of the Bank's Industrial Area branch. During the pendency of the said application, the Bank also filed an application dated 10th January, 2012 seeking an interim injunction to restrain the Company and its Director from wasting or alienating the property and assets of the Company pending the determination of the application. The Company opposed the application by a replying affidavit sworn on 11th January, 2012 by its Managing Director.

Both applications were canvased by way of oral submissions. The Judge assessed and analized the record and made observations on the Company's case. He noted that the Company acknowledged its debt to the bank in its letter dated 6th October, 2011; that the Company's main reason for resisting the winding up petition was because, the bank was not a secured creditor owing to non-registration of the security documents. The Company had also contended that it was viable and that a winding-up order would greatly prejudice it and other stake holders considering that there were other avenues for recovery of the money owed to the bank by the Company which had not been exhausted. It was also contended that the winding-up proceedings had been actuated by differences between the shareholders of the Company and the management of the Bank, which prompted the Company to file HCCC No. 526 of 2011 to forestall the impending Winding Up

petition. The bank had also filed a counterclaim.

Turning to the Bank's case, the learned Judge observed, *inter alia* that, it contended that, no proof of debt was required in a winding-up cause brought under **section 220** of the Companies Act; (Cap 486, now repealed) (the Act), whose prerequisites the Bank had complied with before initiating Winding-Up petition.

On the law, the Judge construed **section 219** of the Act and held, that a company may be wound up if, it is unable to pay its debts; that a company is deemed to be unable to pay its debts if a creditor to whom it is indebted has served on it a demand requiring it to pay the sum due and owing to the creditor and the company has after three weeks thereafter neglected to pay the sum or to secure or compound the debt to the reasonable satisfaction of the creditor.

Ultimately the Judge found that there was no requirement of proof of debt in a winding –up petition; that to succeed under **section 220(a)** of the Act, the Bank was only required to demonstrate that the company was indebted to it in a sum exceeding one thousand shillings and that the Company had been served with a notice of the debt and had failed to pay for a period of three weeks following service of the notice. He further found that the Company had admitted the debt in the letter of restructuring dated 6th October, 2011 which was *prima facie* evidence of the Company's inability to pay the debt. A statutory notice of three weeks was served on the Company on 11th November, 2011 and expired on the 4th December, 2011. The Company had also failed to pay any part of the undisputably debt owed to the bank. That the Company's assertion that its assets are valued at Kshs. 1 billion was not in itself a bar to the institution of the winding up petition because the Company had failed to apply the alleged assets towards liquidation of the debt owed to the Bank within the notice period.

It was further the Judge's findings that the existence of other recovery options was not in law a bar to the institution of winding up proceedings and that the motive for filing a winding up petition has no place in winding up proceedings.

In light of the above findings, the Judge drew out the following conclusion:

> ***"It is evident that efforts were underway to restructure the debt and to secure it before breakdown of negotiations. Consequently, I feel that this Court is has a duty to give the parties a chance to revisit their relationship and attempt a restructuring that will obviate the need for winding up of the company. I think it would be in the interests of both parties to put aside their egos and get back to the discussion desk. The company is in my view still viable and able to attract business that can service its debts if a reasonable debt programme can be agreed upon by the parties. This court would not wish to preside over the demise of a company enjoying EPZ status and in the light of the fluctuating fortunes that the cotton industry in the country has seen over the last decade or so. That is a sector that needs support and killing a company in the sector should be a last resort for this court. I would therefore exercise my discretion to stay advertisement of the winding-up petition and any proceedings in that regard for a limited period of time to allow the parties to explore amicable settlement of the dispute in this matter. That is indeed in line with Article 159(2) (c) of the Constitution of Kenya, 2010."***

On the basis of the above conclusion, the Judge issued orders, *inter alia* as follows:-

> ***1. That the temporary injunction orders issued in respect of the Company's Notice of Motion dated 21st December, 2011 in terms of prayer No.2 of the Motion are hereby extended for a period of 60 days from today.***
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> ***2. That the temporary injunction orders granted on 11th January, 2012 and issued on 12th January, 2012 in respect of the Petitioner's chamber summons dated 10th January, 2012 are hereby extended for a further period of 60 days from today.***
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> ***3. In the event that the parties will have failed to reach a settlement on expiry of 60 days from today, the petitioner shall be at liberty to advertise the petition.***
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> ***4. That the Notice of Motion dated 21st December, 2011 as amended on 9th January, 2012 and the Chamber Summons application dated 10th January, 2012 are hereby compromised in the above terms.***
>
> ***5. Costs shall be in the cause."***

The appellant was aggrieved and filed this appeal raising four (4) grounds of appeal. It is the appellant's complaint that the Judge erred in law and in fact:

> ***1. In holding that a petitioner for winding up need not establish the veracity of the debt claimed.***
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> ***2. In applying the wrong test in law in reaching a determination that the bank could proceed with the winding up proceedings.***
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> ***3. In failing to consider that the bank had other legal avenues for the recovery of the debt claimed besides the draconian order of winding up granted against the company.***
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> ***4. In failing to consider that the company was financially stable and granting a winding up order against it which would have far reaching consequences that outweigh the banks claim.***

The appeal was canvased by way of oral submissions by learned counsel **Mr. R. Mutiso,** instructed by the firm of R.M. Mutiso & Co**.**

Advocates for the appellant, and written submissions, fully adopted and orally highlighted by learned counsel, **Njeri Mucheru**, instructed by the firm of Mucheru Oyatta & Co. Advocates for the respondent.

Arguing grounds one and two of the appeal as one, **Mr. Mutiso** faulted the Judge: for misapprehending the contents of the letter of 6th October, 2011 and erroneously holding that it constituted an admission of debt; for the failure to scrutinize the circumstances surrounding the disputed debt to establish its existence before sanctioning the winding Up Petition proceedings; and also for the failure to consider as material evidence, the pendency of proceedings in HCCC Number 526 of 2011 between the same parties and over the same subject matter.

Turning to grounds three and four of the appeal also argued as one, counsel submitted that the orders issued by the Judge were draconian in nature as they marked the demise of an otherwise viable and ongoing company to the detriment of not only the company but also its stakeholders; that the Judge failed to properly appreciate the affidavits filed by the company in support of its position and in opposition to the Banks position which clearly demonstrated that the Company was viable.

To buttress the above submission, **Mr. Mutiso** relied on the case of **Re Global Tours and Travels Ltd** in support of his submission, that where an alleged debt is disputed on substantial grounds, there is no basis for sanctioning a winding up petition.

Rising up to oppose the appeal, learned counsel, **Ms. Njeri Mucheru** submitted that section 218 of the Act donates power to the High Court to wind up any Company registered in Kenya, subject to compliance with **sections 219 (e)** and **220 (a)** of the Act, which in counsel's view, the Bank complied with.

Counsel relied on **Rule 23** of the Winding up Rules and the High Court cases of **Eric Cairns Hanna versus International Homes Ltd & others [2005] eKLR,** and **Re Wildlife Shop Ltd & others [1981] eKLR**, in support of the submission that the Judge was entitled to discharge the injunction previously granted in favour of the Company as the Company was simply using it as a weapon to frustrate the Bank from proceeding with the hearing of the winding up petition.

Counsel further submitted that the Judge cannot be faulted in his findings as there was sufficient demonstration that although, the company had claimed that it was viable; it failed to apply its alleged assets towards the settlement of its indebtedness to the Bank within the stipulated statutory notice period, which position in counsel's view, was sufficient justification for the Court sanctioning the winding up petition against the company.

Turning to case law relied upon by **Mr. Mutiso,** counsel urged us to distinguish these from the facts of this appeal.

In reply, **Mr. Mutiso** reiterated that, since the Bank had filed a counter claim in the High Court proceedings, which were pending, the right to proceed with the winding up petition did not lie as in counsel's view, the existence of the High Court proceedings was sufficient demonstration that the debt had been substantially disputed by the Company.

We have anxiously considered the record in light of the rival submissions by counsel for the respective parties. This is an interlocutory appeal on the exercise of discretion by the trial court. Only one issue falls for our determination namely; whether the trial Judge exercised his discretion judiciously when he granted the impugned orders.

The principles that guide the Court when deciding whether to interfere with the exercise of judicial discretion were set out in **United India Insurance Company Limited versus East African Underwriters Kenya Ltd [1985] KLR 898,** which we fully adopt. These are that, we can only interfere with the exercise of that discretion if we are satisfied that the Judge misdirected himself in law, misapprehended the facts, took account of considerations which he should not have taken into account, failed to take into account a considerations of which he should have taken into account or that his decision albeit a discretionary one, is plainly wrong.

Applying the above principles, it is our finding that it was sufficiently demonstrated that the Company applied for and was granted financial facilities by the Bank; that security for the said facilities though provided by the Company to the Bank were not registered in accordance with the law; that the above position notwithstanding, the Bank allowed the Company to draw down on the facilities; that none of the facilities drawn down by the Company were repaid as at the time the Bank initiated the winding up petition, thereby prompting the Company to file HCCC No. 526 of 2011. **Section 212** of the Act provides for three modes of winding up a company namely; by the court, secondly, voluntarily and thirdly, subject to the supervision of the court. **Section 218** of the Act on the other hand vests in the High Court jurisdiction to wind up any company registered in Kenya. **Section 219** makes provision for circumstances under which a company may be wound up. **Section 219(e**) provides that a company may be wound up, if it is unable to pay its debts. **Section 220** on the other hand makes provision for the definition of inability to pay a debt. This arises in instances where there is demonstration that a debt is owed in excess of Kshs. 1,000; that a notice to that effect has been served on the company by the creditor; and that the company has failed to meet its indebtedness to the creditor within the stipulated statutory period of twenty one (21) days.

From the record and as correctly found by the Judge, the debt owed by the Company to the Bank was in excess of Kshs. 1,000/=. A demand for the same had been made by the Bank to the Company but had not been satisfied as at the time the Bank moved to initiate the winding up petition, prompting the Company to initiate HCCC No. 526 of 2011 alleging invalidity of the unregistered security on the basis of which the Bank had founded its right to initiate the winding up petition. The issuance of the statutory 21 days' notice by the Bank to the Company was also not contested.

From the record, there is no doubt that the Judge was satisfied and correctly so in our view, that the above prerequisites had been satisfied. Besides being satisfied with the above position, the Judge was also obliged to bear in mind **section 220 (C)** of the Act which requires, upon the court being satisfied that the company is unable to pay its debts, to determine whether an alleged debt forming the basis of the winding up proceedings is disputed on substantial grounds.

After finding in the affirmative with regard to the bank's compliance with the prerequisites of **section 220(a)**, the learned Judge ought to have proceeded to determine whether the Company's assertion that it disputed the debt on substantial grounds was sustainable to warrant an order staying winding up petition. It was not disputed that the security documents on the basis of which the Bank had moved to initiate the winding up proceedings against the Company had not been registered as required by law, a condition the Company alleged rendered the said security documents invalid and therefore vitiated the Bank's right to initiate the winding up petition. Such validity was dependent on the outcome of the litigation in HCCC No. 526 of 2011 which was still pending. This in our view, was a material consideration that the Judge ought to have determined before arriving at the conclusions that he reached on the matter.

In light of the above, this case is distinguishable from **Pride Inn Hotels & Investment Limited versus Tropicana Hotels Limited [2018] eKLR**, in which the majority Judgment sanctioned the insolvency process because, the appellant and its guarantors had admitted indebtedness as per the terms set out in the summary of lease; both parties had agreed that the appellant had made partial payment of the debt in question; and lastly, that there was also admission that payment of the indebtedness had been halted, a position not demonstrated to exist in this appeal.

In the result, and for the reasons given above, it is our finding that the Judge exercised his discretion wrongly and thereby arrived at a wrong decision on the matter for which we are justified to interfere.

The appeal is therefore allowed. The orders issued by the Judge on 15th March, 2012 are set aside and substituted with orders as follows:

(1) We direct that the winding up petition be stayed pending hearing and determination of HCCC No. 526 of 2011.

(2) HCCC No. 526 of 2011 shall be heard expeditiously on priority basis within ninety (90) days from the date of this Judgment.

(3) Costs of the appeal shall abide the outcome of HCCC No. 526 of 2011.

Dated and delivered at Nairobi this 10th day of May, 2019.

P.N. WAKI

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JUDGE OF APPEAL

R.N. NAMBUYE

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JUDGE OF APPEAL

K. M'INOTI

.....

JUDGE OF APPEAL

I certify that this is a

true copy of the original.

DEPUTY REGISTRAR.