IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: WAKI, NAMBUYE & MURGOR JJA)

CIVIL APPEAL NO. 51 OF 2017

BETWEEN

GEORGE LALLA ODUOR.....APPELLANT

VERSUS

CANNON ASSURANCE (K) LTD.....RESPONDENT

(Appeal from the Judgment/Decree of the High Court of Kenya

at Nairobi (G.V. Odunga, J.) Dated 6th May, 2016

in

H.C. Civil Case No. 174 of 2007)

****

JUDGMENT OF THE COURT

This is a first appeal arising from the Judgment of the High Court of Kenya at Nairobi, Milimani Commercial Court **G.V. Odunga, J** dated 6th May, 2016.

The background to the appeal is that, the appellant is the registered proprietor of LR. No. Nairobi/Block 79/8/3, situated at Buru Buru Nairobi (the suit property). In the year 1999, he was advanced Kshs.1, 500,000.00 or thereabouts by the respondent using the suit property as a collateral. On 22nd April, 1999, the respondent lodged a charge against the suit property which the appellant alleged was defective notwithstanding, that he admitted that as at the time he filed his claim against the respondent, he had repaid to the respondent a total of Kshs. 3,685,000.00 inclusive of interest. He contended the charge was defective because, it was not executed by him, and secondly because the respondent had illegally, fraudulently and unlawfully inserted and or replaced some pages and also inserted a provision for charging penalty interest contrary to the terms agreed upon as between them; that despite the charge being tainted with illegality, the respondent had demanded payment of Kshs.4, 088, 259/; and that he was not indebted to the respondent in the sum of Kshs. 18,681,310/= as claimed in the respondent's counterclaim. The appellant therefore sought from the court a declaration that the charge effected by the respondent against the suit property, was illegal and unenforceable and on that account, stood discharged save for accounts to be taken. He also sought a permanent injunction restraining the respondent jointly and severally by herself, through her agents, servants and /or employees from advertising, selling, trespassing, evicting, alienating and /or in any other manner interfering with the suit property.

In rebuttal, the respondent filed a defence dated 2nd day of May, 2003 and subsequently amended on the 1st day of November, 2011 to incorporate a counter claim. It was the respondent's averments that the charge was properly executed and registered against the suit property with the appellant's acquiescence. It denied that the charge was defective or that it was unknown to the appellant; that the appellant signed the charge before his own advocate a **Mr. M.O. Omuga** on 16th April, 1999 who witnessed and certified the appellant's signature as being correct before the charge was registered against the title on 22nd April, 1999. It further denied changing the terms of the charge illegally, fraudulently or unlawfully by inserting or replacing some pages and asserted that the appellant was duly indebted to the respondent in the sum counterclaimed from him in the sum of Kshs. 18,681,310/.

In rebuttal to the respondent's pleadings, the appellant filed a reply to defence and defence to the counterclaim joining issue with the respondent on its defences while reiterating his averments in the plaint.

The cause was canvassed by way of oral testimony. In support of his claim, the appellant gave evidence as PW1 and also called one witness **Mr. Wilfred Abincha Onono** (PW2), while the respondent called one witness **Edith Nyambura Muahiri** (DW1).

In summary, the appellant reiterated his averments in the plaint on the basis of which he requested the court to declare that he had repaid his indebtedness to the respondent in full, and that the mortgage executed over the suit property was illegal. Firstly because it had been unilaterally altered by the respondent to the detriment of the appellant; and, secondly because the respondent was not licenced by the Central Bank to transact in mortgage business.

PW2 on the other hand stated that, he confined the findings in his report dated 5th December, 2006 to the documents handed to him by the appellant for verification of the correctness of the interest. At no time did he take into consideration the respondent's views on the correctness of his report which according to him, indicated clearly that as at 31st August, 2006, the amount outstanding in the appellant's loan account should have been Kshs. 954,908.38 as opposed to the amount of Kshs. 4,088.259/- pleaded in the defence or Kshs. 18,681,310/= pleaded in the counterclaim.

DW1's evidence on the other hand was based on the documents held by the respondent on the transaction which demonstrated that the appellant was granted a loan whose terms included levying of penalty interest on arrears; that the appellant defaulted in his loan repayment; and that the appellant was duly indebted to the respondent in the sum stated in the counterclaim.

At the conclusion of the trial, the trial court analyzed the record in light of the rival submissions of the respective parties before it as well as the principles of law relied upon by the respective parties and framed issues which were determined in the following terms. As to whether there was a valid charge, the trial court made findings that the charge was duly registered; that the appellant did not produce his copy of the letter of offer to demonstrate that its contents were different from the copy tendered in evidence by the respondent; that the appellant admitted that the charge tendered in evidence by the respondent had been executed before his own advocate a **Mr. Omuga** whom he did not call to testify.

Relying on the case of **Green Palms Investments Ltd versus Kenya Pipe Line Co. Ltd Mombasa** HCCC No. 90 of 2003, the trial court concluded that in the absence of any explanation as to why the appellant never called his lawyer as a witness, the only reasonable inference to be drawn from that conduct was that, had the said lawyer been called, his evidence would have been prejudicial to the appellant's case or embarrassing to the lawyer.

The trial Judge also relied on **section 107 (2**) of the Evidence Act Cap 80 Laws of Kenya; the case of **Mbura and others versus Castle Brewing Kenya Limited and another [2006] 1EA185;** and **Gandhi Brothers versus H.K. Njage T/A K Enterprises** Nairobi Milimani HCCC No. 1330 of 2001 and ruled that the appellant had not discharged the onus placed upon him in law to prove on a balance of probabilities that the charge relied upon by the respondent was invalid. The trial court also added that the appellant's conduct during the course of the transaction left no doubt in the trial court's mind that he raised no objection to the validity of the charge at the earliest opportunity. In fact, according to the trial court, there was sufficient proof on the record to demonstrate that he had communicated in writing to the respondent that he was unable to service the loan, a position he could not have taken had he strongly believed that the charge was defective.

Associating itself fully with the position taken in the case of **Govindji Popatlal Shah versus Nathooo Visandjee [1960] EA 361** as approved in **Govindji Popatlal Shah versus Nathoo Visandjee [1962] EA 372** the trial court ruled that the subject charge having been duly registered, it was enforceable by the court as conclusive evidence of the validity of the charge executed between the appellant and the respondent.

On alleged existence of fraud, the trial court reviewed among others the case of **Central Bank of Kenya Ltd versus Trust Bank Ltd & 4 others** Civil Appeal No. 215 of 1996; and **Kenya Commercial Finance Company Limited versus Kipng'eno Arap Ng'eny & another [2002] KLR,** and ruled that the appellant's oral evidence that the charge had been altered could not in law be used to contradict, vary, add or subtract from the written terms in the charge document on which the parties had deliberately agreed to transact and on that account, dismissed the appellant's assertions of alleged fraud.

Turning to the issue of penalty interest, the trial court among others reviewed the case of **Husa Muddin Gulamhussein Pothiwalla Administrator, Trustee and Executor of the Estate of Gullamhuseein Ebrahim Pothiwalla versus Kidogo Basi Housing Co-operative Society Limited and 31 others,** Civil Appeal No. 330 of 2003 for the principle that parties are bound by the terms of a contract freely entered into by them and a court of law has no business rewriting such a contract. In light of the above, guiding principles the trial court ruled that, the appellant was bound by the terms of the contract he freely executed between himself and the respondent which in the trial court's view, explicitly contained a provision for levying of penalty interest in the event of any default on the repayments. He could not therefore escape responsibility of paying penalty interest. On that account, the trial court found circumstances prevailing in the suit before it distinguishable from those prevailing in the case of **Fina Bank Limited versus Spares & Industries Limited [2000] KLR** where in the Court made observation that there are instances when Equity could be called in aid to rescue a party from a bad bargain.

Turning to the issue as to whether the respondent had the powers to advance a loan against a security, the trial court made a finding that, although the Central Bank was clear that it does not regulate Insurance Companies, **section 50** of the Insurance Act Cap 487 Laws of Kenya permitted Insurance Companies to invest by way of advancement of loans and to take securities for such a loan and since the appellant had not demonstrated how that provision had been violated, the trial court declined to allow him to turn around and challenge a loan facility he himself had benefited from. On that account, the court found the appellant's suit unmerited and dismissed it with no order as to costs.

Turning to the respondent's counterclaim, the trial court disallowed it with no order as to costs for reasons as follows:

> ***"80. With respect to the defendant's claim, there is no evidence that the defendant has released the charged property to grant the***

counter claim in the manner sought before the security is realized at an amount known to the court may well amount to unjust enrichment. Accordingly I decline to grant the counterclaim.

81. In the premise both the plaintiff suit and the defendant's claim fail.

82. There will be no order as to costs."

The appellant was aggrieved and filed this appeal raising ten (10) grounds of appeal subsequently condensed into 4 in their written submissions as follows:-

(1) That there was no valid charge.

(2) That the charge perfected was an illegal contract as it offends Cap 488 of the Banking Act.

(3) That in the absence of a licence under the Banking Act, the respondent lacked legal capacity to prefer the charge.

(4) That the loan advanced has been fully repaid."

The appeal was canvassed by way of written submissions fully adopted and orally highlighted by learned counsel for the respective parties. Learned counsel **Mr. Ochanda O** and **J Omwenga** appeared for the appellant, while learned counsel **Miss E. Ngonde** appeared for the respondent.

Supporting the appeal, learned counsel **Mr. Ochanda** contended that the respondent did not qualify to carry on mortgage business for lack of a valid licence from the Central Bank for that purpose; that this was a mandatory requirement as provided for under **section 4** of the Banking Act; that lack of such a statutory capacitation rendered the mortgage transaction between the appellant and the respondent illegal and a nullity *ab initio*; that they raised this issue before the trial court which shied away from making any pronouncement on it. We were therefore urged to find that the trial court's conduct of shying away from making a pronouncement on the issue amounted to a misapprehension of the law, hence the erroneous sanctioning of the said illegal mortgage transaction between the appellant and the respondent, a position we should not condone. Counsel submitted that the above is sufficient to warrant the orders sought on appeal by the appellant but since the other issues raised in the remainder of the condensed grounds of appeal were equally important, counsel found it prudent to address us on the same.

Counsel submitted that **section 50** of the Insurance Act Cap 487 of the Laws of Kenya relied upon by the trial court to sustain the impugned mortgage transaction between the appellant and the respondent, only related to investments undertaken by the respondent in the course of its business. It had nothing to do with sanctioning the respondent to engage in a mortgage business; that from the record it was undisputed that though the appellant had borrowed Kshs. 1.5. Million from the respondent, he had as at the time of filing the suit repaid Kshs. 3.8 million. In counsel's view, the debt had been fully repaid as what the respondent counterclaimed for was what was allegedly levied as penalty interest which in law, the respondent would not be allowed to levy for the same reason of want of banking licence. The penalty interest charged under the purported mortgage agreement between them and the appellant was therefore tainted, stood vitiated and therefore unenforceable.

To buttress the above submissions, counsel relied on the Court of Appeal of Uganda case of **Bhatia versus Granes Bank Limited [2015] EA 154** for the holding that:

"***an award of interest must be guided by established principles; secondly, that courts of law should not enforce payment of interest that is harsh or unconsionable; and thirdly, that it is now trite law that an illegality once brought to the attention of the court overrides all matters including pleadings and cannot therefore be sanctioned by a court of law."***

Opposing the appeal, learned counsel **Miss Ngonde** submitted that, the appeal arises from a transaction executed by the appellant and the respondent arising from a loan facility of about Kshs. 1,700,000.00 disbursed to the appellant on 27th April, 1999 and 19th June, 2002; that the loan was secured by a legal charge over the suit property; that the loan was to be repaid over a period of five (5) years by sixty (60) equal monthly installments of Kshs. 49, 000/= each, calculated at an annual interest rate of 27.5% per annum; that from the record, the appellant only paid consistently upto the 15th installment when he defaulted; and as at 31st August, 2006, the appellant's indebtedness to the respondent stood at Kshs. 3,565,765.00. In light of the above undisputed position on the record according to the respondent, counsel urged us to affirm the position held by the trial court that there exists a valid charge over the suit property; that there was no fraud on the part of the respondent in the handling of the charge; that the respondent as an insurance company lawfully lent monies to the appellant and lawfully held the title to the suit property as security; that the respondent was justified to charge penalty interest; and lastly, that in arriving at the above conclusion, the trial court took into consideration all relevant material presented to court by the respective parties and therefore the trial court not only exercised its discretion judiciously but also arrived at the correct conclusion on both facts and the law, a position we were urged to affirm.

As to whether there exists a valid charge between the parties, counsel relied on **section 107 (2)** of the Evidence Act Cap 80 Laws of Kenya; the case of **Salem Ahmed Hassan Zaidi versus Faud Hussein Humeidon [1960] EA 92**; and the case of **Govindji Popatlal Shah versus Nathoo Visandjee [1960] EA 361** and submitted that both **section 107(2)** of the Evidence Act and the principles of law in those cases placed a burden on the appellant to prove his allegations that the charge was invalid, which burden in the respondent's view, was never discharged. According to them, the appellant never tendered evidence to demonstrate the invalidity of the charge and therefore, the trial court was not in error in holding that the charge in question was voluntary and properly executed by the respective parties without any form of coercion and thus became a legally binding agreement. Secondly, that the undisputed registration of the impugned charge was further conclusive evidence of its validity. Thirdly, that the appellant cannot seek to benefit from equity when he had failed to bring himself within the maxim that he who comes to Equity must come with clean hands; that the appellant having admitted benefiting from the charge

transaction validly executed between them cannot turn around and contend that it is invalid and therefore unenforceable.

As to whether the respondent had a legal capacity to enter into a mortgage Finance with the appellant without a licence from the Central Bank of Kenya, the respondent relied on the case of **Coast Brick & Tiles Ltd & others versus Premchand Ltd [1960] EA 154; Maithya versus Housing Finance Co. of Kenya & another [2003] 1EA 133** and **Alghussein Establishment versus Eton College [1991] 1ALLER 267** and submitted that Part **V** of the Insurance Act which is concerned assets, liabilities and interest provides that Insurance Companies regulated by the Insurance Regulatory Authority can invest by way of advancement and to take security; that in this regard, the appellant failed to show how the respondent had violated the provisions of the Insurance Act or any other provision of the law with regard to the manner the mortgage charge was executed between them; that at the request of the appellant , the Central Bank was clear in its response that it does not regulate Insurance Companies; that upon being referred to the Insurance Regulatory Authority for clarification the appellant took no further action; that if the appellant failed to seek clarification on that issue from the Insurance Regulatory Authority, he cannot be allowed to revert to it and use it to support his appeal. Counsel therefore urged us to affirm the position taken by the trial court and reject the appellant's quest for sympathy from the court as there was clear demonstration on the record that he executed a valid charge over the suit property, benefited from it from his own admission and cannot therefore be allowed in law to turn around and challenge the validity of the charge at a time when the respondent was legally exercising its right to realize the security. We were also urged to find that by his conduct, the appellant is applying double standards when he admits having borrowed money from the respondent and then turns around to challenge the validity of the charge he validly executed securing the loan he admits he took from the respondent.

Turning to the appellant's assertion that, the loan advanced had been fully repaid, counsel relied on the case of **National Bank of Kenya Ltd versus Pipe Plastic Samkilit (K) Ltd & another [2001] eKLR** and urged us to affirm the trial court's finding that the charge between the parties was valid and; that the parties rightly and properly exercised their right of autonomy to enter into the said contract. The appellant should not be allowed to choose what aspect of the said charge he should honour and what aspect he should not as the executed charge had to be considered in totality; that we should affirm the trial court's proper appreciation of the reason behind the levying of penalty interest, which is to deter a borrower from defaulting on his installments, that the court had no jurisdiction to substitute interest provided for in the charge instrument with any other; and lastly, that applying the holding in **Fina Bank Limited versus Spares & Industries Limited** (supra); and **Samuel Kamau Macharia versus Daima Bank Limited [2008] eKLR,** we should find that the appellant's case was not one of those cases where equity could be applied to relieve him from a bad bargain as he had not demonstrated that the trial court failed to properly appreciate the terms of engagement stipulated for in the letter of offer.

As to whether the respondent lacks the statutory powers of sale, counsel urged us to find that **clause 13** of the charge instrument which stipulated clearly that the respondent could realize the security in the event of the appellant defaulting on the repayment of his indebtedness to it was sufficient authority for the respondent to realize the security.

This is a first appeal. Our mandate is to re-appraise the evidence and draw out own inferences of fact. See **Rule 29(1) (a)** of CAR and also **Selle & Another versus Associated Motor Boat Company & others [1968] EA 123** where the Court stated:

> ***"An appeal to this Court from a trial by the High Court is by way of retrial and the principles upon which this Court acts in such an appeal are well settled. Briefly put they are that this Court must reconsider the evidence, evaluate it itself and draw its own conclusions though it should always bear in mind that is has neither seen nor heard the witnesses and should make due allowance in this respect. In particular this Court is not bound necessarily to follow the trial Judge's findings of fact if it appears either that he has clearly failed on some point to take account of particular circumstances or probabilities materially to estimate the evidence or if the impression based on the demeanor of a witness is inconsistent with the evidence in the case generally (Abdul Hameed Saif vs. Ali Mohamed Sholan (1955), 22 E.A.C.A 270."***

We have considered the record and the above mandate in light of the rival submissions and principles of law relied upon by the respective parties in support of their opposing positions. The issues that fall for our determination are the same as those condensed by the appellant in his submissions.

Issue numbers 1, 2 and 3 all relate to the validity of the charge executed between the parties and will be dealt with as one. It is undisputed that the appellant was advanced a loan or Kshs. 1.5 million by the respondent, secured by a charge duly executed by the respective parties over the suit property as the collateral. The charge had been preceded by the letter of offer. The trial court rejected the appellant's assertion that the letter of offer relied on by the respondent, and the mortgage executed between the parties, were not the correct documents. There was simply no evidence of other documents and the appellant failed to call his former advocate to confirm the authenticity of the charge.

It is also not disputed that an amount was still outstanding as at the time the litigation resulting in this appeal was initiated, with the appellant relying on the report tendered in evidence by IRAC through PW2 of Kshs. 954,908.62. PW2's evidence was that the resulting figure was arrived at using interest rate applicable by an entity not engaged in banking business; that such an entity is not allowed in law to charge interest at commercial rates; that the respondent by the nature of its business was not such a banking business institution and could not therefore be permitted in law to charge penalty interest. In contrast, the respondent maintained that the amount then outstanding as at 31st August, 2006 was Kshs. 4,088,259.00 which on account of penalty interest had increased to Kshs. 18,681,310/ as stated in the counterclaim.

When rejecting the appellants claim, the trial court relied heavily on the issue of the validity of the charge which, according to the trial court had validly been entered into and was therefore enforceable. Although the appellant raised the issue of the executed charge document falling short of the threshhold, provided for in **section 50(6**) of the Insurance Act Cap 487 of the laws of Kenya and **section 4** of the Banking Act, we find no serious interrogation and pronouncement on this issue by the trial court. It is therefore the appellant's contention that this is the fulcrum of the appeal. In contrast, the respondent has relied on clause 13 of the executed charge as providing sufficient basis for the mode of recovery of the appellant's indebtedness to them. **Section 50(6)** of the Insurance Act which featured prominently in the appellant's submission both before the trial court and on appeal before this Court is indicated to have been repealed by Act number 12 of 1994. It

therefore follows that it did not fall for consideration either by the trial court or this Court.

The respondent in its submission has instead relied on Part **V** of the Insurance Act as authorizing the respondent to engage in mortgage business. Although an extract of this portion was included in the respondent's bundle of authorities, none of the provisions of law falling into this part was cited to us as providing basis for the respondent to engage in mortgage business. The said provisions are therefore accordingly found in applicable to the issues in controversy in this appeal and therefore rejected.

Our rejection of the application of the provisions in **Part V** of the Insurance Act, as the basis for carrying out mortgage business leaves clause 13 of the Mortgage as the only basis relied upon, as against **section 4** of the Banking Act which the appellant relies on. It provides as follows:

> ***"(4) (1) Every institution intending to transact banking business, financial business or the business of mortgage finance company in Kenya shall before commencing such business apply in writing to the Minister through the Central Bank for a licence ...."***

Section 4(1) of the Banking Act is couched in mandatory terms. It therefore follows that the respondent was obligated to apply and be licensed as such before engaging in any mortgage transaction with the appellant. **Section 4(1)** of the Banking Act being a mandatory statutory provision cannot be overruled by clause 13 in the mortgage charge instrument. In light of the above reasoning, it is our finding that the respondent had no statutory power to engage in mortgage business. The above being the correct position in law, it follows that the mortgage transaction entered into by the appellant and the respondent falls short of the mandatory statutory requirement provided for under **section 4(1) of** the Banking Act.

The above finding however, does not in any way absolve the contracting parties from their obligations under the said mortgage agreement in so far as the repayment and recovery of the loan advanced. What it all amounts to is that the respondent cannot enforce its rights attendant thereto as if those rights were arising from a legally executed and registered mortgage. Those rights revert to the status of civil rights and claims arising with regard thereto are therefore recoverable as a civil debt. In addition to the foregoing, another issue that will fall for determination by the Civil court is the issue as to whether interest provided for in the contract document inclusive of penalty interest is applicable in ordinary civil claims. We say no more on this for fear of either preempting or prejudicing the outcome of any future claims.

Turning to the last issue as to whether the loan had been fully paid, this is answered in the negative. Our reason for saying so is that the appellant's own plaint and as supported by the evidence of both himself and his witness PW2 clearly indicated that Kshs 954,908.62 was still outstanding. The figure arrived at by the appellant took into consideration interest rate chargeable in an ordinary civil debt and not the mortgage rate interest, while the amount of Kshs4,088,259/= was calculated by the commercial mortgage rate. These are matters that will fall for reconciliation and determination before the civil claims court.

The upshot of the above reasoning and assessment is that we find merit in this appeal. It is accordingly allowed. The High Court's Judgment delivered on 6th May, 2016 and the decree resulting therefrom, be and are hereby set aside and substituted there for the following orders:

(1) A declaration be and is hereby made that the charge registered against LR. No. Nairobi Block 76/813 is unenforceable through realization of the suit property.

(2) Any outstanding debt arising from the said charge as between the appellant and the respondent is recoverable as an ordinary civil debt.

(3) A permanent injunction be and is hereby issued restraining the respondent jointly and /or severally by herself, through her agents, servants and or employees from advertising, selling, trespassing , evicting, Auctioning and or any other manner interfering with the suit property LR. No. Nairobi/Block 76/813.

(4) Due to the nature of the proceedings in this appeal, the order on costs that commends itself to us is that each party shall bear its own costs both on appeal and the court below.

Dated and Delivered at Nairobi this 11th day of October, 2019.

P.N. WAKI

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JUDGE OF APPEAL

R.N. NAMBUYE

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JUDGE OF APPEAL

A.K. MURGOR

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JUDGE OF APPEAL I certify that this is a true copy of the original.

DEPUTY REGISTRAR.