

High Court Rules Against Lenders Pursuing Guarantors for Failing to Recover an Outstanding Debt

In a ruling that has understandably sent shock waves across the banking sector in Kenya, the High Court has declared that a lender cannot pursue a guarantor for any outstanding amounts on a loan facility if having been unsuccessful in selling the charged property after exercising its statutory right to do so under section 97 of the Land Act, it purchases the land itself.

In its ruling the Court sitting in Nairobi, stated as follows:

"[T]he Court's understanding of [section 97] is that the [secured creditor] is not in a position to recover the sums advanced during an exercise to sell the charged property and in this case ...was granted leave to purchase the charged property. The secured creditors cannot, therefore, purchase the said property and still go after the guarantors to recover the sum owed."

In many financial transactions, it is common for a lender to require a guarantee, in addition to taking security such as charges and debentures. The position under the law has always been to give lenders the flexibility to choose which security (including guarantees) it wishes to enforce and when and there has been no suggestion in previous case law to our knowledge, which states that after enforcing its rights in respect of a security over assets, that a lender is restricted from pursuing guarantors for the shortfall. It is not surprising, therefore, that the High Court's decision has been received with much concern from the banking sector.

The High Court delivered the same ruling in four different applications for a statutory demand filed by the lender against each of the four corporate guarantors of a loan to a customer.

Background

Home Afrika Limited, Home Afrika Communities Limited, Linyati Limited and Tulip Trustee Company Limited (the Guarantors) had executed letters of guarantee and indemnity (the Guarantees) through which they had guaranteed to pay on demand all money and discharge all the obligations and liabilities owed to Ecobank Kenya (the Bank) by Moru Ridge Limited (the Borrower). In the Guarantees, the Guarantors had pledged to pay on demand the principal sum in an amount exceeding KES 483 million (USD 3.7 million) (the Guaranteed Sum).

Upon default of the loan by the Borrower, the Bank called upon the Guarantors to pay the Guaranteed Sum. However, this demand was ignored and accordingly, the Bank issued a statutory demand to the Guarantors for the Guaranteed Sum.

In response to the statutory demand, the Guarantors made an application to the Court for orders to set aside the statutory demand on the grounds that the debt owed by the Borrower to the Bank, had been wholly settled due to the acts of the Bank in realising its security pursuant to the Orders of the High Court of Kenya in **Civil Suit No. F137 of 2018 (O.S) Ecobank Kenya Limited Vs. Moru Ridge Limited** in which the Bank had been granted leave to purchase the charged property. It is not clear from the ruling in that case what value was placed on the property. In this case, the Bank had requested the court to allow it to purchase the property by public auction, however, the court held that it would be illogical to allow the Bank to purchase the property at a public auction and expect it to obtain the best price reasonably obtainable when it had admitted to the court that such an option had already failed. To this end, the Court allowed the Bank to purchase the property by private treaty "at market price" as this was the most appropriate way of achieving the best price for the property in line with the provisions of section 97(1) of the Land Act.

An Overview of the Key Arguments

The Guarantors contended that the Guarantees upon which the claim against them were premised were extinguished by the Bank's resolve to purchase the security it held in respect of its loans to the Borrower.

On the other hand, the Bank argued that in line with the court's decision in the case of *Peter Munga v African Seed Investment Fund LLC [2017]*, a creditor has the liberty to decide on when to act and on which security, without any direction by the debtor, sureties or the court, unless parties had expressly agreed to the contrary in the security documents. The Bank stated that the charged property had not been sold yet and in any event, as per the last valuation, the forced sale value of the property was lower than the outstanding debt. As a result, the Bank argued that the debt was still due and owing and therefore, it was lawfully entitled to recover the same from the Guarantors as per the terms of the Guarantees.

Further, the Bank argued that the exercise of its statutory power of sale under the Land Act does not discharge the Guarantors of their obligations under the Guarantees as the obligations of the Guarantors are created by the guarantee document itself and not the terms of the charge document.

High Court sides with the Guarantors

The High Court however resolved the dispute on the issue of whether the Court can set aside the statutory demand against the Guarantors on the basis of its interpretation of regulation 17 of the Insolvency Regulations and also its interpretation of sections 97(1) and 97(5) of the Land Act on whether a chargee can go after a guarantor after exercising its statutory power of sale.

Firstly, in its analysis of regulation 17 (6) of the Insolvency Regulations, the Court held that a statutory demand may be set aside if the creditor holds some security in respect of his debt. This is, in our view, an erroneous interpretation of regulation 17 (6) because the provision goes further to add that it applies if, either paragraph (6) is not complied with in respect of the demand, or the Court is satisfied that the value of the security equals or exceeds the full amount of the debt. Our interpretation of this regulation is that if the value of the security is lower than the full amount of debt owed then the statutory demand cannot be set aside. In the present case the Bank put forward evidence to show that the value of the charged property was not enough to settle the full debt and as a result, it would have been expected that the Court would have recognised the Bank's right to pursue the Guarantors for the balance of the debt that would have been due had the charged property been sold. We would have expected the Court to have requested for a valuation of the charged property to verify its value in order to determine whether or not the charged property was sufficient to cover the due debt in full. This appears not to have been done or was not considered.

Furthermore, we note that regulation 17 under Part V of the Insolvency Regulations relates to personal bankruptcy. That being said, there appears to be conflicting decisions on this issue as the High Court in the case of *Peter Munga v Africa Seed Investment Fund LLC (2017)* had held that it is not within the purview of the court to set aside a statutory demand in relation to companies by referring to regulations 16 and 17 of the Insolvency Regulations as these are not applicable with regards to the liquidation of companies but for bankruptcy of individuals. The recent decision appears to contradict this holding and nevertheless invoked regulation 17 in a dispute involving companies.

Secondly, in its interpretation of section 97 (1) and 97 (5) of the Land Act, the Court concluded that where a chargee has exercised its right to sell charged property in pursuance of an order of the court, he shall not be entitled to "still go after the guarantors to recover the sum owed". With respect, this is not what these sections say. Section 97(1) of the Land Act requires a chargee to secure the best price reasonably obtainable upon exercising a power of sale over charged property. Section 97 (3), which we note that the Court did not refer to in its analysis, provides that a chargee shall be in breach of its duty of care imposed in section 97(1) if the charged land is sold below market value. Section 97(5) bars a chargee from any compensation or indemnity from the chargor or guarantor in respect of any liability arising from a breach of the duty imposed by subsection (1). That being said, the Bank did in fact produce evidence that the charged property had not yet been sold and further that the value of the property was not enough to repay all debts due from the Borrower. The issue of the Bank failing to get the best price reasonably obtainable therefore did not arise. Consequently, the Bank could not have been held to have breached any of the provisions of section 97 if the sale of the charged property had not been finalised and it is unclear how the Court concluded that the Bank could not go after the Guarantors given the evidence at hand. Accordingly, we are of the view that the Court erred in its analysis of section 97 of the Land Act and therefore, its decision in favour of the Guarantors, holding that the Bank cannot pursue the Guarantors for any outstanding amounts on the amounts advanced to the Borrower is not merited in law.

Conclusion

It will be interesting to know if the Bank will be appealing against this decision which, based on our analysis, is seriously flawed. In the meantime, it is expected that lenders will be extremely concerned that the Courts have once again delivered a hugely impactful decision without sufficient basis.

In the meantime, the strategies that lenders adopt in exercising their rights following a default will need much more careful consideration.

We will continue to monitor the situation and keep you apprised on any developments.

Should you have any questions regarding the information in this legal alert, please do not hesitate to contact [Sonal Tejpar](#) or [Shellomith Irungu](#).



Sonal Tejpar
Partner
ALN Kenya | Anjarwalla & Khanna

sonal.tejpar@aln.africa



Shellomith Irungu
Partner
ALN Kenya | Anjarwalla & Khanna

shellomith.irungu@aln.africa

Contributor

1. James Mungai – Senior Associate
2. Abdulrahman Faiz – Trainee Lawyer

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