



REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA AT NAIROBI

MILIMANI COMMERCIAL COURTS

CIVIL SUIT NO 266 OF 1999

MERCANTILE FINANCE COMPANY LIMITED PLAINTIFF

VERSUS

JOHN WACHIRA WAMBUGU DEFENDANT

RULING

The Plaintiff filed HCCC No 266 of 1999 against the defendant, claiming a sum of Kshs.23,626,403.30 together with interest at the rate of 30% from 1st September, 1998 until payment in full. This claim was made on account of money lent and advanced by the Plaintiff to the defendant together with interest as at 31st August, 1998. The defendant filed a defence and denied liability. He also filed a counter-claim against the Plaintiff for Kshs.5,016,916/= plus interest at the rate of 31% per annum with effect from 1st March, 1997. He also sought an order that accounts be taken for all the funds held to the credit of the defendant and/or his associated companies. The Plaintiff then filed a reply to the defence, and a defence to the counterclaim of the defendant.

By a letter dated 2nd November, 2000, and signed by the two counsel for the parties herein, this case was referred to Mr Richard M Mwongo, for arbitration. According to that letter, the terms and conditions of arbitration were to be found in details and information arising from the pleadings. The letter instructed the arbitrator to call for any such further documents or information which he may deem necessary. The arbitrator heard the matter and filed an award in court on 9th December, 2002.

One of the properties which the defendant offered as security for the moneys lent to him was L R No 3734/103, which the Plaintiff at paragraph 25 of the Plaint, alleges, was discharged without its knowledge or consent. The arbitrator, in the award, found that the defendant herein, procured the discharge of charge on L R No 3734/103 Lavington, by fraud and found the defendant liable to the Plaintiff for any loss and damage suffered as a result of the discharge of charge. That award having been filed in court, the defendant filed an application dated 19th December, 2002 seeking an order to set aside the arbitral award made by the arbitrator on 11th October, 2002. He also sought a declaration that the findings of the arbitral tribunal are void, invalid, and unenforceable. He sought a further order that, the contract which was the subject of the arbitration is tainted with illegality and that it is against public policy. That application was brought by way of motion under the provisions of Order XLV Rules 15 and 19 and Order L Rule 1 of the Civil Procedure Rules as well as Section 59 of the Civil Procedure Act. It

was also brought under Section 35 of the Arbitration Act and Rule 7 of the Arbitration Rules, 1997, on the following grounds:-

- “1. That the arbitral Tribunal had no jurisdiction to arbitrate on the issue which forms the subject matter of the award herein.**
- 2. That the arbitral award deals with a dispute not contemplated by or not falling within the terms of reference to the arbitration.**
- 3. The arbitral award contains decisions on matters beyond the scope of the reference to arbitration which matters were not pleaded as required by law.**
- 4. The arbitral award is therefore void and invalid.**
- 5. The claimant cannot enforce the award since it is not the proper party herein.”**

The application is supported by the annexed affidavit of the defendant in which he deposes that by a letter dated 2nd November, 2000, the parties herein agreed to refer the dispute for arbitration and that the terms and conditions of arbitration were contained in the said letter. It is further deposed that such terms and conditions were to be found in details and information arising from the pleadings in this suit and that fraud or forgery was not pleaded by the parties. However, at paragraph four (4) of the said affidavit the defendant concedes that the Plaintiff pleaded fraud in its reply to the defence filed by the defendant. I have looked at the reply to defence filed on 22nd April, 1999, paragraph 2 thereof, part of which reads that:-

“..... for the avoidance of doubt, the Plaintiff further avers that it never executed any discharge or other similar document in respect of the said property and reiterates that, the purported discharge thereof was fraudulent.”

The particulars of fraud, were however, not given. It is the defendant's case that, by finding fraud, in the arbitral award, the arbitral tribunal acted in error because:-

- 1. It lacked jurisdiction to make an award on fraud since that was not an issue in the reference.**
- 2. It dealt with an issue which was outside the terms of reference thereby exceeding its mandate**
- 3. It assumed the role of an investigator thus further exceeding its mandate.**
- 4. It failed to consider that the Plaintiff had already transferred the claim herein to a third party and could not therefore enforce a claim or award herein.**
- 5. It relied on circumstantial evidence, speculation and inferences in arriving at the conclusion and award.**

The Plaintiff filed a replying affidavit and in it, maintained, that the issue of fraud and forgery clearly arose in the pleadings in this case as this was pleaded by the Plaintiff in its reply to defence and defence to counter-claim (See RN 5), which was filed with the arbitrator. At paragraph 6(f) of the replying affidavit, it is deposed that, the parties agreed on the issues which called for the determination of the arbitrator and consequently submitted to the arbitrator, a joint statement of issues, dated 3rd August, 2001 (R N 6 refers) and that fraud and forgery were included as issues for determination. It is therefore the Plaintiff's

case, that fraud and forgery, fell squarely in terms of reference and that the arbitrator had the mandate of the parties to determine them.

The arbitrator is accused of disposing of the matter on the issue of fraud/forgery, which according to the defendant was not an issue before him, and therefore that, the arbitrator exceeded his mandate. I propose to first deal with this issue. Did the arbitrator exceed his mandate" In order to address this issue, I shall re-visit the letter dated 2nd November, 2000, which gave the arbitrator the mandate to determine this dispute (annexure JWW (i) refers). The last paragraph of that letter reads as follows, in part:-

***“.....Enclosed herewith, please find copies of pleadings filed herein for your reference. The same contain all the relevant details pertaining to the claims herein. do not hesitate to call for any such further documents as you may deem necessary*”**

The pleadings therefore contained the details of the dispute. I have earlier noted that, in the reply to defence, and defence to counter-claim, the Plaintiff pleaded fraud at paragraph 2 (two), without giving particulars. Had this suit been heard by the court, it is not known if the Plaintiff could have amended the reply to defence to set out the particulars of the alleged fraud. That opportunity was open to the Plaintiff in which case, fraud was an issue which the court could have been called upon to determine as it was in the Plaintiff's reply to defence. Annexure "RN 1" to the Plaintiff's affidavit is a copy of the minutes of a meeting held with the arbitrator. The two counsel for the parties were present and so was the arbitrator. At that meeting, it is shown at page 3 thereof that, the parties had agreed, on the issue of pleadings, to provide statements of their case with evidence which they each wished to rely on, annexed. Following that agreement, a timetable was agreed for submission of pleadings. The parties therefore agreed to plead a fresh before the arbitrator despite the court pleadings. This meeting took place on 16th February, 2001 after which direction number 1 was issued by the arbitrator on 28th February, 2001 directing the order in which pleadings were to be filed. The parties complied with the timetable in that the Plaintiff filed its statement of claim (annexure RN 3), followed by the defendant's reply to the claim (RN 4 refers) together with a counter-claim. The Plaintiff then filed a reply to the defence filed and defence to counter-claim (RN 5 refers). In the reply to the defence that had been filed, it pleaded fraud as an issue and set out the particulars of fraud. This pleading related to the manner in which the Respondent had discharged the claimant's charge over L R No 3734/103 without the claimants knowledge or consent and without any consideration whatsoever. It is after that pleading that the particulars of fraud are set out.

Further, pursuant to direction number 1 by the arbitrator, the two counsel filed a joint statement of issues for determination by the arbitrator. These are dated 3rd August, 2001. Counsel for the defendant submitted that fraud was not an issue for determination while Plaintiff's counsel referred the court to issues number 3, 5, 6, 11, 23 and 25 and submitted that those issues deal with whether or not the discharge of charge was proper and so they deal with fraud as it is the Plaintiff's case that the discharge was without consideration and without the knowledge and consent of the Plaintiff. I have read through those issues and can here say that issue number 3 deals with whether the defendant repaid the moneys advanced to him and secured by the securities pleaded in paragraph 5 of the statement of claim. Issue number 11 deals with the defendant's loan accounts and whether the Plaintiff agreed to retrieve those loan accounts in order to provide the defendant with tax benefits. Issue number 16 is whether the securities were discharged after the defendant had repaid the amount due to the Plaintiff in full. Those issues are relevant to the Plaintiff's pleading that the securities were released fraudulently without payment and I agree with Plaintiff's counsel that although the issues do not specifically mention the word fraud anywhere, if they are read together with the Plaintiff's pleading in the reply to defence on the issue of fraudulent discharge of securities, they bring into focus the issue of fraud.

After the filing of pleadings and agreed issues for determination, the arbitrator gave direction

number 4 (annexure RN 7), pursuant to Rule 16 (b) (5) to determine the question of bad faith, dishonesty or fraud which was an issue in the dispute. He directed that the parties lead evidence limited only to the allegations of fraud and forgery with regard to the discharge of charge of L R No 3734/103 as a preliminary matter upon which he would issue an interim award. From the award which was filed herein, the parties were heard on the issue of fraud. They gave evidence and an interim award was made on that issue. The arbitrator found that the Defendant procured the discharge of charge of LR 3734/103 Lavington NRBI by fraud. In reaching that decision, the arbitrator did not exceed his powers as he had the issue of fraud before him for determination.

I shall now consider the defence counsel's submission that the process by which the arbitrator determined the issue of fraud was faulty and that he constituted himself into a document examiner and hand writing expert and did not use expert witnesses. The document in dispute was the discharge of charge. The signatures appearing on it were not in dispute, however, the claimants managing director whose signature was appended to the discharge in dispute denied signing it, much as the signature was his. The arbitrator observed the discharge in question, the ink used and noted differences. He observed the first and second pages of it and noted inconsistencies in the spacing, margin and font tone that were evident on it and found that the two pages were not from the same document. He then found that the second page was inserted or annexed to the discharge from elsewhere and that the second page could not have been signed as part of the discharge in question. The second page, he found was from a completely different document. He gave a very well reasoned account of his conclusion that the discharge in question was a fraud. He even reproduced the evidence of the defendant at pages 27, 28 and 29 of the award. The defendant had no written request for release of the securities. He said the application was oral. He had no evidence of a letter that forwarded the discharge to his office and he said that there was nothing in writing. Asked whether he got the original title back from the claimant, he said he required the original title of the security in order to register the discharge and that he got it from the Plaintiff. Again he had no letter requesting for the original title from the Plaintiff, neither did he have any letter from the Plaintiff forwarding the certificate of title from the Plaintiff to himself.

Taking all this into account and the exhaustive manner in which the arbitrator dealt with the issue of fraud, I do not agree that he required the evidence of an expert to resolve that issue. From his observations of the discharge and the evidence of the defendant I have pointed out above, he had sufficient evidence before him to resolve that issue.

The next issue I shall deal with is the legality of the second agreement. The defendant urged the court to find that the contract, on which the arbitrator decided the issue of fraud was tainted with illegality and that the exchange control Act had been violated. To this, Mr Regeru for the Plaintiff replied by saying that the arbitrator did not consider this issue because the interim award was dealing with the issue of fraud in the discharge of the charge and that as far as the issue of fraud was concerned, the illegality of the contract/agreement was not an issue for determination.

At paragraph 16 of the Plaintiff, it is pleaded that in or about August, 1993 the defendant and the Plaintiff entered into a second agreement for the provision to the defendant by the Plaintiff of a loan facility in the sum of Kshs.26,500,000/=. One of the terms of the said second agreement was that interest rate would be 65% which was the CBK Treasury Bill rate at the time. The defendant in the defence at paragraph 13 pleaded that, the second agreement provided that the Kshs.26,500,000/= was payable within three months and was secured by a cash collateral in foreign currency deposited to the Plaintiff in the Plaintiff's bank abroad. The defendant states in the said paragraph that the second agreement was void for illegality as it contravened the Exchange Control Act as well as the Banking Act by providing that interest was not payable. This was an issue that should have been addressed. I do not think that it can be overlooked by saying that it was not an issue in the determination of the fraud

allegation/issue. Even after determining the issue of fraud, the arbitrator should have found it necessary to deal with this issue of the illegality of the second agreement to see if he will reach the same finding that the defendant was liable to the Plaintiff for loss and damage suffered. I cannot ignore the issue of the illegality of the second agreement and as it is a serious issue which as I have earlier said should have been dealt with, it would not be right to conclude this case by totally disregarding it. For that reason, having already found that fraud was an issue and the same having been determined by the arbitrator, the issue of the illegality of the agreement would be dealt with before a decision is reached on whether the defendant is liable to the Plaintiff for the loss and damage if any suffered by it as a result of the discharge of charge.

I allow the defendant's application dated 19th December, 2002 in part, and set aside the arbitrators order to the effect that the defendant is liable to the claimant. The parties shall agree on how to proceed from there. The Plaintiff shall pay to the defendant, the costs of the application.

Delivered at Nairobi this 16th day of May, 2003. Mr Mwaura for defendant.

Mr Regeru for the Plaintiff absent but aware of date.

S. C. ONDEYO

JUDGE

16.5.2003



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