

**A COMPARISON OF KENYAN AND SOUTH AFRICAN LAW ON  
SECURITY BY MEANS OF MOVABLES**

by

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## **ABSTRACT**

This study compares the legal principles applicable in both South Africa and Kenya in the creation of security by means of movables. It identifies the forms of security that can be created in the two jurisdictions. The main focus will be on the creation, publicity, priority of security interest and enforcement of the said interests. The research will in addition establish the challenges (if any) that are encountered when creating security by means of movables in Kenya and identify practical solutions that can be adopted in order to improve the creation of security by means of movables in Kenya.

## **KEY WORDS**

Movable property; Creation of security; Access to finance; Secured transactions; Kenyan law; South African law; Security by means of movables; Challenges of security by means of movables; Lenders and Security; Law reform.

## **LIST OF ABBREVIATIONS**

<b>EACLJ</b>	EAST AFRICAN CENTRE FOR LAW & JUSTICE
<b>KLRC</b>	KENYA LAW REFORM COMMISSION
<b>NCR</b>	NATIONAL CREDIT REGULATOR
<b>OHADA</b>	ORGANISATION POUR L'HARMONISATION EN AFRIQUE DU DROIT DES AFFAIRES
<b>UCC</b>	UNIFORM COMMERCIAL CODE
<b>UK</b>	UNITED KINGDOM
<b>UNCITRAL</b>	UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW
<b>ZAR</b>	SOUTH AFRICA RAND

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## CHAPTER ONE

### SECURITY: KEY COMPONENT FOR ACCESSING FINANCE IN KENYA

#### 1 INTRODUCTION

Approximately 95 percent of lenders<sup>1</sup> are concerned whether the loans they advance will be repaid.<sup>2</sup> This uncertainty often leads them to require assurances from a borrower on repayment, in the form of security.<sup>3</sup> The law recognises real and personal security. However, this study deals with real security.

Lenders generally prefer security over immovable property as opposed to movable property and Kenya is not an exception to this general tendency. However, Kenyan borrowers do not always own immovable property.<sup>4</sup> Studies show that movable property forms a major part of the assets owned by both enterprises and individuals; it comprises 78 percent of the capital stock of businesses in the developing world compared to 22 percent of immovable property.<sup>5</sup>

#### 1.1 RESEARCH PROBLEM, HYPOTHESIS, RESEARCH AIM AND METHODOLOGY

##### 1.1.1 RESEARCH PROBLEM

Property plays a critical role in advancing commerce and industry and in accessing credit. Therefore, the Kenyan legal system needs to continuously embrace “imaginative and constructive law”<sup>6</sup> and modify its property rules appropriately<sup>7</sup> in order to promote the use of movables as security. This will in turn drive the country towards achieving its long term goal of becoming a globally competitive and prosperous country with a high quality of life by 2030 (*Kenya Vision 2030*).<sup>8</sup>

##### 1.1.2 HYPOTHESIS

This paper aims to undertake a comparative study of the law governing security over movables in both Kenya and South Africa. The hypothesis of the study is that although movable property

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<sup>1</sup> Karumba and Wafula *Collateral Lending* 2.

<sup>2</sup> Van Erp *Property and real security* 647.

<sup>3</sup> UN *UNCITRAL Guide* paragraph 5; page 46.

<sup>4</sup> Ellis *et al Gender* 46, 47.

<sup>5</sup> De la Campa March 2011 *Policy Research Working Paper* 3.

<sup>6</sup> Sacks 1982 *SALJ* 605.

<sup>7</sup> Allen *Right to Property* 1.

<sup>8</sup> *Kenya Vision 2030* <http://www.vision2030.go.ke/index.php/home/library> (Date of use 2nd September 2014).

can provide good security for loans, certain deficiencies in the Kenyan law make it unattractive to lenders and therefore the need for reform.

## 1.2 OVERVIEW OF KENYAN AND SOUTH AFRICAN LEGAL SYSTEMS

A legal system refers to *inter alia* the rules, institutions, case law, doctrines and elements of a state-nation.<sup>9</sup> Zweigert and Kötz classify legal systems into Romanist, Germanic, Nordic and common law families, laws of the People's Republic of China, Japanese, Islamic and Hindu law.<sup>10</sup> However, some countries have a mixed legal system (also called the “third legal family”).<sup>11</sup>

Kenyan law is premised on the English common-law system, which originates from English customs and beliefs. Over time, the nation has developed its own legal system<sup>12</sup> based on its Constitution, written laws and judicial decisions. Acts of Parliament of the United Kingdom, common law, doctrines of equity and statutes of general application have also shaped the Kenyan legal system.<sup>13</sup> African customary law guides Kenyan courts in civil matters where a party is affected by it so long as it is not repugnant to justice and morality or inconsistent with written law.<sup>14</sup> The *Constitution of Kenya 2010* further provides that the general rules of international law<sup>15</sup> and any treaty or convention that Kenya has ratified form part of Kenyan law.<sup>16</sup>

South Africa has a pluralist system of law that is a mix of both uncodified Roman-Dutch civil law [derived from Roman law and Germanic customary law] and English common law.<sup>17</sup> It is also influenced to a limited extent by African customary law.<sup>18</sup> Case law, legal writings by authors such as Voet and Grotius, and statutes play a key role in dispute resolution.<sup>19</sup> South African

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<sup>9</sup> Husa *Legal Families* 491.

<sup>10</sup> David and Brierley *Major Legal Systems* 21, 23.

<sup>11</sup> Palmer (ed) *Mixed Jurisdictions Worldwide* pp. 1- 613; Palmer *Mixed Jurisdictions* 590.

<sup>12</sup> See Laster *Law as Culture* 91; Shah *Kenya* 223.

<sup>13</sup> See S 3(1) *Judicature Act* (Cap 8).

<sup>14</sup> See S 3(2) *Judicature Act*; Article 2(4) *Constitution of Kenya 2010*.

<sup>15</sup> Article 2 (5).

<sup>16</sup> Article 2 (6).

<sup>17</sup> See Du Plessis *South Africa* 814; Mostert *Constitutional Protection* 34, 35.

<sup>18</sup> S 211(3) *Constitution of the Republic of South Africa 108 of 1996*; Van der Merwe *et al Republic of SA* 110, 111.

<sup>19</sup> Zimmermann *Double Cross* 4.

property law is based mainly on Roman-Dutch law, but procedural and insolvency law is strongly under the influence of English law.<sup>20</sup>

### 1.3 JUSTIFICATION FOR COMPARING THE KENYAN AND SOUTH AFRICAN LEGAL SYSTEMS

Kenya and South Africa are members of the Commonwealth<sup>21</sup> where comparative law plays a major role in legal development and has shaped the rights to property in these jurisdictions.<sup>22</sup> Through this study, Kenyan decision makers, especially judges, will gain knowledge on South African law governing interests in movables that could assist them in resolving difficult questions of law.<sup>23</sup> In this way case law (an important source of law in common-law jurisdictions) will be developed.<sup>24</sup>

Additionally, South African law has experienced significant legal developments. Its legal jurisprudence, particularly of the Constitutional Court has been described as “path-breaking and progressive reflecting a commendably innovative approach to comparative law”.<sup>25</sup> By studying the South African position, the Kenyan lawyer will gain better understanding of the deficiencies that are present in his local laws. This will form a basis for law reform especially if, from the comparison, South African law appears to be better than Kenyan law.<sup>26</sup>

Lastly, South Africa has been the largest economy in Sub-Saharan Africa until it was recently surpassed by Nigeria.<sup>27</sup> Despite this, South Africa is still an economic powerhouse and is regarded by investors as the gateway to African countries.<sup>28</sup> Kenya is also a vital commercial and financial hub for Eastern and Central Africa.<sup>29</sup> This study could form the basis for assessing the possibility and desirability of unification or harmonization<sup>30</sup> of laws in the two regions in order

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<sup>20</sup> Zimmermann *Double Cross* 6.

<sup>21</sup> <http://thecommonwealth.org/member-countries> (Date of use: 1st July 2014).

<sup>22</sup> Gutteridge *Introduction* 27.

<sup>23</sup> Michaels *Comparative Law* 1.

<sup>24</sup> Glenn *Aims of Comparative Law* 69.

<sup>25</sup> Du Plessis *South Africa* 814.

<sup>26</sup> Gutteridge *Introduction* 161.

<sup>27</sup> Magnowski April 2014 <http://www.bloomberg.com/news/2014-04-06/nigerian-economy-overtakes-south-africa-s-on-rebased-gdp.html> (Date of use: 23rd June 2014).

<sup>28</sup> Guest Contributor <http://theglobalbusinessadvisor.com/south-africa-a-promising-emerging-market-p130-95.htm> (Date of use: 5th September 2014).

<sup>29</sup> Office of the PM “Sessional Paper on Vision 2030” 91, 92.

<sup>30</sup> Michaels *Comparative Law* 2.



to enhance trade. This unification has already taken effect amongst seventeen states in the West and Central African region through the OHADA initiative.<sup>31</sup>

#### **1.4 OBJECTIVES OF STUDY**

This mini-dissertation aims at comparing the law of security over movables in Kenya and South Africa; assessing the sufficiency of the current legal provisions in Kenya in promoting the use of movables as security; and identifying deficiencies in the law and areas that require reform.

#### **1.5 RESEARCH QUESTIONS**

The study sought to establish how South African law on security over movables is similar to or different from Kenyan law; what the basis for the similarities or differences is; what can be learnt from the similarities or differences; and whether Kenyan law in this area can be improved in light of the findings from the research.

#### **1.6 METHODOLOGY**

Being a qualitative comparative study, both the problem solving approach<sup>32</sup> and the functional approach<sup>33</sup> were adopted. Through the problem solving approach, I sought to establish how the South African system resolves problems of a similar nature as those identified in Kenya and through the functional approach; I identified the institutions in South Africa that have similar functions as Kenyan institutions in regard to security interests over movables.

#### **1.7 SCOPE AND LIMITATIONS OF STUDY**

This research entails a review of literature from various sources including legislation, case law, legal text books and journals, government publications and internet sources. The information from these secondary sources is likely to be influenced by the legal backgrounds, schools of thought of various authors, and the environment in which they practice law. I will ensure that these opinions are analysed and adopted in an objective manner in order to arrive at original, unbiased conclusions.

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<sup>31</sup> <http://www.ohada.com/> (Date of use: 2<sup>nd</sup> September 2014).

<sup>32</sup> This approach stems from a belief that similar problems have similar solutions across legal systems though they are resolved differently, Örucü *Methodology* 443.

<sup>33</sup> This approach entails comparing legal systems whose doctrinal structures are different but serve the same function, Michaels *Comparative Law* 2.

## **1.8 LITERATURE REVIEW**

Some sources that have shaped this mini-dissertation include Zimmermann R, Visser D and Reid K (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (Oxford University Press New York 2004), which is a comparative study of South African and Scottish law. *Elgar Encyclopedia of Comparative Law* 2<sup>nd</sup> ed (Edward Elgar Publishing Cheltenham 2012) contains numerous articles on Comparative Law.

Badenhorst PJ, Pienaar JM and Mostert H *Silberberg and Schoeman's The Law of Property* (Lexis Nexis Butterworths Durban 2006); and Mostert H and Pope A (eds) *The Principles of the Law of Property in South Africa: Private Law* (Oxford University Press Cape Town 2010) provided general South African law on property and real rights.

Burrows A (ed) *Oxford Principles of English Law: English Private Law* 3<sup>rd</sup> ed (Oxford University Press Oxford 2013); and Beale H *et al The Law of Security and Title-Based Financing* 2<sup>nd</sup> ed (Oxford University Press Oxford 2012) provided the English common law position on property and security interests.

Laibuta KI *Principles of Commercial Law* 2<sup>nd</sup> ed (Law Africa Nairobi 2011) provided the Kenyan legal position; while De Lacy J (ed) *The Reform of UK Personal Security Law: Comparative Perspectives* (Routledge-Cavendish Oxon 2010), discussed personal security reforms in the United Kingdom.

## **1.9 STRUCTURE OF MINI-DISSERTATION**

Chapter 1 highlights the aim of the research; the reason for comparing the legal systems of Kenya and South Africa. Chapter 2 discusses the nature of real security rights and the basic principles of security. South African law is the starting point as I indicate where Kenyan law deviates from the former's system.

Chapter 3 provides an in-depth discussion of the different security interests created over movables in Kenya and the factors that affect their creation. The aspects that render these security interests unattractive to lenders are also highlighted. Chapter 4 discusses the security interests over movables recognised in South Africa and it identifies the similarities and/or differences in the two jurisdictions. Chapter 5 discusses how the challenges identified in Kenya

are addressed in South Africa and whether similar solutions can be employed in Kenya. Chapter 6 draws a conclusion based on the foregoing discussions and provides recommendations.

## CHAPTER TWO

### NATURE OF REAL RIGHTS AND BASIC PRINCIPLES INVOLVED

#### 2 INTRODUCTION

Property in Kenya refers to both a thing (*res*), and the right that a person has over the thing.<sup>34</sup> In South Africa, it encompasses three concepts: the right of ownership in a legal object; the legal object to which the right relates to; and the variety of legal relations that qualify for protection as property under the Constitution.<sup>35</sup> Property rights only exist where a legal system has mechanisms for recognizing, protecting and enforcing them.<sup>36</sup>

Ownership (*ius in re propria*) is the greatest possible interest in a thing<sup>37</sup> since the owner has exclusive control over it.<sup>38</sup> One can have a real right over another person's property; this right is considered to be less than ownership and thus the person holds a limited real right (*ius in re aliena*).<sup>39</sup> A security right (civil-law system) or security interest (common-law system) is a limited real right. The term "security interest" will be used since the paper focuses on Kenyan law which is premised on common law. I progress to discuss the nature of real rights; real security interests over movables; their advantages; and the basic principles governing these interests. South African law forms the basis of the discussion and I strive to show where it differs from Kenyan law.

#### 2.1 NATURE OF REAL RIGHTS

Ojienda and Rachier<sup>40</sup> define a real right as an affirmative claim that one asserts against another in relation to a particular situation, object or thing where the person vested with the right has an interest. South Africa has no closed legal system of real rights (*numerus clausus*) as new rights can be created.<sup>41</sup> Various theories have been formulated to determine whether a right is real or personal including the subtraction from the *dominium* test.<sup>42</sup> This test requires

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<sup>34</sup> Laibuta *Commercial Law* 421.

<sup>35</sup> Badenhorst, Pienaar and Mostert *Law of Property* 1; See also Pienaar and Van der Schyff 2007 *Law, Environment and Development Journal* 188.

<sup>36</sup> Hepburn *Principles* 3.

<sup>37</sup> Ojienda and Rachier *Conveyancing Practice* 4.

<sup>38</sup> Limitations may be imposed by laws of general application such as the South African Neighbour law or Kenyan tort law on nuisance.

<sup>39</sup> Mostert and Pope (eds) *Principles of Property* 42.

<sup>40</sup> *Conveyancing Practice* 3.

<sup>41</sup> Milo *Property Rights* 734; De Waal 1999 *EJCL* <http://www.ejcl.org/33/abs33-1.html> (Date of use: 23rd September 2014).

<sup>42</sup> Badenhorst, Pienaar and Mostert *Law of Property* 55.

one to look not so much to the right, but to the correlative obligation. If the obligation amounts to a burden upon the land (a subtraction from the *dominium*) then the corresponding right is a real right and registrable.<sup>43</sup>

Although the list of rights is not closed at Common law, it is difficult to introduce new rights.<sup>44</sup> This principle seems secure in common law, but not in equity, which recognizes other property rights that common law does not.<sup>45</sup> English courts have formulated the closed list approach<sup>46</sup> and the criteria approach<sup>47</sup> to determine real rights. There is insufficient information as to whether the issue of new rights has been tested in Kenyan courts. In the absence of Kenyan case law, the English-law position would help to determine whether a particular right is a property right.

The distinction between real<sup>48</sup> and personal<sup>49</sup> rights is important in South Africa as it lays the foundation for the patrimonial law to be divided into either the law of things or the law of obligations.<sup>50</sup> It also determines whether a particular right is registrable, since only real rights can be registered.<sup>51</sup> In Kenya, the terms real and personal rights relate to the action that one can institute to protect his interests over real and personal property.<sup>52</sup> Real property is protected by a real action<sup>53</sup> while personal property is protected through a personal action.<sup>54</sup>

### 2.1.1 NATURE OF REAL SECURITY INTERESTS

A security interest is a right over property given by a debtor to a creditor whereby the creditor acquires priority over the property if the debtor fails to repay the debt.<sup>55</sup> In South Africa the Roman-Dutch term “hypothec”, was used to refer to real security interests generally, but the

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<sup>43</sup> *Ex Parte Geldenhuys* 1926 OPD 155.

<sup>44</sup> See Milo *Property Rights* 734; Swadling *Property* 4.09- 4.12 and 4.114- 4.115.

<sup>45</sup> Swadling *Property* 4.26- 4.28.

<sup>46</sup> *Hill v Tupper* (1863) 2H & C 121, 127-128, 159 ER 51, 53.

<sup>47</sup> *National Provincial Bank v Ainsworth* (1965) AC 174, HL.

<sup>48</sup> A right to a thing.

<sup>49</sup> A right to performance that can be exercised only against a specific individual.

<sup>50</sup> Badenhorst, Pienaar and Mostert *Law of Property* 50- 65.

<sup>51</sup> Van der Walt 1992 *THRHR* 172.

<sup>52</sup> Swadling *Property* 4.13- 4.16.

<sup>53</sup> An action that can be exercised against everyone since the real right imposes duties of abstention to the entire world and the remedy is recovery of a specific thing (*res*).

<sup>54</sup> An action that is exercised against a particular person who is the subject of the obligation and the remedy is usually specific performance or damages for the loss suffered. Mattei *Basic Principles* 9.

<sup>55</sup> *Armour v Thyssen Edelstahlwerke AG* [1990] 3 All ER 481, HL, 486. See South African definition in s 2 of *Insolvency Act* 24 of 1936.

English-law term “mortgage” has been accepted.<sup>56</sup> For a mortgage to be in place there must be an obligation (principal debt) to be secured; the mortgage must attach to the property of another; and a real security interest must be created.<sup>57</sup>

#### 2.1.1.1 Obligation to be secured

A mortgage is accessory in nature since security secures the performance of a valid principal obligation (principal debt). A security interest cannot be created, transferred or extinguished without transferring or honouring the underlying obligation it is securing.<sup>58</sup> The obligation can either be a present, future, conditional or contingent one and furthermore, it can be of a monetary, delictual or contractual nature.<sup>59</sup> If the obligation is invalid, the mortgage accessory to it will also be invalid and in the case of an illegal contract, the enforceability of such a mortgage will depend on whether the illegality goes to the root of the contract.<sup>60</sup>

#### 2.1.1.2 Attachment to property of another

A mortgagor can only mortgage what belongs to him (*nemo dat quod non habet* principle).<sup>61</sup> However, if a mortgagor or pledgor ratifies a mortgage or pledge that was created without his consent or he receives adequate consideration the mortgage can be upheld.<sup>62</sup> Furthermore, a mortgage can exist over property belonging to a third party to secure a debtor’s debt.

#### 2.1.1.3 Creation of security interest

Real security interests can be created through an agreement (express mortgages), by operation of law (tacit or legal mortgages) or through judicial attachment.<sup>63</sup>

### 2.1.2 BASIC PRINCIPLES OF REAL SECURITY INTERESTS

The specificity principle requires the property being mortgaged to be easily identifiable and this is a challenge where movable property cannot be identified with precision.<sup>64</sup> The publicity principle requires that an outsider ought to be able to infer from external indications that there

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<sup>56</sup> Pienaar and Steven *Rights* 759.

<sup>57</sup> Scott and Scott *Wille’s Law* 4.

<sup>58</sup> See Pienaar and Steven *Rights* 759, 760

<sup>59</sup> Badenhorst, Pienaar and Mostert *Law of Property* 359.

<sup>60</sup> Scott and Scott *Wille’s Law* 6.

<sup>61</sup> Badenhorst, Pienaar and Mostert *Law of Property* 359.

<sup>62</sup> Badenhorst, Pienaar and Mostert *Law of Property* 360.

<sup>63</sup> See De Lacy *Evolution* 4; Pienaar and Steven *Rights* 759.

<sup>64</sup> Fleisig, Safavian and De la Peña *Reforming Collateral* 27.

exists a real right to the property or that a real right is transferred or extinguished.<sup>65</sup> The form of publicity depends on the nature of the asset, but it is mainly through transfer of possession or by filing or registering the interest at a registry or trade journal.<sup>66</sup> The principle of perfection requires the creditor to take certain steps to ensure his security is effective against third parties if the debtor becomes insolvent.<sup>67</sup> Perfection can be achieved through transfer of possession to the creditor, through filing or registration; or by exercising control over the object.<sup>68</sup>

## 2.2 ADVANTAGES OF REAL SECURITY INTERESTS

A secured creditor is accorded a right to preferential treatment *vis-à-vis* the debtor's unsecured creditors when the debtor becomes insolvent.<sup>69</sup> He also gains certainty that his debt will be settled either by the debtor performing his obligation or through realization of his security on default by the debtor.<sup>70</sup>

## CONCLUSION

Having discussed the nature of real rights and real security interests and the basic property law principles governing the creation of real security interests, I progress to discuss the existing forms of security over movables that can be created in Kenya. I also set out the essential requirements for the creation of these interests and discuss the various principles that apply to these rights and the problems that are encountered during their creation.

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<sup>65</sup> Ferran and Ho *Corporate Finance* 301; Pienaar and Steven *Rights* 761

<sup>66</sup> Wood *Comparative Law* 3-006.

<sup>67</sup> Mostert and Pope (eds) *Principles of Property* 74.

<sup>68</sup> Beale *et al Law of Security* 9.01, 9.02.

<sup>69</sup> Muñoz *Personal Security* 12.

<sup>70</sup> Muñoz *Personal Security* 13.

## CHAPTER THREE

### SECURITY INTERESTS CREATED OVER MOVABLE PROPERTY IN KENYA

#### 3 INTRODUCTION

Kenyan law on security over movables is encompassed in commercial law<sup>71</sup> while the protection of personal property rights is governed by the law of torts.<sup>72</sup> Various forms of real security interests can be created in Kenya and each undergoes various formalities of creation and perfection as discussed herein after.

#### 3.1 REAL SECURITY INTERESTS OVER MOVABLES IN KENYA

##### 3.1.1 CHATTELS SECURITIES

The *Chattels Transfer Act* (Cap 28) (hereinafter *Chattels Act*) governs chattel securities generally. A chattel is any movable property that can be completely transferred by delivery<sup>73</sup> but excludes property belonging to government, local authorities and other corporate bodies.<sup>74</sup> Security over a chattel is created using an instrument, which is defined as any instrument that secures the payment of money or the performance of some obligation. This includes any bill of sale, mortgage, lien or any other document that transfers or purports to transfer the property in or right to the possession of chattels, whether by way of sale, security, pledge, gift, settlement or lease.<sup>75</sup> This definition envisions that various instruments can be created although the Act only prescribes the form for a mortgage, which should be modified to create other instruments.<sup>76</sup> This leads to a lack of uniformity in the instruments created.

An instrument must be specifically described<sup>77</sup> for it to confer a good title over the chattel; otherwise it will be rendered void against a receiver, assignee or trustee in bankruptcy.<sup>78</sup> The Act only indicates how stock, crops, book debts and other debts should be described and not other chattels. A grantor is defined to include the successors and assignees of a company or corporation. This definition is problematic since it intimates that these institutions can create an instrument whereas their assets are excluded from being deemed chattels under the Act.

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<sup>71</sup> Samuel *Common Law* 183.

<sup>72</sup> Swadling *Property* 4.01.

<sup>73</sup> S 2.

<sup>74</sup> S 2.

<sup>75</sup> S 2.

<sup>76</sup> S23(1).

<sup>77</sup> S 7.

<sup>78</sup> S 13.



An instrument must be attested by at least one witness,<sup>79</sup> be stamped with duty<sup>80</sup> and registered with the Registrar-General.<sup>81</sup> Registration is done through the filing of the instrument and two affidavits sworn by the grantor and a witness.<sup>82</sup> The need to swear two separate affidavits is not clear. An instrument that does not satisfy these formalities may be deemed invalid.<sup>83</sup> Registration must be within twenty-one days from the date of execution, unless leave of court is obtained to register out of time.<sup>84</sup> Registration takes approximately fourteen days<sup>85</sup> since Kenya's documents based registration system is cumbersome and inefficient. Digitization of the Companies Registry was undertaken that saw over 20 million pages of documents being scanned and stored to allow for online searches.<sup>86</sup> To date, online searching cannot be done and search results take between 4 to 5 days to be obtained.

The Registrar should transmit an abstract of the instrument to the Provincial Commissioner of the province where the person resides or where the chattels are situated.<sup>87</sup> The Provincial Commissioner's docket is not recognised under the *Constitution of Kenya* 2010. Former President Mwai Kibaki appointed County Commissioners to take up the role of the defunct Provincial Commissioners, a move that was deemed to be unconstitutional<sup>88</sup> making it uncertain to whom the abstracts should be sent to.

An instrument must be renewed every five years for it to be effective as notice to the world.<sup>89</sup> This requirement seems unfair since it is not required for other securities devices such as a charge. A memorandum of satisfaction of debt signed by the grantee or his attorney discharging the chattels needs to be presented to the Registrar for filing,<sup>90</sup> although this is not compulsory leading to registers containing inaccurate information. When a chattel is sold in execution of a

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<sup>79</sup> S 15.

<sup>80</sup> S 38 of *Stamp Duty Act* (Cap 480).

<sup>81</sup> S 5.

<sup>82</sup> S 5.

<sup>83</sup> See *Geoffrey Njenga v Godfrey W. Karuri and another* Civil Case No. 95 of 1998.

<sup>84</sup> S 6.

<sup>85</sup> Attorney General's Performance Contract [www.devolutionplanning.go.ke](http://www.devolutionplanning.go.ke) (Date of use: 17<sup>th</sup> October 2014).

<sup>86</sup> Kobia July 2010 <https://sites.google.com/a/ict.go.ke/tandaa/activities/companyregistry> (Date of use: 28<sup>th</sup> July 2014).

<sup>87</sup> S 7(4).

<sup>88</sup> EACLJ <http://eaclj.org/constitution/20-constitution-feature-articles/139-role-of-the-county-commissioners-under-the-devolved-government.html> (Date of use: 19 September 2013).

<sup>89</sup> S 10.

<sup>90</sup> S 35.

judgement,<sup>91</sup> surplus proceeds are payable to the purchaser<sup>92</sup> contrary to common law where the debtor is entitled to the surplus and not the purchaser.

### 3.2 OTHER SECURITY INTERESTS CREATED IN KENYA

The commonly recognized instruments over movables are a pledge, mortgage, charge, lien, letters of hypothecation and assignment.

#### 3.2.1 PLEDGE

A pledge (pawn or *pignus*) is a form of bailment<sup>93</sup> that requires the delivery of the article to the creditor to hold as security until his debt is repaid.<sup>94</sup> It can be created over both tangible property and documentary intangibles that are identifiable and are in a form that can be possessed.<sup>95</sup> Delivery of possession can either be actual<sup>96</sup> or constructive.<sup>97</sup> Possession prevents third parties from being deceived that the property is available and unencumbered.<sup>98</sup> It entails exercising of control over the object while having the intention to possess the object (*animus possidendi*).<sup>99</sup> At common law, a presumption of fraud is made by the courts where the pledgor retains possession of the pledged item.<sup>100</sup> Sham contracts will not be enforced if the parties intended to give to third parties or the court a semblance of creating legal rights and obligations that they had no intention of creating.<sup>101</sup>

A pledge is extinguished if the pledgee loses possession of the article unless possession is relinquished by the pledgee for a limited purpose.<sup>102</sup> However, if the pledgee is wrongly dispossessed, he can institute proceedings for conversion against the dispossessor and recover the full value of the item.<sup>103</sup> Under common law, a pledgee has a right of sale that is already implied from the very nature of a pledge and thus it is not required that a pledge agreement

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<sup>91</sup> S 39 (1).

<sup>92</sup> S 39 (4).

<sup>93</sup> Swadling *Property* 4.132.

<sup>94</sup> Ogola *Business Law* 288.

<sup>95</sup> Beale *et al Law of Security* 5.43, 5.44.

<sup>96</sup> The pledged article is under the pledgee's actual control.

<sup>97</sup> McCormack *Pressured* 86.

<sup>98</sup> Smith *Security* 5.68.

<sup>99</sup> Baskind, Osborne and Roach *Commercial Law* 30.

<sup>100</sup> De Lacy *Reform of UK Law* 9, 10.

<sup>101</sup> Coleman *Tax Avoidance* 5-8.

<sup>102</sup> Smith *Security* 5.68.

<sup>103</sup> Beale *et al Law of Security* 5.06.

expressly provides for this.<sup>104</sup> Only a default notice needs to be issued before exercising the right.<sup>105</sup> Since the *Chattels Act* (Cap 28) contains blanket provisions for creating an instrument including a pledge, I assume that the registration formalities therein should be complied with. Registration of a pledge instrument would deviate from common law where this is not required. Kenyan advocates do not as a matter of practice register pledge instruments and this conflict between the statutory- and common-law positions may cast doubt on the validity of an unregistered pledge instrument in Kenya.

Borrowers at times obtain loans from loan sharks (shylocks) under loosely worded loan agreements, at exorbitant interest rates and short repayment periods.<sup>106</sup> The borrowers deposit their chattels and title documents as security and upon default; the shylocks sell the articles at a profit while some unlawfully retain the surplus. Besides the *Law of Contract Act* (Cap 23), no other laws presently regulate the shylock business. A critical assessment of this business reveals that it is tantamount to pawning and a solution to this menace could be found in the *Pawnbrokers Act* (Cap 529). This Act provides that advances not exceeding three hundred Kenya shillings (approximately ZAR 30)<sup>107</sup> can be secured by articles deposited with the pawnbroker.<sup>108</sup> Registration of the pawn is not required although the pawnbroker must keep a register and issue a pawn ticket to the pawner.<sup>109</sup> The Act regulates the amount of profit and charges that the pawnbroker can charge.<sup>110</sup> However, the pawned article becomes the pawnbroker's absolute property if the pawner does not redeem it within the specified period.<sup>111</sup> Additionally, a pawnbroker can bid and purchase any article on sale at an auction<sup>112</sup> contrary to the common law position where a pledgee can neither foreclose on the pledged article nor buy it himself since he conducts the sale as the pledgor's agent.<sup>113</sup>

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<sup>104</sup> Beale *et al Law of Security* 5.09.

<sup>105</sup> Laibuta *Commercial Law* 232.

<sup>106</sup> Oguoko, Michira and Gisesa

[http://www.standardmedia.co.ke/?articleID=2000080901&story\\_title=inside-the-murky-world-of-shylocks&pageNo=1](http://www.standardmedia.co.ke/?articleID=2000080901&story_title=inside-the-murky-world-of-shylocks&pageNo=1) (Date of use: 14<sup>th</sup> October 2014).

<sup>107</sup> This amount ought to be enhanced.

<sup>108</sup> S 2.

<sup>109</sup> S 8 (1), (10).

<sup>110</sup> S 11; Second Schedule.

<sup>111</sup> S 13.

<sup>112</sup> S 15.

<sup>113</sup> *Diamond Security over Movable* 26.

### 3.2.2 LIEN

This security arises where a lienee who has performed work for a lienor retains the goods or documents of the lienor that are in his possession until he is paid the charges or fees for the work done.<sup>114</sup> It is considered to be a 'self-help' remedy<sup>115</sup> that is not affected by third party rights.<sup>116</sup> Such a position in law is detrimental to lenders as their security interests become subordinated to lien holders, unless the lien holder agrees to waive the lien. Various types of liens exist that arise from common law, contract, statute, equity or maritime law<sup>117</sup> and can either be particular<sup>118</sup> or general.<sup>119</sup> The nature of a lien affects its ranking at the time of insolvency. An example is where equitable and contractual liens are not enforceable against a *bona fide* purchaser without notice.<sup>120</sup>

The possessory (common law) lien has its origins in custom and certain trades and arises by operation of law. The lienee has a right to retain possession of a tangible movable that was originally delivered to him for a different purpose, and the property was improved through the holder's skill<sup>121</sup> or for services rendered. A contractual lien is created through contract under circumstances where one would not usually arise and the parties usually agree on the amount to be secured by the lien.<sup>122</sup> It differs from a pledge in that delivery to a pledgee is intended at creating security while delivery, under a contractual lien, is not intended to act as security.<sup>123</sup>

Some statutes confer a lien right (statutory lien) to creditors in possession under certain circumstances and the nature of the lien is deduced from interpreting the statute, for example the unpaid seller's lien under section 41 of the *Sale of Goods Act* (Cap 31). Although most statutes confer on the lienee a right to retain possession, some give a lienee a right to sell the property and repay his debt from the proceeds.<sup>124</sup> This lien ranks depending on the priority that the statute accords it. An equitable lien is an equitable charge over property that arises by operation of law.<sup>125</sup> It attaches independently of the property and therefore possession by a

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<sup>114</sup> Bradgate and White *Commercial Law* 326.

<sup>115</sup> Bradgate and White *Commercial Law* 326; *Tappenden v Artus* [1964] 2 QB 185.

<sup>116</sup> *Albermarle Supply Company v Hind Company* (1928) 1 KB 307.

<sup>117</sup> Beale *et al Law of Security* 5.56 – 5.87, 6.140 – 6.164

<sup>118</sup> Relates to indebtedness arising from a particular transaction.

<sup>119</sup> Goods are retained until any obligations owed to the lienee generally are discharged by the owner.

<sup>120</sup> Jones *Treatise* 1048.

<sup>121</sup> Smith *Security* 335.

<sup>122</sup> Beale *et al Law of Security* 5.78, 5.79.

<sup>123</sup> See McCormack *Secured Credit* 44; *Re Cosslett (Contractors) Ltd* [1998] Ch 495.

<sup>124</sup> Bradgate and White *Commercial Law* 327.

<sup>125</sup> See Montagu *Summary* 2; McCormack *Pressured* 87.

creditor is not required. An example is the equitable lien conferred upon a seller of intangible property such as shares or intellectual property to secure the price.<sup>126</sup> A court order is required before enforcing this lien.<sup>127</sup>

Under maritime law, a ship or its cargo can be retained and sold under a court order to satisfy a debt owed.<sup>128</sup> The *Merchant Shipping Act* (Cap 389) outlines the claims that are secured by maritime liens.<sup>129</sup> The lien has priority over a mortgage and all other preferential rights cited in the Act or that arise during bankruptcy.<sup>130</sup> These preferential rights under section 108 have not been spelt out probably due to an error of omission. Therefore there is need for the Act to be amended to outline them.

### 3.2.3 LETTER OF HYPOTHECATION

Hypothecation of goods was described in *Dodhia v National Grindlays*<sup>131</sup> as the pledging goods as security for a debt or demand without requiring the pledgor to part with them and the lender obtains a right *in rem* over the goods of the pledgor.<sup>132</sup> The court acknowledged that very little case law existed in England and “virtually none” in East Africa on the nature of the rights created through hypothecation. Despite this, banks frequently use this security device that is a form of equitable charge. The lender’s right to take possession of the goods or sell them without instituting judicial proceedings must be stipulated in the instrument.<sup>133</sup> It is difficult for a lender to claim with certainty that particular goods were financed by his portion of the loan where there are multiple lenders because the goods are constantly being sold and replaced.<sup>134</sup> There is need to assess the need for this security since it is similar to a charge.

### 3.2.4 MORTGAGE

This non-possessory security involves the transfer of ownership of the movables to the mortgagee under an agreement that ownership will be retransferred to the mortgagor upon

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<sup>126</sup> Bradgate and White *Commercial Law* 327.

<sup>127</sup> See Ogola *Business Law* 289; Smith *Security* 5.8.

<sup>128</sup> Ogola *Business Law* 289.

<sup>129</sup> S 105 (1).

<sup>130</sup> S 106.

<sup>131</sup> Civil Appeal No. 53 of 1968.

<sup>132</sup> Field Fisher Waterhouse July 2011 <http://www.fieldfisher.com/media/1689850/Security-Over-Goods.pdf> (Date of use: 20<sup>th</sup> November 2014).

<sup>133</sup> Ogola *Business Law* 358.

<sup>134</sup> *Dodhia case*.

payment of the debt.<sup>135</sup> However, possession remains with the mortgagor while the mortgagee is conferred with a right to seize and sell the goods in the case of default if the agreement stipulates this.<sup>136</sup> The *Chattels Act* (Cap 28) prescribes the chattels mortgage format. The courts will not uphold any agreement that acts as an obstacle to the debtor's right of redemption.<sup>137</sup> Equitable mortgages do not require registration since they are created when the title documents are deposited with the mortgagee together with a memorandum of deposit and enforcement is through a court order. The *Merchant Shipping Act* (Cap 389) governs the mortgaging of a ship or a share in ship<sup>138</sup> while the Kenya Civil Aviation Authority is mandated under section 7 (1)(u) of the *Civil Aviation Act* 21 of 2013 to register rights and interests in aircraft although the Act does not presently contain provisions on registration.

### 3.2.5 CHARGE

This non-possessory security is a creature of equity that is codified in the *Companies Act* (Cap 486) and the *Co-operative Societies Act* (Cap 490) (hereinafter *Co-operatives Act*). It can be created over all types of property belonging to a company or co-operative society. The charge is created on the date the instrument is executed by the chargor and for an equitable charge, on the date of title deposit.<sup>139</sup> The instrument must be drawn by an Advocate, be stamped and registered within forty-two days for companies<sup>140</sup> and thirty days for co-operative societies,<sup>141</sup> or later with leave of court.<sup>142</sup> A certificate of registration is then issued, which is conclusive evidence that the requirements relating to the charge have been satisfied.<sup>143</sup>

A fixed charge is created over permanent assets such as land<sup>144</sup> and the chargor cannot deal with them without the chargee's approval.<sup>145</sup> A floating charge is created over a fluctuating body of assets,<sup>146</sup> of which a chargor can deal with in the ordinary course of business without the

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<sup>135</sup> See *Smith Security* 5.74; *Sihombing Goods* 152.

<sup>136</sup> *Sihombing Goods* 152.

<sup>137</sup> *Smith Security* 5.74.

<sup>138</sup> S 95.

<sup>139</sup> S 96 (9) (c).

<sup>140</sup> S 96 (1) *Companies Act*.

<sup>141</sup> S 51 (2) *Co-operatives Act*.

<sup>142</sup> S 102 *Companies Act*.

<sup>143</sup> S 99 *Companies Act*; s 52 (2) *Co-operatives Act*.

<sup>144</sup> *Laibuta Commercial Law* 439.

<sup>145</sup> *Ogola Business Law* 207.

<sup>146</sup> *Re Cosslett (Contractors) Limited* [1998] Ch 495, 510C-D.

chargee's consent<sup>147</sup> including creating other interests that may rank above the floating charge<sup>148</sup> until crystallization occurs. Crystallization refers to conversion of a floating charge into a fixed charge when the chargor is liquidated or he is in default and the chargee takes steps to enforce his security.<sup>149</sup> The crystallization event is usually not publicised therefore third parties are often misled into believing that the floating charge is still in existence and that the chargor is able to continue trading.<sup>150</sup>

If someone creates a fixed charge having actual or constructive notice of a prohibition under a floating charge against creating a fixed charge, the fixed charge will not be accorded priority.<sup>151</sup> Two floating charges created over the same property will rank in their order of registration and a floating charge that is created over specific assets will rank above a floating charge created over general assets.<sup>152</sup> A charge is enforced through appointment of a receiver or manager either under the instrument or through a court appointment.<sup>153</sup>

### 3.2.6 ASSIGNMENT

The *Transfer of Property Act*, 1882 (repealed) contained provisions for assignment of actionable claims<sup>154</sup> through a deed signed by the transferor or his agent.<sup>155</sup> However, claims under marine and fire insurance policies are not actionable claims. In Kenya, an express written notice of assignment must be issued to the debtor<sup>156</sup> and failure to issue it affects the assignee's ranking. Therefore, a subsequent assignee who issues notice first in time will have priority as per the rule in *Dearle v Hall*.<sup>157</sup> The assignment deed is not registered making it difficult for third parties to know it exists.

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<sup>147</sup> See Omar *Law relating to security* 14, 15; *Re Yorkshire Woolcomber's Association Limited* [1903] 2Ch 284, at 295.

<sup>148</sup> Beale *et al Law of Security* 6.71.

<sup>149</sup> Gichuki *Financial* 204, 207.

<sup>150</sup> Locke 2008 *CILSA* 150.

<sup>151</sup> Calnan *What's Wrong* 182.

<sup>152</sup> KLRC <http://www.kenyalawresourcecenter.org/2011/07/companys-lien.html> (Date of use: 16th December 2014).

<sup>153</sup> S 103 (1) *Companies Act*; s 54 *Co-operatives Act*.

<sup>154</sup> S 3.

<sup>155</sup> S 130 (1).

<sup>156</sup> S 130(1), 131 *Transfer of Property Act*, 1882 (repealed).

<sup>157</sup> (1828) 38 ER 475.

### 3.3 OTHER CHALLENGES EXPERIENCED IN KENYA

Kenya lacks a singular piece of legislation to govern consumer credit providers making it difficult to regulate their activities. The Central Bank of Kenya's bank supervisory unit currently supervises deposit taking institutions only and not non-deposit taking ones. The security registries are fragmented since they are classified according to the type of asset and/or the owner of the asset. Kenyan insolvency laws are also complicated and fragmented and have not been reformed in over 50 years. They are found in the *Companies Act* (Cap 486) (for winding up of companies - its provisions also apply *mutatis mutandis* to co-operative societies) and the *Bankruptcy Act* (Cap 53) (for individuals and other entities). Claims such as taxes and local rates, Government rents in arrears *et cetera*<sup>158</sup> are favoured during insolvency. This is disadvantageous to unsecured *bona fide* creditors since they may not recover their debts, if there is no free residue available for distribution. The law does not support the rehabilitation of insolvent debtors and no proper framework exists for handling cross border insolvency matters where the creditor is a foreign entity.<sup>159</sup> Lenders whose loan agreements do not incorporate summary execution clauses undergo lengthy, costly and complicated court processes to obtain enforcement orders and debtors at times seek court injunctions aimed at delaying the proceedings.

### CONCLUSION

Having highlighted the challenges that Kenya experiences when creating security interest over movables, I progress to compare the law governing security interests in South Africa and identify the types of securities that can be created over similar assets in Kenya. I analyze the similarities and differences of these security types and establish whether South Africa faces similar problems as Kenya.

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<sup>158</sup> See Masoud *Insolvency Law* OLJ 198; S 38(1) *Bankruptcy Act*.

<sup>159</sup> Masoud *Insolvency Law* OLJ 199.



## CHAPTER FOUR

### SECURITY INTERESTS CREATED OVER MOVABLES IN SOUTH AFRICA

#### 4 INTRODUCTION

Under South African law, anything that can be bought or sold can be hypothecated, whether movable, immovable or incorporeal but excluding claims that are statutorily protected;<sup>160</sup> property not *in commercio* and *res litigiosae* (things in litigation).<sup>161</sup> South African property law categorises security interests as either express security, interests arising by operation of law, or judicial security.<sup>162</sup> The main security interests that are created by agreement over movable property are a pledge, notarial bond, lien and security by means of claims. The landlord's tacit hypothec over the movables of the lessee and the credit grantor's tacit hypothec over the movables subject to the credit agreement are security rights created by operation of law.

#### 4.1 SECURITY INTERESTS OVER MOVABLES IN SOUTH AFRICA

##### 4.1.1 PLEDGE

The pledge under Kenyan and South African law has similar features where delivery of possession can either be actual or constructive. However, *constitutum possessorium* is not a valid form of delivery in South Africa<sup>163</sup> unless the owner agrees to hold the property in another capacity, like an agent.<sup>164</sup> Delivery by attornment is recognised in both countries, which stems from English law.<sup>165</sup> South African courts, just as in Kenya, will not uphold any disguised or simulated transaction that is aimed at conferring the benefit of a pledge to a creditor to the disadvantage of other creditors, while posing as a different transaction.<sup>166</sup> The pledgee obtains no preference upon insolvency of the pledgor if the pledged article is not delivered to him.<sup>167</sup> In both countries, the pledge is extinguished if possession of the pledge is lost unless it is temporary loss to meet commercial exigencies.<sup>168</sup>

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<sup>160</sup> Scott and Scott *Wille's Law* 39.

<sup>161</sup> Badenhorst, Pienaar and Mostert *Law of Property* 360.

<sup>162</sup> Pienaar and Steven *Rights* 759.

<sup>163</sup> See *Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A). This principle is also recognised in Kenya though the term "*constitutum possessorium*" is not used.

<sup>164</sup> See *Ikea Trading and Design AG v BOE Bank Ltd* 2005 (2) SA 7 (SCA) 21; Pienaar and Steven *Rights* 763, 764.

<sup>165</sup> Reid and Van Der Merwe *Themes* 647.

<sup>166</sup> *Nedcor Bank Ltd v ABSA Bank Ltd* 1998 (2) SA 830 (W); See paragraph 3.2.1.

<sup>167</sup> Scott and Scott *Wille's Law* 58, 59.

<sup>168</sup> Pienaar and Steven *Rights* 764.

Most pledge agreements include *parate executie* (summary execution) clauses which allow the pledgee to sell the pledged property upon default, without recourse to the court. In *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd*,<sup>169</sup> the court suggested that these clauses could be unconstitutional, but this decision has been challenged and criticised as being ill considered and wrong.<sup>170</sup> The Supreme Court of Appeal in *Bock v Duburoro Investments (Pty) Ltd*<sup>171</sup> and in *Juglal v Shoprite Checkers t/a OK Franchise Division*<sup>172</sup> did not follow the *obiter dictum* of the *Findevco* case. However, for the position in the *Bock* and *Juglal* cases to be upheld in South Africa, there is need for the Constitutional Court to make a decision confirming that such a clause is not unconstitutional.<sup>173</sup> It therefore means that the present South African position is similar to the Kenyan position, which recognises summary execution clauses in security agreements.<sup>174</sup>

Any clause in a pledge agreement that allows for the forfeiture of the pledged article upon default (*pactum commissorium*) is not enforceable in South Africa.<sup>175</sup> Kenyan law also protects the right of redemption save for the *Pawnbrokers' Act* (Cap 529), which permits foreclosure.<sup>176</sup> The duty of a pledgee to account to the pledgor for the proceeds of sales is also embedded in South Africa.<sup>177</sup>

#### 4.1.2 NOTARIAL BOND

This express non-possessory security arises where the debtor hypothecates his movable property without delivering the article to the creditor.<sup>178</sup> It is created by way of registration either generally<sup>179</sup> over all the movables of a debtor or specifically over identified corporeal or incorporeal movables.<sup>180</sup> The *Security by Means of Movable Property Act* 57 of 1993 (hereinafter *SMMP Act* 57 of 1993) governs special notarial bonds.

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<sup>169</sup> 2001 (1) SA 251 (E).

<sup>170</sup> Cook and Quixley 2004 *SALJ* 719; see Scott 2002 *THRHR* for a rebuttal of the arguments set out in the discourse by Cook and Quixley.

<sup>171</sup> [2003] 4 All SA 103 (SCA).

<sup>172</sup> 2004 (5) SA 248 (SCA).

<sup>173</sup> Cook and Quixley 2004 *SALJ* 723.

<sup>174</sup> *Dodhia case* Civil Appeal No. 53 of 1968.

<sup>175</sup> Pienaar and Steven *Rights* 766.

<sup>176</sup> Paragraph 3.2.1.

<sup>177</sup> Pienaar and Steven *Rights* 766.

<sup>178</sup> S 102 *Deeds Registries Act* 47 of 1937.

<sup>179</sup> Jansen 2003 *JBL* 155.

<sup>180</sup> See Scott 1995 *THRHR* 675; Jansen 2003 *JBL* 155.

The bond holder may be authorised to possess the property through a perfecting clause in the bond agreement or under a court order.<sup>181</sup> A general bondholder without possession of the property may lose the bond if the property is alienated without his consent and the bond will not bind a third party who acquires the property.<sup>182</sup> There is no prescribed form for a notarial bond although it must be attested by a notary public and registered within three months of its execution,<sup>183</sup> which is considered a long period.<sup>184</sup>

Before 1993, a creditor secured by a general notarial bond enjoyed preference over concurrent creditors upon the debtor's insolvency, and this preference extended to all of the debtor's movables at the time of sequestration of his estate.<sup>185</sup> If there was no delivery, then the creditor did not have a real right over the movables purported to be encumbered by the bond; this was not applicable in the former Natal province.<sup>186</sup> Notarial bonds created under the *Notarial Bonds (Natal) Act* 18 of 1932 (repealed) had the legal effect of a pledge and they enjoyed priority over unsecured creditors. This position prevails for a special notarial bond under the *SMMP Act* 57 of 1993.<sup>187</sup> Once the Natal bond was registered, the movables subject to the bond were protected from attachment in execution.<sup>188</sup>

The case of *Cooper v Die Meester*<sup>189</sup> referred to the discrepancies existing between the Natal bonds and bonds created elsewhere in the country. The court rejected the presumed legal position that a creditor secured by a special notarial bond enjoys preference when the debtor becomes insolvent. It viewed that sections 96 to 102 of the *Insolvency Act* 24 of 1936 did not provide for a special notarial bond where the mortgagor retained possession of the movable. Therefore, the creditor did not have "statutory preference over concurrent creditors" in respect to the free residue of the debtor's estate. This judgment resulted in the *SMMP Act* 57 of 1993 being enacted.<sup>190</sup>

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<sup>181</sup> Badenhorst, Pienaar and Mostert *Law of Property* 388.

<sup>182</sup> Mostert and Pope (eds) *Principles of Property* 322.

<sup>183</sup> S 61 *Deeds Registries Act* 47 of 1937.

<sup>184</sup> Sacks 1982 *SALJ* 633.

<sup>185</sup> Badenhorst, Pienaar and Mostert *Law of Property* 385.

<sup>186</sup> Badenhorst, Pienaar and Mostert *Law of Property* 385.

<sup>187</sup> Scott 1995 *THRHR* 673.

<sup>188</sup> Scott 1995 *THRHR* 673.

<sup>189</sup> 1992 (3) SA 60 (A).

<sup>190</sup> Badenhorst, Pienaar and Mostert *Law of Property* 386.

The *SMMP Act 57* of 1993 was enacted to regulate the legal consequences of registration of a notarial bond over specified movable property and to repeal the *Notarial Bonds (Natal) Act 18* of 1932.<sup>191</sup> It creates a special notarial bond over specified movable corporeal property and confers a real security right on the bondholder once the bond has been registered.<sup>192</sup> The property is deemed to be pledged to the mortgagee as effectually as if the property had been pledged and delivered to the mortgagee.<sup>193</sup> The *SMMP Act 57* of 1993 creates a “fictitious” pledge<sup>194</sup> and therefore the principles applicable to pledges also apply to this bond.<sup>195</sup>

A special notarial bond is invalid if the movable asset is not readily identifiable by a third party from the bond itself without referring to extrinsic evidence.<sup>196</sup> This specificity requirement limits the use of the special notarial bond as security over a revolving class of assets that cannot be specifically identified,<sup>197</sup> a problem also experienced in Kenya.<sup>198</sup> Once the debt has been repaid, the bondholder is only required to furnish the mortgagor with proof of discharge in the required form.<sup>199</sup> The mortgagor is expected to register the cancellation of the bond and if it is not done immediately, the register will reflect inaccurate information,<sup>200</sup> a problem experienced in Kenya.

The time of registration of a bond<sup>201</sup> and the nature of the property, affects the priority of a bondholder. For example, a notarial bond created over specific corporeal movables and registered since 1993 (or before 1993 in Natal) without delivery, bestows the same preference as a pledge; a notarial bond over specific corporeal movables registered before 1993 outside Natal without delivery only confers preference to the free residue of the insolvent estate.<sup>202</sup>

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<sup>191</sup> Badenhorst, Pienaar and Mostert *Law of Property* 386.

<sup>192</sup> Pienaar and Steven *Rights* 766.

<sup>193</sup> S 1(1) of *SMMP Act*.

<sup>194</sup> Scott 1995 *THRHR* 680.

<sup>195</sup> Mostert and Pope (eds) *Principles of Property* 323.

<sup>196</sup> See Mostert and Pope (eds) *Principles of Property* 323; *Ikea Trading and Design AG v BOE Bank Ltd* 2005 (2) SA 7 (SCA).

<sup>197</sup> Locke 2008 *CILSA* 141.

<sup>198</sup> Paragraph 3.1.1.

<sup>199</sup> S 1 (2).

<sup>200</sup> Terblanche *Simulated Contracts* 19.

<sup>201</sup> Pienaar and Stevens *Rights* 767.

<sup>202</sup> Pienaar and Stevens *Rights* 767.

#### 4.1.3 LIEN

South African law classifies liens differently from Kenya law as they can either be salvage and improvement liens (premised on principles of unjust enrichment) or debtor and creditor liens (premised on contractual relationships between parties).<sup>203</sup> The State can also create liens (statutory liens) under particular statutes; for example the *Customs and Excise Act* 91 of 1964.<sup>204</sup> Liens are non-registered real security rights in both countries. Contractual liens in South Africa are generally regarded as personal<sup>205</sup> rights<sup>206</sup> and therefore rank below real rights while, enrichment liens are real rights that have priority at insolvency.<sup>207</sup>

The lien is lost if the lienee releases the property voluntarily or when possession is lost because of fraud, mistake or force, but it will revive once possession is restored.<sup>208</sup> Wiese<sup>209</sup> views that the lien under South African law does not revive *per se* but rather a new retention right comes into being once possession is restored. In Kenya, the lien is lost when the lienee is dispossessed or transfers the property by sale, but not if he is dispossessed unlawfully or through trickery. However, if the lienee actually transfers possession, but retains constructive possession,<sup>210</sup> the lien will not terminate.<sup>211</sup>

In South Africa, the lienee who loses possession can pursue the property with the *mandament van spolie* (spoliation remedy)<sup>212</sup> or he can claim *restitutio in integrum* from someone wrongfully retaining the property.<sup>213</sup> Wrongful dispossession of a lienee is a tort of conversion in Kenya and a suit can be instituted for return of possession or to claim for damages. The lienee does not lose his lien when he delivers the property to the debtor's trustee in insolvency if he notifies the trustee in writing of his rights and is able to prove his claim against the insolvent estate.<sup>214</sup> In

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<sup>203</sup> See Van der Merwe *Law of Property* 236; Pienaar and Steven *Rights* 779; Scott *Lien* 31 para 50.

<sup>204</sup> Scott *Lien* 54-56.

<sup>205</sup> Wiese views that debtor-and creditor liens can be a real lien too, see Wiese 2011 *CILSA* 86.

<sup>206</sup> Wiese 2011 *CILSA* 81, 86.

<sup>207</sup> Pienaar and Steven *Rights* 776, 783, 785.

<sup>208</sup> See Wiese 2011 *CILSA* 90; Scott *Lien* 35 para 53.

<sup>209</sup> Wiese 2011 *CILSA* 90.

<sup>210</sup> A person is deemed to have constructive possession (or possession in law) where another person representing him has actual possession, Rapalje and Lawrence *Dictionary* 980.

<sup>211</sup> Beale *et al Law of Security* 5.71, 5.76.

<sup>212</sup> See Wiese 2011 *CILSA* 90; *Nino Bonino v De Lange* 1906 (T) 120, 122.

<sup>213</sup> Wiese 2011 *CILSA* 90.

<sup>214</sup> Scott *Lien* 59 para 82.

both South Africa and Kenya, the lienee cannot use the property for his benefit unless there is an agreement with the owner to that effect.<sup>215</sup>

#### 4.1.4 CESSION IN SECURITATEM DEBITI

Cession is an act of transfer where a creditor (the cedent) transfers his claim (creditor's right, personal right or 'debt') against his debtor to the cessionary.<sup>216</sup> There must be an obligation to cede (*pactum de cedendo*) coupled with a cession agreement (*pactum cessionis*), which is known as the cessionary act.<sup>217</sup> In South Africa, the transfer of personal rights is done by way of cession, while the transfer of intellectual (immaterial) rights is by assignment.<sup>218</sup>

The transfer agreement need not be in writing as was held in *Botha v Fick*,<sup>219</sup> since it can be made orally, deduced from surrounding circumstances, be implied from the parties' conduct or by mere consensus.<sup>220</sup> However, the agreement must satisfy all the requirements of a valid contract and it may be embodied in a deed of transfer or the obligatory agreement.<sup>221</sup> The object of cession must be clearly expressed in the transfer agreement, otherwise deed of cession may be rejected by the courts "as being void for vagueness".<sup>222</sup> The reason (*causa*) for transferring the cedent's assets to a cessionary must be indicated in the deed for the transfer to have permanent effect.<sup>223</sup>

Notice of the cession need not be given to the debtor,<sup>224</sup> although it is important to do so because a debtor who pays the cedent without knowledge of the cession, discharges the debt.<sup>225</sup> However, notice to the debtor is required for a pledge of claims in order to fulfil the publicity requirement.<sup>226</sup> In Kenya, the issuance of a notice of assignment is imperative.<sup>227</sup>

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<sup>215</sup> See Scott *Lien* 32 para 50; Beale *et al Law of Security* 5.68.

<sup>216</sup> Scott *Cession* 13, 28.

<sup>217</sup> Nienaber and Gretton *Assignment* 789.

<sup>218</sup> Nienaber and Gretton *Assignment* 788.

<sup>219</sup> 1995 2 SA 750 (A).

<sup>220</sup> See Scott *Cession* 49; Nienaber and Gretton *Assignment* 791.

<sup>221</sup> Scott *Cession* 49.

<sup>222</sup> Scott *Cession* 21, 22, 24.

<sup>223</sup> See Scott *Cession* 53, 54.

<sup>224</sup> Scott *Cession* 63.

<sup>225</sup> Nienaber and Gretton *Assignment* 794. See also *Illings (Acceptance) Co (Pty) Ltd v Ensor NO* 1982 (1) SA 570 (A) 578F-G.

<sup>226</sup> Badenhorst, Pienaar and Mostert *Law of Property* 400, 401.

<sup>227</sup> Paragraph 3.2.6.

Security over claims can be in form of a pledge<sup>228</sup> or an out-and-out cession (fiduciary security cession).<sup>229</sup> The latter is a fiduciary act that is governed by contract law<sup>230</sup> and entails transferring a right to the cessionary coupled with a fiduciary agreement.<sup>231</sup> The pledge construction, initially postulated in *National Bank of SA Ltd v Cohen's Trustee*,<sup>232</sup> means that cession *in securitatem debiti* has the effect of pledging a claim (personal right) to the cessionary while the cedent retains the 'bare dominium' or a 'reversionary interest' in the claim against the principal debtor.<sup>233</sup> The pledgee can only enforce his right after the pledgor defaults and the pledgor has the right to redeem his property by paying the outstanding debt at any time before the pledged item is sold.<sup>234</sup>

Other court decisions<sup>235</sup> have held that security over claims can only take place through an outright cession together with a fiduciary agreement.<sup>236</sup> Scott<sup>237</sup> acknowledges that both pledge and fiduciary security cession are forms of security by means of claims. However, she warns based on the current South African position that the parties to the latter should be wary of the fact that the fiduciary agreement has no third-party operation and that the security cedent will not be protected during the insolvency of the cessionary. Kenyan law does not recognise this form of security.

#### 4.1.5 LANDLORD'S TACIT HYPOTHEC OVER THE MOVABLES OF THE LESSEE

This hypothec arises by operation of law when a tenant's rent is in arrears although the landlord is not accorded an automatic real security.<sup>238</sup> It is accessory to the payment of rent and once this obligation is met, the hypothec terminates.<sup>239</sup> Movable property that is hypothecated by a notarial bond under the *SMMP Act 57* of 1993, or that relates to an instalment sale transaction under the *Credit Agreements Act 75* of 1980 (repealed and replaced by the *National Credit Act*

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<sup>228</sup> Paragraph 4.1.1

<sup>229</sup> Scott *Cession* 93-95.

<sup>230</sup> Scott *Cession* 94.

<sup>231</sup> Scott *Cession* 94.

<sup>232</sup> 1911 AD 235. *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) 510I also upheld the pledge construction.

<sup>233</sup> The *Grobler* case paragraph 15.

<sup>234</sup> Scott 2013 *SA Merc LJ* 523.

<sup>235</sup> See *Lief NO v Dettmann* 1964 (2) SA 252; *Trust Bank of Africa Ltd v Standard Bank of SA Ltd* 1968 (3) SA 166 (A).

<sup>236</sup> Scott 2013 *SA Merc LJ* 515.

<sup>237</sup> See Scott 2013 *SA Merc LJ* 517, 518; Scott *Cession* 95.

<sup>238</sup> Joubert *Tacit Hypothecs* 455.

<sup>239</sup> Joubert *Tacit Hypothecs* 455.

34 of 2005) (hereinafter *NCA 34 of 2005*), is not subject to the landlord's tacit hypothec<sup>240</sup> unless the landlord's hypothec was perfected before the notarial bond was registered.<sup>241</sup>

Third party property can be subjected to the landlord's hypothec if certain requirements, as set out in *Bloemfontein Municipality v Jacksons Ltd*,<sup>242</sup> are not met namely: the movables must be on the leased premises with the owner's knowledge and consent; the lessor must be unaware that the property belongs to a third party; the property must be brought to the premises for the lessee's use and enjoyment; and the property must be intended to remain on the premises indefinitely.<sup>243</sup> The court in *Eight Kaya Sands v Valley Irrigation Equipment*<sup>244</sup> confirmed that if the tenant creates an appearance to the landlord that the third party property belongs to him; he exposes the goods to the landlord's tacit hypothec unless the third party notifies the landlord that he owns the property.<sup>245</sup> The landlord must obtain a court order before he sells the property and he can obtain an interdict preventing the tenant from removing or alienating the property before an action for rent is instituted.<sup>246</sup>

Kenyan law recognises the landlord's statutory right of distress for rent (landlord's lien)<sup>247</sup> for rent accrued up to six months prior to or after commencement of bankruptcy proceedings.<sup>248</sup> However, third party property, tools of trade, perishable goods, wearing apparel and beddings are excluded from being distrained.<sup>249</sup> Distrained goods can be sold without a court order through a licensed auctioneer upon expiry of a demand notice from the landlord and any surplus is paid to the property owner.<sup>250</sup> The auctioneer can also seize any goods that were unlawfully removed from the premises and sell or dispose of them although a *bona fide* purchaser for value and without notice will not be affected.<sup>251</sup>

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<sup>240</sup> S 2(1) *SMMP Act*.

<sup>241</sup> S 2(2) *SMMP Act*.

<sup>242</sup> 1929 AD 266.

<sup>243</sup> Badenhorst, Pienaar and Mostert *Law of Property* 405, 406

<sup>244</sup> 2003 (2) SA 495 (SCA).

<sup>245</sup> Badenhorst, Pienaar and Mostert *Law of Property* 406.

<sup>246</sup> Badenhorst, Pienaar and Mostert *Law of Property* 405.

<sup>247</sup> S 3(1) *Distress for Rent Act* (Cap 293).

<sup>248</sup> S 40 *Bankruptcy Act* (Cap 53).

<sup>249</sup> S 16(1).

<sup>250</sup> S 4(1).

<sup>251</sup> S 9 and 11.



#### 4.1.6 CREDIT GRANTOR'S TACIT HYPOTHEC OVER MOVABLES SUBJECT TO THE CREDIT AGREEMENT

This hypothec also arises by operation of law. Any property that is delivered to a debtor through an instalment agreement under section 1 of the *NCA* 34 of 2005, at the time of the debtor's sequestration, is regarded as subject to a hypothec in favour of the creditor for the amount that is outstanding.<sup>252</sup> The debtor's trustee in insolvency must deliver the property in his possession to the creditor, if the creditor so requires and the creditor will progress to hold the property as security for his debt. This enables him to progress to realize his security under section 83(1) of the Act.<sup>253</sup> The hypothec also arises from transactions where the purchase price is payable as a lump sum at a future date or payable in instalments in whole or in part.<sup>254</sup>

This security device is not recognized in Kenya because the *Sale of Goods Act* (Cap 31) deems a contract of sale to have occurred when goods are transferred from the seller to the buyer.<sup>255</sup> Where the transfer of the goods occurs in the future or when a condition is fulfilled later, this amounts to an agreement to sell.<sup>256</sup> The latter converts into a sale when the stipulated time elapses or when all the conditions required for the transfer to happen are met.<sup>257</sup> If at the time of the debtor's insolvency, he had not fulfilled the conditions of an instalment sale, he has no title in the goods since they still belong to the instalment creditor.

#### CONCLUSION

It is evident that save for a pledge, the other forms of securities greatly differ in South Africa and Kenya mainly because of different origins of the two legal systems. In the next chapter, I establish how the problems experienced in Kenya have been addressed in South Africa and whether any lessons can be drawn from the South African system.

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<sup>252</sup> See S 84(1) *Insolvency Act* 24 of 1936.

<sup>253</sup> Joubert *Tacit Hypothecs* 464.

<sup>254</sup> Badenhorst, Pienaar and Mostert *Law of Security* 404.

<sup>255</sup> S 3 (1).

<sup>256</sup> S 3 (4).

<sup>257</sup> S 3(5).

## **CHAPTER FIVE**

### **SOLUTIONS FROM SOUTH AFRICA AND OTHER LEGAL SYSTEMS FOR REFORMING SECURITY BY MEANS OF MOVABLES IN KENYA**

#### **5 INTRODUCTION**

The problems experienced in Kenya are on two levels: the fragmentary nature of existing legislation both in regard to the nature of credit transactions and the different security interests, and also in regard to legal persons, insolvency and other areas that have an effect on security interests over movables. Where the problem is also encountered in South Africa and therefore the system is unable to offer a solution, then regard would be to consider other jurisdictions as a basis for reform.

#### **5.1 LESSONS FROM SOUTH AFRICA AND OTHER LEGAL SYSTEMS**

##### *5.1.1 UNIFICATION OF LAWS AND REGULATION*

Most of the laws applicable to this topic in Kenya are relics from our British colonial past and require reforming and modernizing. The numerous statutes that presently establish various financial institutions<sup>258</sup> need to be repealed and consolidated into a single act such as the *NCA* 34 of 2005 that consolidates the law governing the consumer credit industry in South Africa. This Act also establishes the National Credit Regulator (NCR) which has the mandate of regulating the consumer credit industry and providing education, undertaking research and policy development, and registering credit providers amongst others.<sup>259</sup> I therefore suggest that the Central Bank of Kenya's bank supervisory unit<sup>260</sup> be transformed into a fully fledged regulatory authority, similar to the NCR.

Kenya needs to outlaw shylock business like South Africa and require small scale credit providers to be regulated through introducing licensing requirements and clear operating guidelines. These guidelines can be coined from statutes such as the *Microfinance Act*, 2006 and the *Pawnbrokers Act* (Cap 529). Additionally, the numerous statutes creating various security interests over movables should be unified. The South African legal system seems to be in a similar position relying on solutions from its common law (Roman-Dutch law), statutes such as the *SMMP Act* 57 of 1993, the *Notarial Bonds (Natal) Act* 18 of 1932 (repealed), and various

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<sup>258</sup> Chapter 3.

<sup>259</sup> NCR [http://www.ncr.org.za/index.php?option=com\\_content&view=article&id=38](http://www.ncr.org.za/index.php?option=com_content&view=article&id=38) (Date of Use: 2<sup>nd</sup> November 2014).

<sup>260</sup> Paragraph 3.3.

conventions governing interests over specific assets such as ship and aircraft. Countries such as the United States of America, Canada,<sup>261</sup> New Zealand<sup>262</sup> and Australia<sup>263</sup> have reformed and unified their personal property law. Article 9 of the American *Uniform Commercial Code (UCC)* is a model law for secured transactions that creates one security device which integrates all security interests thus simplifying the law. The United Kingdom (UK) embarked on reforming<sup>264</sup> its laws relating to company security interests and the results of these reforms have been embodied mainly in the *Companies Act 2006* (c. 46) and the *Enterprise Act 2002* (c. 40). Kenya can benefit from reviewing and analyzing the reforms undertaken in these jurisdictions to facilitate its own reform.

### 5.1.2 REGISTRATION SYSTEM

South Africa's web-based platform *DeedsWeb*<sup>265</sup> enables all information on land and other deed-based transactions to be accessed online by registered users. This non-restriction policy, premised on section 7 of the *Deeds Registries Act 47* of 1937, permits any interested person to inspect the public registers in line with international standards.<sup>266</sup> Reformed jurisdictions recognize a single system of priorities of all security interests that is based on the filing of notices.<sup>267</sup> This system permits the registration of all interests in movable property that have the effect of providing security including *quasi-security* interests,<sup>268</sup> assignment of rights and actionable claims. The notice filing system is simple and uncomplicated and has been adopted in the *UCC* and the personal property securities acts of Canada and New Zealand. Before Kenya can move towards a notice filing system,<sup>269</sup> it could adopt the current South African model of automation, twenty four hour online access and unrestricted access in the interim.

The various registries in Kenya need to be consolidated into a single one such as the South African Deeds Registry. Alternatively, companies and co-operative society's registries should be interconnected with other specialized registries dealing with interests in land, intellectual

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<sup>261</sup> Canada enacted the *Personal Property Securities Act*.

<sup>262</sup> New Zealand enacted the *Personal Property Securities Act 1999*.

<sup>263</sup> Australia enacted the *Personal Property Securities Act 2009*.

<sup>264</sup> Law Commission Final *Company Security* x.

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<http://www.deeds.gov.za/ITSODEedsWebB/deedsweb/welcome.jsp?tagopen=Welcome&tagHeader=WelcometoDeedsWeb> (Date of use: 28<sup>th</sup> July 2014).

<sup>266</sup> De la Campa, Downes & Henning April 2012 *Making Security* 6.

<sup>267</sup> Fleisig, Safavian and De la Peña *Reforming Collateral* 38.

<sup>268</sup> Law Commission *Registration* 16.

<sup>270</sup> Paragraph 3.3.

property, motor vehicles, ship and aircraft among others. The specialized registries notify the companies or co-operatives registry of all entries registered thereat by a company or cooperative society without requiring the secured creditor to go through a similar rigorous process of registration at the latter registries.

### 5.1.3 INSOLVENCY LAWS

The *Insolvency Act* 24 of 1936, also accords preference to certain claims during insolvency just as in Kenya.<sup>270</sup> However, statutory obligations<sup>271</sup> are settled after secured creditors,<sup>272</sup> funeral and death-bed expenses,<sup>273</sup> costs of sequestration and execution<sup>274</sup> and salaries and wages of employees.<sup>275</sup> The UK adopted a recommendation of its Law Commission in section 251 of the *Enterprise Act* 2002 (c. 40) that does away with crown preference at insolvency. The monies due to the State are now required to be placed in a fund that is available for distribution amongst unsecured creditors.<sup>276</sup> Kenya could benefit from this provision.

Unlike Kenya, South African law allows an insolvent debtor to apply for rehabilitation.<sup>277</sup> However, the Act does not contain any special procedures relating to foreign creditors although they can institute insolvency claims in the domestic courts. The Kenyan *Insolvency Bill*, 2010 once passed into law by Parliament will amend and consolidate the law relating to receiverships, insolvency, winding up and individual bankruptcy in Kenya. The Bill contains provisions for rehabilitation of debtors through the introduction of a moratorium or corporate rescue efforts where it is possible to salvage the situation before a bankruptcy declaration is made.<sup>278</sup> The Bill also alters the preference enjoyed by creditors, with the state claims losing their current super-priority. Cross border insolvency regulations that are based on the *UNICTRAL Model Law on Cross-Border Insolvency* (1997)<sup>279</sup> are also incorporated.

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<sup>270</sup> Paragraph 3.3.

<sup>271</sup> S 99.

<sup>272</sup> S 95.

<sup>273</sup> S 96.

<sup>274</sup> S 97, 98.

<sup>275</sup> S 98A.

<sup>276</sup> S 252 *Enterprise Act*.

<sup>277</sup> S 124 *Insolvency Act* 24 of 1936.

<sup>278</sup> Masoud *Insolvency Law* OLJ 199.

<sup>279</sup> [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html)

#### 5.1.4 AMENDMENT TO THE CHATTELS ACT (CAP 28)

The specificity requirement<sup>280</sup> should be abolished since countries with modern secured transactions laws do not require a specific description of the property, but rather allow the parties to describe the property in any manner they deem fit.<sup>281</sup> Furthermore the process of creating security interests under this Act must be simplified, by doing away with the two affidavits that are presently sworn. The requirement for renewal of an instrument after every five years<sup>282</sup> should also be dispensed with. The Act should prescribe the form of the various instruments that can be created to ensure uniformity.<sup>283</sup> This Act and others such as the *Pawnbrokers' Act* (Cap 529) should be realigned to the governance structure under the 2010 Constitution.<sup>284</sup> Any surplus from sale of a chattel under the Act should be paid to the debtor or any person entitled to it.

#### 5.1.5 REGISTRATION PERIOD

The duration for registering a security interest should be reduced.<sup>285</sup> Fleisig, Safavian and De la Peña<sup>286</sup> advocate for advance filing of interests or reservation of priority rankings (blocking) in order to prevent other security interests from being created while the lender is progressing with registering his security. Kenya can consider the practicality of this proposal for adoption. The UK Law Commission proposed that obtaining leave of court to register security out of time should be abolished since it is in the lender's best interest to ensure that his security is registered within the prescribed time therefore rendering the judicial process unnecessary.<sup>287</sup> The 'first in time' rule would apply to determine priority. Additionally, a debtor and/or secured creditor should be compelled to register the memorandum of satisfaction of debt within a prescribed period to ensure the registers contain accurate information. A penalty should be meted out in case of non compliance.

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<sup>280</sup> Paragraph 3.1.1.

<sup>281</sup> Fleisig, Safavian and De la Peña *Reforming Collateral* 29.

<sup>282</sup> Paragraph 3.1.1.

<sup>283</sup> Paragraph 3.1.1.

<sup>284</sup> Paragraph 3.1.1.

<sup>285</sup> Paragraph 3.2.5.

<sup>286</sup> *Reforming Collateral* 40.

<sup>287</sup> Law Commission *Report* xi, 27.

### 5.1.6 AMENDMENTS TO THE COMPANIES ACT (CAP 486)

All business entities in Kenya should be allowed to create a floating charge. The proposed *Companies Bill 2010*<sup>288</sup> proposes the creation of a one-person company.<sup>289</sup> The *Companies Act* (Cap 486) currently requires that a private company must have at least two members. This provision would allow all businesses to be able to create floating charges. However, individuals would still not benefit from this and therefore a security device similar to the South African general notarial bond should be created. The Act should also provide for the registration of a notice of crystallization of a floating charge.

### 5.1.7 ENFORCEMENT

Kenyan lenders should ensure that their loan agreements contain summary execution clauses that will enable them enforce their security without recourse to court as is the case in South Africa. The judicial system needs to fast track enforcement proceedings<sup>290</sup> and injunctions should not be issued arbitrarily, especially where it is clear that a debt is owed to a lender and the borrower only wishes to use the court process as a delaying tactic. Additionally, more courts need to be designated to handle commercial matters. Parties to loan agreements should opt for alternative dispute resolution mechanisms to resolve debt recovery matters.

## CONCLUSION

I have highlighted the key areas relating to security interests that require reform in Kenya although the list is not exhaustive. A thorough assessment of the law should be undertaken in line with modern practices and international standards. In the next chapter I draw some conclusions and also make recommendations for future legal reform and development in this area in Kenya.

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<sup>288</sup> This Bill awaits the second reading stage.

<sup>289</sup> Article 5.

<sup>290</sup> Paragraph 3.3.

## **CHAPTER SIX**

### **CONCLUSION**

It is evident from the foregoing discussions that Kenyan law on security by means of movable property is in dire need of reform. Whereas some practices from the South African legal system could be adopted to resolve its problems, it is evident that this will not sufficiently address all of them. I regard the South African law of security by means of movables to be inappropriate to follow because it is very different from the Kenyan system. Also, they face the same problems as Kenya since their system is also outdated compared to the recent reforms in many jurisdictions. Due to this, I suggest that law reform should take place in line with developments in other common-law jurisdictions such as the United States of America, Canada, New Zealand and Australia. I am aware of the fact that this cannot be achieved immediately, and therefore suggest piecemeal reforms to be undertaken in certain areas in the interim.

To conclude my dissertation, I view that the move towards the unification of the Kenyan laws relating to interests over movable property will be achieved by consolidating into one Act of Parliament all the laws that govern various aspects of movable property after undertaking thorough research of the topic. I suggest that the Kenya Law Reform Commission (KLRC) should commence the process of reviewing the current legal regime to identify key reform areas. The KLRC should also evaluate the American, Canadian, New Zealand and Australian models on personal property security in order to develop a suitable one for Kenya.

If a total overhaul would not be possible in the short term, the KLRC could analyze the findings and recommendations made by the UK Law Commission in its various reports that identified problems that are very similar to what Kenya is presently experiencing probably due to our colonial links with the UK. The reforms should include consolidation of the laws pertaining to financial institutions and credit providers into one Act of Parliament. The supervisory role of these financial institutions should also be transferred to an authority that will regulate the consumer credit industry. Furthermore, Shylock businesses should be outlawed in Kenya and all credit providers including pawn brokers ought to be licensed and regulated. As to the recommendations specifically dealing with security law, I suggest that attention should be paid to all aspects of security interests over movable property with an aim of unifying and simplifying the system. To achieve this, I recommend that the following issues be addressed:

- 1 The law should be amended to allow individuals and all business entities to create a general security interest over all their assets similar to the floating charge.<sup>291</sup>
- 2 Kenyan law should be amended to allow for the registration of all transactions that have the effect of creating security over movable property including liens, assignment and *quasi*-security interests. This should be done in order to safeguard the interests of third parties by publicizing the existence of these interests.<sup>292</sup>
- 3 The Kenyan registration system should shift to the notice filing system and the registries should be fully automated and accessible online at any time by any member of the public who requires the information without restriction.<sup>293</sup>
- 4 There should be synchronization of the companies' and cooperative societies' registry with specialized registries. In this case, the latter should be required to notify the central registry of all interests filed therein without requiring the secured lender to register the interest in both registries.<sup>294</sup>
- 5 The registration system should be amended to allow for a reservation or blocking of priority rankings during the prescribed period of registering a security in order to prevent other interests to be registered during that time.<sup>295</sup>
- 6 The proposed amendments<sup>296</sup> to the *Chattels Act* (Cap 28), *Pawnbrokers Act* (Cap 529) and *Companies Act* (Cap 486) should be undertaken.

It is my view that the suggested reforms would be instrumental in convincing investors and lenders to advance more money to debtors without relinquishing protection of vulnerable debtors in Kenya.

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<sup>291</sup> Paragraph 3.1.5

<sup>292</sup> Paragraph 5.1.2.

<sup>293</sup> Paragraph 5.1.2.

<sup>294</sup> Paragraph 3.3.

<sup>295</sup> Paragraph 5.1.6.

<sup>296</sup> Paragraph 5.1.1, 5.1.4, 5.1.6 and 5.1.7.



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