

THE REPUBLIC OF UGANDA

IN THE COURT OF APPEAL OF UGANDA AT KAMPALA

[Coram: Owiny-Dollo, DCJ, Egonda-Ntende & Hellen Obura, JJA)

CIVIL APPEAL NO. 13 OF 2004

(Arising from High Court Civil Suit No. 1252 of 2000 at Kampala)

BETWEEN

DELUXE ENTERPRISES LIMITED.....APPELLANT

AND

UGANDA LEASING CO. LIMITED.....RESPONDENT

*(On Appeal from the Judgment and Decree of the High Court of Uganda,
(Byamugisha, J., as she then was), dated 27th April 2001) **JUDGMENT OF
FREDRICK EGONDA-NTENDE, JA***

Introduction

1. This is an appeal from a decision of High Court of Uganda (C.K. Byamugisha, J., as she then was). The appellant filed Civil Suit No. 1252 of 2000 against the respondent for recovery of UGX 147,165,030. The suit was dismissed with costs and judgment was entered in favour of the respondent on the counter claim for the sum of UGX 80,943, 112 carrying interest of 24% per annum from the date of judgment till payment in full.
2. Dissatisfied with the decision of the trial court the appellant has appealed to this court on the following grounds;
'(1) that the learned trial judge erred in law when she failed to consider the fact that Clause 10A of the Master Lease Agreement was a penalty.
2. That the learned trial judge erred in law and in fact when she held the respondent's claim was a genuine pre-estimated of loss which could be claimed as liquidated damages.
3. That the learned trial judge erred in law when she failed to consider authorities relied upon by the appellant.
4. That the learned trial judge erred in law and in fact when she entered

judgment in respect of the counterclaim.

Submissions of Counsel

- (2) At the hearing of this appeal, the appellant was represented by Mr. Salim Makeera and the respondent by Mr. Edmond Wakida. Both parties agreed to file written submissions.
- (3) Mr. Makeera submits that Clause 10A of the master vehicle lease agreement is a penalty in so far as it gives the respondent the right to claim for future rentals after repossession of the vehicles upon termination of the agreement. That the sum the respondent claimed is exorbitant, unreasonable and unconscionable. He relies on the cases of AMEV-UDC Finance Limited v Austin & Anor f 19881 LRC (Comm) 344, O'Dea v All States Leasing System (WA) Pty Ltd H9831 HCA 3; 152 CLR 359; 45 ALR 632 H9831 HCA 3
- (4) In response Mr Wakida submits that the appellant's cause of action on the plaint was breach of contract. The claim that Clause 10A of the agreement is a penalty was never contested in the appellant's pleadings hence the appellant ought to stick to its pleadings. The respondent relies on Cavendish Square Holding BY v Talal El Makdessi, and ParkingEye Ltd v Beavis [2015] UKSC 67 for the submission that Clause 10A of the agreement is not penal as it is a genuine pre-estimate of the loss suffered and is not intended to punish the appellant. That the authorities the appellant relied on relate to hire purchase agreements which while there are similar to lease financing agreements are different in material implications.
- (5) Mr. Wakida referred to the Finance Lease Laws of jurisdictions like Ghana, Sri-Lanka, Tanzania, Seychelles, the Unidroit Model Law on leasing 2008 and some specific sections which govern the lessor's right to repossess the leased property and recover damages as will place the lessor in the position in which he would have been had the lessee performed the financial lease in accordance with the terms of the contract. Mr Wakida also cited section 60(1) of the Income Tax Act 11/97 for the proposition that a finance lease is comparable to a loan agreement for taxation purposes. He therefore contended that it is

unreasonable to suggest that a lessor is only entitled to recover arrears of rent up to the date of termination.

(6) On the second ground, Mr. Makeera submits that the amount claimed by the respondent as a genuine pre-estimate of loss was not certain. It depended on the number of instalments that were unpaid. That the sum claimed by the respondent exceeds by a big margin the greatest loss which the lessor suffered as a result of default in payment of instalments. He relies on the case of Commissioner of Public v Hills f 19061 AC 368, AMEV-UDC Finance Limited v Austin & Anor (supra). Counsel for the respondent replied by referring to his earlier submission in the first ground.

(7) On the third ground, counsel for the appellant referred to section 16 of the Judicature Act and the case of Rashid Moledina & CO. (Mombasa) Ltd & Ors v Hoima Ginnors Ltd 1967 EA 647 where the courts of law are enjoined to take into consideration decisions from any commonwealth court where a similar system of law appertaining in East Africa, most especially decisions of English courts that enunciate the common law or equity or statutes that have been substantially copied in East Africa. Mr Wakida replies that the authorities the appellant relied on were only persuasive and the High court is not obliged to follow them. Article 132(4) of the Constitution sets out the precedents that are binding on High Court. That the Australian and English decisions the appellant cited are not settled law on the doctrine of penalties and the issue of penalties has been settled under the Contracts Act.

(8) On the fourth ground, Mr. Makeera submits that the appellant filed a reply to the counter claim in accordance with Order 8 rule 18(3) of the Civil Procedure Rules hence court ought to have heard the appellant's defence in accordance with Order 9 rule 10 of the Civil Procedure Rules. Mr. Wakida contends that the appellant did not file a reply to the counter claim and that the parties were heard in respect to the counter claim during the main suit

Analysis

- (9) The facts of this case are not largely in dispute. On the 22nd of October 1998, the parties entered into a Master Vehicle Lease Agreement for the leasing of 4 motor vehicles for a term of 4 years commencing on 24th February 1999. The total capital cost of the vehicles was UGX 333,293,199. The monthly rental for the vehicles was UGX 10,148,778 plus 17% VAT making a total of UGX 11,874,70 per month.
- (10) The appellant provided a bank draft of UGX 34,375,000 and land at Mukono comprised in LRV 260 Folio 7 plots 1033, 1034 and 1035 as securities. The appellant also deposited 48 post-dated cheques each for the sum of UGX 11,874,070 for encashment as rental payment as they fell due.
- (11) The appellant defaulted on the payment of the rental sums and on the 22nd of November 1999 the lease agreement was determined by the respondent company which took possession of the vehicles. The respondent sold the land at Mukono and obtained a sum of UGX 104,254,450. The vehicles were either leased to other companies or sold. The sum realized is contained in exhibit D.5 which information was the basis of the counter claim by the respondent.
- (12) On the 19th September 2000, the appellant instituted H.C.S.C No. 1252 of 2000 claiming the following reliefs; the refund of UGX 95,400,960 being the unremitted balance of the money realized from the sale of the appellant's land at Mukono, a refund of UGX 51,764,70 being the excessive rent paid to the defendant, interest of 25% per annum and general damages for breach of contract.

Grounds No. 1 & 2

- (13) The first and second ground will be answered jointly. With regard to what is a penalty clause, Lord Neuberger and Lord Sumption in Cavendish Square Holding BY v Talal El Makdessi, and ParkingEye Ltd v Beavis [2015]

UKSC 67 quoted Lord Diplock in *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The "Scaptrade")* [1983] 2 AC 694 where he stated that;

‘The classic form of penalty clause is one which provides that upon breach of a primary obligation under the contract a secondary obligation shall arise on the part of the party in breach to pay to the other party a sum of money which does not represent a genuine pre-estimate of any loss likely to be sustained by him as the result of the breach of primary obligation but is substantially in excess of that sum. The classic form of relief against such a penalty clause has been to refuse to give effect to it, but to award the common law measure of damages for the breach of primary obligation instead.’

(14) Their Lordships agreed with Lord Roskill who stated in *Export Credits Guarantee Department v Universal Oil Products Co* [1983] 1 WLR 399 (“ECGD”) that;

‘[P]erhaps the main purpose, of the law relating to penalty clauses is to prevent a plaintiff recovering a sum of money in respect of a breach of contract committed by a defendant which bears little or no relationship to the loss actually suffered by the plaintiff as a result of the breach by the defendant. But it is not and never has been for the courts to relieve a party from the consequences of what may in the event prove to be an onerous or possibly even a commercially imprudent bargain.’

(15) In essence the rule is concerned with protecting parties from unconscionable or

extravagant terms contrary to public policy. But identifying what is unconscionable requires some standard or norm against which a term is to be judged. Over the years, the modern rule against penalties in the common law has usually consisted of the adoption of Lord Dunedin's guidelines in Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd (Dunlop) [1915] AC 79 (HL). Lord Dunedin listed four tests that may prove helpful, or even conclusive: first, a sum that is extravagant or unconscionable when compared to the greatest loss likely to be proved from breach is a penalty; secondly, where the breach is a failure to pay, a sum that is greater than the amount that was originally required to be paid will be a penalty; thirdly, a sum that is required to be paid in response to several different breaches that cause differing extents of damage is a penalty; and finally, a sum is not automatically a penalty simply because precise pre-estimation is not possible.

(16) However, the Supreme Court restated the law in relation to contractual penalties in the co-joined appeals of Cavendish Square Holding BV v Talal El Makdessi, and Parking Eye Ltd v Beavis (supra) in 2015. The important revision made by the Supreme Court in Cavendish to the rule against penalties related to the appropriate standard or test for identifying a penalty. The primacy of the compensation principle in Lord Dunedin's formulation was criticized as too restrictive. Dissatisfaction with both compensation and deterrence as the appropriate standards by which to identify penalties was clearly noted by Lord Neuberger and Lord Sumption at paragraph 31 of the judgment;

‘The real question when a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss. These are not natural opposites or mutually exclusive categories.

A damages clause may be neither or both. The fact that the clause is not a pre-estimate of loss does not therefore, at any rate without more, mean that it is penal. To describe it as a deterrent (or, to use the Latin equivalent, in terrorem) does not add anything. A deterrent provision in a contract is simply one species of provision designed to influence the conduct of the party potentially affected. It is no different in this respect from a contractual inducement. Neither is it inherently penal or

contrary to the policy of the law."

- (17) Their Lordships though criticised the definition as too wide and adopted the definition of a penalty in Legione v Hateley (1983) 152 CLR 406, 445 as follows:

‘A penalty, as its name suggests, is in the nature of a punishment for non-observance of a contractual stipulation; it consists of the imposition of an additional or different liability upon breach of the contractual stipulation ...’

- (18) Lord Neuberger and Lord Sumption went ahead to state at paragraph 32 that;

‘The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach, and we therefore expect that Lord Dunedin’s four tests would usually be perfectly adequate to determine its validity’

- (19) The Court replaced the yardstick of compensation with the notion of a legitimate interest in performance of the relevant primary obligation. The tests proposed in the multiple judgments are all consistent on this point, although worded slightly differently.

- (20) Turning to our jurisdiction, the law governing penalty clauses in contracts in Uganda had been unsettled till the enactment of the Contracts Act Cap 2010. We are aware of the fact that this Act came into force in 2010 and does not have retrospective effect. Section 62(1) of the Act states as follows;

‘Where a contract is breached, and a sum is named in the contract as the amount to be paid in case of a breach or where a contract contains any stipulation by way of penalty, the party who complains of the breach is entitled, whether or not actual damage or loss is proved to have been caused by the breach, to receive from the party who breaches the contract, reasonable compensation not exceeding the amount named or the penalty stipulated, as the case may be.’

(21) It is clear that the common law doctrine of penalties has been overtaken by this provision and the doctrine of freedom of contract. Penalties are enforceable. However, what is prohibited is the innocent party receiving from the party that breaches the contract an unreasonable compensation exceeding the amount named in the penalty stipulated in the agreement. It is irrelevant whether the innocent party has suffered any actual damage or loss. Section 62 (2) is to the effect that the penalty may provide for an interest on the amount of compensation to be paid.

(22) Clause 10A which is the subject of contention in this matter states as follows;

‘If termination of the leasing of the Vehicles occurs by reason of a fundamental breach or repudiation of this Agreement by the Lessee pursuant to the provisions of Clause 8 or by reason of an agreed terminating event(being any of the events set out in clause 8.i to xii) inclusive), the Lessee shall pay to the Lessor on the date of termination of the leasing of the Vehicles (the “ Termination Payment Date”) an amount (the “ Termination sum”) for the period in which the Termination Payment Date occurs equal to the aggregate of:

- i. all arrears of Rental due up to and including the Termination Payment Date and any other moneys due to the Lessor under this Agreement up to and including the Termination Payment Date together with

interest on any overdue sum in accordance with Clause 3.E;

- ii. an amount equal to the aggregate of all payments of Rental which would but for such termination have been payable under this Agreement during the period from and including the day following the Termination Payment Date to the end of the Lease Term,
- iii. all costs and expenses incurred by the Lessor or on its behalf, whether before or after such termination, in connection with the repossession, refurbishment, storage. Insurance and/or sale of the Vehicles; and
- iv. all losses, costs. Charges and expenses incurred or payable by the Lessor arising out of the premature termination of any funding commitments in connection with this Agreement.

Any such Termination Sum shall be subject to adjustment pursuant to clause 3.C B. the termination sum shall, in the case of a fundamental breach or repudiation by the Lessee be recoverable as Liquidated Damages and in the case of termination consequent upon a termination event shall be recoverable as a debt or liquidated damages.’

(23) The learned trial judge was right to hold that this provision in the contract envisaged three situations in which termination payments were to be made that is; upon fundamental breach by the lessee, repudiation and an agreed terminating event as provided by clause 8(1) to xii inclusive. Clause 8(1) i provided that if at any time during the Lease Term;

‘...the lessee shall fail to pay any Rental or other sum due hereunder on the due date, thereof or if no due date is specified, within two (2) business days of the written demand thereof made by the Lessor upon the Lessee. ...Then in the event of any of the above as stated in Clause 8 i) to xii) occurring (without prejudice to any other right or remedy which the Lessor may have) the

Lessor may with or without notice terminate the leasing of the Vehicles under this Agreement and take possession of them. Notwithstanding repossession the Lessee will remain liable to perform all obligations under the Agreement.’

(24) From the agreement, non-payment of rental instalments within the prescribed time entitled the lessor to terminate the lease without notice. This was a fundamental term, breach of which the parties agreed could lead to termination of the contract by the lessor.

(25) From the evidence on record, exhibit D5 in particular, the appellants failed to pay the rentals within the prescribed time and kept on postponing the date of payment for various reasons. By 6th September, the outstanding arrears in rentals were totalling UGX 27,000,000. The appellants suggested to the respondents a payment method to cover all the arrears per annexure D4. They promised to commit to fulfilling their obligation of the suggested payment and conceded that the respondent would be free to repossess the equipment hence terminating the contract as provided by the agreement. On record, the cheques issued by the appellant for the payment of the March and July 1999 rentals were dishonoured.

(26) The parties further agreed that the Lessee upon repossession was still under obligation to fulfill its duties under the contract which included the payment of the termination sum under Clause 10A. Generally, under the law of contract, the injured party who terminates the contract is entitled to damages. The purpose of an award of damages is to put the injured party in the position he would have been if the breach had never occurred. In Hadley vs Baxendale (1854) 9. Ex.311, the Court of Exchequer held that when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties know when they made the contract to be likely the result from the breach of it. Damages are meant to compensate the innocent party as far as is practicably possible.

(27) Clause 10 Ai covered all rental arrears that had accumulated to the termination date and the interest thereunder. These are arrears which the appellant is ordinarily under

obligation to pay.

(28) Clause 10 Aii provided for accelerated future rentals. It is not uncommon for this clause to be included in lease finance agreements. The respondent cited common law jurisdictions that have incorporated such provisions in their local laws on lease financing. Though Uganda is not a party to the Convention on International Financial Leasing 1988, am inclined to seek guidance from this treaty and the Unidroit Model Law on leasing 2008. Article 13(2) is to the effect that the Lessor can recover the unpaid accrued rentals, together with future rentals where the lease agreement states so. In modern law lease finance agreements, such provisions are not foreign and are enforceable in so far as they cover damages for loss of profit.

(29) In defining the concept of leasing financing, Chitty on Contracts (27th Edition 1994) Vol.11 at Para 32-056 it is stated that;

‘... If the lease is terminated prematurely, the lessor is entitled to recoup its capital investments (less an allowance to reflect the realization value of the equipment at the time) and its expected finance charges (less an allowance to reflect the accelerated return of capital).’

(30) Clause 10 Aiii provides for repayment of costs and expenses incurred by the Lessor in connection with the repossession, refurbishment, storage, insurance and or sale of the vehicles. When assessing damages, these costs and expenditures are to be put into consideration as they are a direct consequence of breach of contract. The respondent adduced evidence in court that it sold off one of the vehicles and leased out the other two vehicles to offset the losses. An injured party in case of breach of contract must take steps to reasonably mitigate the losses suffered. The sums obtained for the particular transactions were credited to the appellant’s account indicating that the respondent had taken reasonable steps to mitigate their losses.

(31) Clause 10 AIV deals with cost, charges and expenses incurred or payable by the Lessor arising out of the premature termination of any funding

commitments in connection with the agreement. These are foreseen liabilities that the Appellant ought to have to put into contemplation at the time of entering the contract that the respondent would incur in case of termination of the contract hence the clause provides for a fair representation of the losses that would have to be incurred in case of breach.

- (32) In conclusion grounds no. 1 and no. 2 are answered in the negative. Clause 10 A is not a penalty clause but a representation of the losses the respondent was to incur in case of termination of the contract to which it is entitled to as damages in a lease finance agreement.

Ground No.3

- (33) The learned trial judge at page 11 of her judgment while refraining from setting a precedent in this area of the law stated that the basis of her decision was the agreement between the parties.

- (34) Most of the cases the appellant relied on were dealing with hire purchase agreements which are quite different in structure from lease finance agreements. (Guaranty Discount Company Ltd vs. Oliver Lawrence Ward 11961] 1 EA 285, Financing Limited vs Baldock [1963] 2 OB. The cases of AMEV-UDC Finance Ltd V Austin & Another [1988] LRC [Comm] and O'Pea & Ors vs Allstates Leasing SYSTEM (W.A) Pro Prietary Limited & Ors 152 C.L.R were discussed in the Cavendish case and the decisions thereunder have been overturned.

- (35) I am unable to fault the learned trial judge for not following the decisions that the counsel for the appellant cited. Ground No. 3 is answered in the negative.

Ground No.4

- (36) Ground no. 4 is to the effect that the learned trial judge erred in law and fact when she entered the judgment in respect of the counterclaim. The

appellant contends that the trial judge did not follow the proper procedure when entering the judgment in respect to the counter claim. He cited Order 18 rule 18(3) and Order 9 rule 10 of the Civil Procedure Rules. That the court ought to have set down the case for hearing of the counter claim upon the appellant's filing of its reply to the counter claim.

(37) It appears that the appellant is alleging that it was not given an opportunity to be heard on the counter claim. Nothing could be further from the truth. This case was fought on agreed facts. No witnesses were called to testify. The proceedings are at pages 91 to 94 of the record of appeal. The court set out a list of agreed facts and documentary exhibits admitted by consent. The matters not agreed upon were set out as the issues in the case. These were 2. Firstly, 'Whether the Defendant was and is entitled to recover full rental payment after termination.' Secondly If the issue is answered in the affirmative, what remedies are available.'

(38) After setting out the above issues the parties agreed to file written submissions after which the case was set for judgment.

(39) It is clear that the subject of the counter claim was the substance of issues no.1 and no.2 agreed to by the parties as the matters in issue. The learned trial judge decided these 2 issues on the basis of the agreed facts and documentary evidence by the parties. The claim that the appellant was not given an opportunity to defend the counter claim has no basis. He agreed to the procedure adopted by court to resolve the issues. This ground has no merit.

(40) I would dismiss this appeal with costs.

Signed ,dated and delivered at Kampala this 4th day of August 2018

Fredrick Egonda-Ntende

Justice of Appeal

THE REPUBLIC OF UGANDA

IN THE COURT OF APPEAL OF UGANDA AT KAMPALA

[Coram: Owiny-Dollo, DCJ, Egonda-Ntende & Hellen Obura, JJA)

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(On Appeal from the Judgment and Decree of the High Court of Uganda, (Byamugisha, J., as she then was), dated 27th April 2001)

JUDGMENT OF HELLEN OBURA, JA

I have read in draft the judgment prepared by my brother Egonda-Ntende, JA and I concur with his findings and conclusion that this appeal be dismissed with costs as it lacks merit.

Dated at Kampala t h i s 2 9 t h d a y of August 2018.

Hellen Obura

Justice of Appeal

THE REPUBLIC OF UGANDA

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CORAM:

1. HON. MR. JUSTICE ALFONSE C. OWINY - DOLLO, D.C.J.
2. HON. MR. JUSTICE FREDRICK EGONDA - NTENDE, J.A.
3. HON. LADY JUSTICE HELLEN OBURA, J.A.

JUDGMENT OF ALFONSE C. OWINY - DOLLO, D.C.J.

I have perused the draft version of the judgment prepared by my learned brother, Hon Justice Egonda-Ntende J.A. I am in full agreement that the appeal is devoid of merit; and has to be dismissed.

Since Hon. Lady Justice Hellen Obura J.A. is equally in agreement; there will be orders in the terms proposed by Egonda-Ntende J.A.

Dated at Kampala; this 29th day of August 2018

Alfonse C. Owiny – Dollo

DEPUTY CHIEF JUSTICE