THE REPUBLIC OF UGANDA

IN THE HIGH COURT OF UGANDA SITTING AT KAMPALA

(COMMERCIAL DIVISION)

CIVIL APPEAL No. 0004 OF 2017

(Arising from Mengo Chief Magistrates Court Civil Suit No. 0059 of 2014)

ECOBANK UGANDA LIMITED …… APPELLANT

VERSUS

VICTOR CONSTRUCTION WORKS LIMITED …… RESPONDEN

Before: Hon Justice Stephen Mubiru.

JUDGMENT

a) Background;

The respondent successfully bid for Ref. No. UNRA/Works/2008-09/00012/02/02 and on 28th August, 2009 executed contract No. UNRA/RMM/08/09/071 with the Uganda National Roads Authority for marking the 76 Kms of Arua-Nebbi Road over a period of four months. Performance of the contact was to commence within fourteen days, i.e. 12th September, 2009 and be completed by 11th January, 2010. In order to finance that contract, the respondent on or about 21st September, 2009 obtained an advance payment guarantee in the sum of shs. 121,780,000/= from the appellant bank, expiring January, 2010. The respondent further secured a loan of shs. 50,000,000/= to enable it discount a certificate from UNRA worth shs. 85,000,000/= The respondent further on or about 25th November, 2009 secured an overdraft of shs. 55,000,000/= with a maturity date of 30th January, 2010, in order to increase its working capital.

As security for all that credit, the respondent deposited with the appellant, certificates of title for land comprised in Busiro Block 359 Plot 922 at Nakatema and executed a mortgage deed to that effect on 28th September, 2009, as well as land comprised in Busiro Block 313 - 320 Plot 2256 and executed a mortgage deed to that effect on 26th November, 2009. The respondent also issued a director's unlimited personal guarantee as further security. It was further agreed that the respondent was to maintain a cash collateral of shs. 60,890,000/= on its account. The respondent having defaulted on its payment obligations, by a letter dated 26th March, 2010 it requested the

appellant to extend the advance payment guarantee and to convert the overdraft into s short term loan. The appellant on or about 31st May, 2010 restructured all that borrowing into a short term loan repayable by 30th June, 2010.

It was agreed that recovery of the debt was to be made by a 50% deduction on the first payment received by the respondent, and thereafter 15% deductions on its interim payment certificates. All payments were to be effected by deposits onto the respondent's account with the appellant bank. During execution of the works, at the instance of the respondent, UNRA instructed the respondent to change the road markings from a width of 100 mm to 150 mm. This necessitated the respondent's acquisition for a new road marking machine, whose procurement caused delays and the eventual failure in execution of the contract to its completion. The respondent nevertheless attributed that delay to UNRA. It was agreed though that Uganda National Roads Authority was to deposit shs. 93,801,773/= on 24th June, 2010 in respect of an interim certificate to enable the respondent purchase road marking paint and other equipment required to complete the contract, on condition that the respondent executed the remaining works.

When the respondent on 24th June, 2010 attempted to withdraw the funds from the account to enable it purchase the material required to purchase the material required, it found that the account was coded "post no debit" (a restriction imposed by banks on specific accounts, preventing customers from making withdrawals, transfers, or any other debits from their accounts) and the funds thereon were inaccessible. From those funds, the appellant deducted shs. 93,000,000/= and shs. 10,000,000/= The respondent having failed to complete the works, Uganda National Roads Authority terminated the contract and on 30th June, 2010 made a call on the advance payment guarantee. Uganda National Roads Authority contended that the respondent had since 14th May, 2010 abandoned the works by which time it had done only 43 Kms of white paint at the road edges and 23 Kms of yellow paint in the centre of the road. The respondent's attempt to injunct the call on the advance payment guarantee was unsuccessful when its application was dismissed on 14th June, 2011. The respondent was on 21st June, 2012 issued with a default notice as a precursor for steps towards recovery of the outstanding sum, which on 27th June, 2011 the appellant had written off, whose outstanding amount at the time stood at shs. 37,200,000/=.

By a letter dated 30th June, 2010 addressed to UNRA, in an attempt to avert the call on the advance payment guarantee, the appellant asked UNRA to accept an extension of the validity period of the guarantee to enable the bank implement a remedial financing plan with the respondent. On account of that letter the respondent contended that the appellant accepted liability for causing the respondent's failure to execute the contract. The respondent further contented that the appellant responded by writing off the debt on 27th June, 2011 and that it should not have made the deductions from the account that it made on 24th June, 2010 in light of the fact that the loan expiry date was 30th June, 2010. Despite this, while the outstanding amount stood at shs. 100,150,897/= the respondent undertook to pay shs. 41,000,000/= and have the balance of shs. 69,150,897/= rescheduled over a period of twelve months, which the appellant accepted. The respondent nevertheless defaulted on the agreed terms. Due to that default of more than 90 days, the debt was written off on 27th June, 2011.

However, on 16th December, 2013 the respondent paid shs. 60,000,000/= as part payment of the debt whereupon the appellant on 2nd April, 2014 indicated that shs. 37,000,000/= was still outstanding. The respondent insisted that sum had been written off and then three years later sued the appellant seeking an order for the release of the two title deeds in its custody offered as security for the loan borrowed by the respondent from the appellant, a declaration that the respondent was not indebted to the appellant, a declarations that the respondent's continued holding onto the title deeds as security was illegal, a declaration that the intended sale of the property comprised in the title deeds was wrongful, a permanent injunction restraining the appellant and its agents from selling or otherwise dealing in the said property, general damages and costs.

In its defence the appellant contended that it was in rightful possession of the title deed since it constituted security for the loan which at the time the suit was filed stood at shs. 37,122,199/= The respondent's account was coded "post no debit" for purposes of recovering the cash collateral of shs. 60,890,000/= in accordance with the terms of the credit facilities. Writing off the debt was a legal requirement under financial regulations enforced by the Bank of Uganda which required the appellant to write off the debt after 90 days of default. The debt was transferred to the non-performing assets account of the appellant as doubtable loan. The appellant engaged the respondent in a discussion over remedial measures for extension of the advance guarantee, not as

acceptance of liability of causing the respondent's breach of its road works contract but as an alternative to cashing the guarantee on which a call had been made. The respondent having defaulted on its loan obligations, the appellant was entitled to realise the security by sale.

b) The judgment of the Court below

In a judgment delivered on 24th January, 2017 the learned Chief Magistrate held that writing off a debt is acceptance that it should never be paid. By doing so the bank accepted that it is an uncollectable loss, thereby reducing the bank's taxable income. The bank statement showed that shs. 22,964,051/= was written off on 27th June, 2011. The appellant froze the respondent's account on 30th June, 2010 thereby disabling the respondent from accessing the funds deposited thereon by the Uganda National Roads Authority, which led to the respondent's failure perform its obligations under the contract. The write off was not in compliance with a legal requirement but rather a step taken to mitigate the losses the appellant had occasioned the respondent by the act of freezing its bank account. The respondent therefore is not indebted to the appellant. It followed that the intended realisation of the appellant's security was unlawful. The Court therefore restrained the appellant from realisation of the security by sale or other method, directed the appellant to release the title deeds back to the respondent, awarded the respondent shs. 10,000,000/= as general damages, and the costs of the suit.

c) The grounds of appeal;

Being dissatisfied with the decision, the appellant appealed to this court on the following grounds, namely;

1. The learned trial Magistrate erred in law and in fact in holding that the plaintiff was not indebted to the defendant in any way since the defendant undertook to write off and indeed wrote off the plaintiff's outstanding loan of shs. 37,200,000/=.
2. The learned trial Magistrate erred in law and in fact in holding that the plaintiff flailed to perform its contract with Uganda National Roads Authority due to the fact that the defendant had frozen its accounts.

3. The learned trial Magistrate erred in law and in fact in holding that the intended sale of the plaintiff's securities by the defendant is illegal since the defendant wrote off the plaintiff's loan obligations. .

d) <u>The submissions of counsel for the appellant;</u>

Counsel for the applicant M/s S & L Advocates (formerly Sebalu & Lule Advocates), submitted that the trial court erred in the finding made in respect of the write off. The trial magistrate attached a literal interpretation to the phrase "write off." Write off has a technical meaning. *The Financial Institutions Credit Classification and Provision Regulations, 2005* provide for non-performing loans. Regulation 6 defines it; unpaid for 90 days or more. Regulation 3 states that it is non-performing. The objective under Regulation 4 (a), (b) and (c) is to do with financial regulation. The appellant had a legal obligation to classify it so. That is the write off. The case of *Salim Akbarali* shows it is an internal accounting mechanism. At trial the respondent did not contest the shs. 37,000,000/= only that it was not payable.

On the 2nd ground about the appellant having caused a failure of the performance by the respondent. There was no freezing of the account. There was placed a no debit post. It was a denial of access to a specified sum. The cash collateral was supposed to be 50% of the sum due from UNRA i.e. shs. 60,976,000/= They could only access above that sum. The sum that came onto the account was shs. 93,000,000/= on 23rd June, 2010. Access to the shs. 85,000,000/= never came up in the evidence. There was no evidence of attempt to withdraw. On 4th January, 2012 the respondent wrote a letter to the appellant marked Exhibit D. Ex.13 stating the reasons for the failure to complete the contract and breach by the appellant was not included. The letter gives different reasons. On the third ground of appeal, it follows from the first ground of appeal. The securities were the cash collateral and a legal mortgage. The respondent obtained an injunction which frustrated the sale. There were three facilities. Each has a different security arrangement. Only the legal mortgage overlapped all credit arrangements.

The bank was entitled to have the collateral of 50% and the subsequent ones at 15% There is no evidence of withdrawal or an attempt to do so on a frozen account. They could transact save for

the 15% Exhibit P. Ex.2 was never received by the bank. D.W.1 at page 20 on the record 2nd last page signed. There is no proof of delivery. It was an attempt to argue the case after the event. It is a concoction since it came the day before the cash came onto the account. Freezing of the account never came up at all but is not reflected on other correspondences. The reason for failure to perform was canvased in a suit filed by the respondent at the point when UNRA had called the guarantee. They sought an injunction to restrain UNRA from calling the guarantee and filed an interim order which was allowed but when the matter came before Justice Hellen Obura she dismissed the temporary injunction. She blamed failure to perform on the respondent. It is exhibit P.Ex.6. The last finding on *prima facie* case. After 30th June, 2010 the parties continued to negotiate. Exhibit D. Ex.8 shows that as late as 3rd November, 2010 even after cashing of the performance guarantee, there were still outstanding funds. Negotiations continued until 2011. UNRA called the guarantee only after dismissal of the temporary injunction application on 14th June, 2011. What made the write off crystallise was dismissal of that application. That is when what should have happened in 2010 happened. Exhibit D. Ex. 9 sparked off the series of activities that called the guarantee. Exhibit P Ex.3 was an attempt by the bank to help the customer pay.

e) <u>The submissions of counsel for the respondent;</u>

In response, counsel for the respondent, M/s Nsubuga Mubiru & Co. Advocates, submitted with regard to the first ground that the write off in the regulations is not what happened in this case. It was an agreement to compensate the respondent for breach of contract caused by the appellant. At page 11 of the typed record of proceedings the background to the facility applications is narrated. The shs. 55,000,000/= was an overdraft after the advance payment guarantee of shs.121,780,000/= Both were extended to 30th June, 2020 as per exhibit D. Ex.5. There was a new facility granted on 20th May, 2010 in the sum of shs. 50,000,000/= as per exhibit D. Ex.3 When the amount of shs. 93,000,000/= came in from UNRA on 24th June, 2020 as per exhibit P. Ex.4 the bank statement. The account was blocked when that amount came in as per page 16 of the oral testimony. There was a debit of shs. 10,000,000/= for extending the facilities up to 30th June, 2010.

The notice of intention to sue written on 23rd June, 2010 exhibit P. Ex.2 last paragraph indicated that they had been blocked. The advance guarantee was paid and the bank was entitled to shs.

60,000,000/= and the respondent 61,000,000/= The extension was up to 30th June, 2010 yet they recovered as soon as the shs. 93,000,000/= came onto the account on 24th June, 2010 yet it was not due. It was used to settle 105 million not the 121 million. It was the overdraft and the earlier borrowing of the shs. 50,000,000/= which was a running loan which was secured by a title. Exhibit D. Ex.3 shows the terms of borrowing of the shs, 50,000,000. Exhibit P. Ex. 4 shows that the sums were deducted on 30th June, 2010.

The bank then backed the respondent's application to extend the validity period of the performance guarantee as per exhibit P. Ex.3. The balance of 28 million continued to attract interest up to a year later to make in 37 million. On 27th June, 2011 the write off takes place. There were no default notices issued. There was a debit withdrawal on 29th July, 2011. The respondent was able to clear that loan of shs. 60,000,000/= on 17th December, 2013 as per exhibit P. Ex.6. It was after clearing the shs. 60,000,000/= when the respondent wrote to the bank to release the securities (exhibit P. Ex.7) that the shs. 37,000,000/= cropped up (exhibit P. Ex.8). The bank sought to compensate for blocking the account by writing off the debt. It was not the technical write off that the bank now relies on.

f) <u>The decision;</u>

It is the duty of this court as a first appellate court to re-hear the case by subjecting the evidence presented to the trial court to a fresh and exhaustive scrutiny and re-appraisal before coming to its own conclusion (see *Father Nanensio Begumisa and three Others v. Eric Tiberaga SCCA 17of 2000*; *[2004] KALR 236*). In a case of conflicting evidence the appeal court has to make due allowance for the fact that it has neither seen nor heard the witnesses, it must weigh the conflicting evidence and draw its own inference and conclusions (see *Lovinsa Nankya v. Nsibambi [1980] HCB 81*).

In its appellate jurisdiction, this court may interfere with a finding of fact if the trial court is shown to have overlooked any material feature in the evidence of a witness or if the balance of probabilities as to the credibility of the witness is inclined against the opinion of the trial court. In particular this court is not bound necessarily to follow the trial magistrate's findings of fact if it

appears either that she has clearly failed on some point to take account of particular circumstances or probabilities materially to estimate the evidence or if the impression based on demeanour of a witness is inconsistent with the evidence in the case generally.

First issue; whether the appellant's placing a "post no debit" on the respondent's account was unjustified and resulted in the respondent's failure to execute its contract.

The second ground of appeal seeks to challenge the trial Court's finding to the effect that when the appellant placed a "post no debit" on the respondent's account it unjustifiably froze it, denying the respondent access to the sum of shs. 93,801,773/= that had been wired on 24th June, 2010 to enable the respondent purchase material required for completion of the project, which resulted in the respondent's failure to execute its contract. It is the appellant's submission that the account was so coded as a mechanism of perfecting the cash collateral, there is no evidence to show that the respondent attempted to withdraw any funds from the account on 24th June, 2010 or thereafter and that the claim it is that code that cause the respondent to breach its contract is an afterthought.

It was the testimony of P.W.1 Mr. Joseph Lukenge, one of the directors of the respondent, that the appellant by freezing the account, prematurely made partial recovery of the debt on 24th June, 2010 whose term had been mutually extended to 30th June, 2010. He contended further that the respondent was as a result of that unable to access the funds, which resulted in its failure to execute the contract since it had no funds to purchase he required material. The appellant's witness D.W.1 Ms. Annette Mwriza the then appellant's Head legal and Company Secretary, refuted this when she testified that he account was so coded as a mechanism of perfecting the cash collateral.

Having examined the evidence on record, I find that by the facility letter dated 21st September, 2009 (exhibit D. Ex.1), as part of the collateral for the shs. 121,780,000/= advance payment guarantee, the respondent was to maintain a shs. 60,890,000/= cash collateral on the account, that had to be retained out of the shs. 121,780,000/= once deposited onto the account by the Uganda National Roads Authority. Since by 25th May, 2010 the respondent's account was overdrawn by shs. 51,738,392.35 (as per exhibit the bank statement exhibit P. Ex.4), it would appear that the

cash collateral was not perfected immediately upon execution of the loan documents, or upon receipt of the first cash deposit made onto the account by the Uganda National Roads Authority.

The cash collateral was instead perfected by coding the account "Post No Debit" on 24th June, 2010 when the Uganda National Roads Authority wired shs. 93,801,773/= onto the account, thereby imposing a restriction preventing the respondent from making withdrawals, transfers, or any other debits from that account, below a credit balance of shs. 60,890,000/= The effect would be that only 32,911,773/= would have been available to the respondent. Out of this, a sum of shs. 10,000,000/= was deducted as fees for restructuring the loan that occurred on 31st May, 2010 (as per exhibit P. Ex.1). The implication is that the respondent could only withdraw, transfer, or make any other debits from that account up to a limit of shs. 22,911,773/= The bank statement, exhibit P. Ex.4 shows that although this sum could have been withdrawn from the account, but there is no evidence of any attempt of that nature by the respondent, until 30th June, 2010 when the funds then available on the account were used in partial offset of the outstanding loan, leaving a debit balance of shs. 29,026,981.37. I have not found any evidence to show that the appellant made any debits from the account on 24th June, 2010 as contended by counsel for the respondent.

That notwithstanding, in litigation between the respondent and the Uganda National Roads Authority in the former's attempt to forestall the latter's call on the performance guarantee, most particularly H.C. Civil suit No. 377 of 2010 and Misc. Application No. 601 of 2010, the respondent attributed its failure to complete the contact to the latter's belated instructions to widen the width of the road markings. It was the respondent's case that the resultant delay occasioned by the process of procurement of another set of equipment for that purpose, exceeded the duration of the contract. It was never suggested that the "Post No Debit" placed onto its bank account on 24th June, 2010 was the cause or contributed to the delay and eventual failure. The respondent relied on a letter dated 23rd June, 2010 (exhibit P. Ex.2) as proof of the causal link. This letter is refuted by the appellant on grounds that it was never delivered to it. I am inclined to believe the appellant on account of the fact that the letter pre-dates the disbursement made on 24th June, 2010, yet it refers to the account having been blocked by 23rd June, 2010.

It was the respondent's case that by the letter dated 30th June, 2010 addressed to the Uganda National Roads Authority (exhibit P. Ex.3), the appellant accepted liability for causing the respondent's failure to execute the road works contract. The appellant refutes this and contends instead that it engaged the respondent in a discussion over remedial measures for extension of the advance guarantee, not as acceptance of liability of causing the respondent's breach of its road works contract, but as an alternative to cashing the guarantee on which a call had been made. The operative paragraph of the letter reads as follows;

> The purpose of this letter is to request Uganda National Roads Authority (UNRA) to accept the extension of the validity period of the Advance Payment Guarantee from Ecobank Uganda Limited to enable the bank to implement a remedial financing plan with the contractor.

The remedial action under discussion then, is explained in the second paragraph of that letter as having been; "on how they [the respondent] can perform on the outstanding works under the contract," and the fact that the appellant believed that it would be possible for the respondent to compete the outstanding works. The remedial action under consideration apparently necessitated an extension of the performance guarantee. I have not found any direct admission of liability for causing the respondent's failure or any that can arise by implication, contained therein.

Causation is an expression of the relationship that must be found to exist between the wrongful act of the defendant and the injury to the plaintiff, in order to justify compensation of the latter out of the pocket of the former. The correlation between a factor and an outcome could be a coincidence, or it could be caused by a completely different factor. Causation works on two levels: (i) the link between the wrongful act and the breach; and (ii) the link between the breach and the loss. It is the chain reaction composed of wrongful act → breach → loss. To show a causal link, a party must adduce evidence that directly or circumstantially explains the connection. If there is no evidence of that nature, then there can at most be only a correlation and not proof. It cannot in that situation be shown that the factor caused the outcome. The court must decide, on the available evidence, whether the thing alleged has been proven.

The plaintiff will usually prove causation when he or she establishes that "but for" the wrongful act of the defendant, he or she would not have sustained the loss. In this case the respondent attributed inability to execute the contract on time, to alterations in the contract specifications made by the Uganda National Roads Authority. The trial Court's finding of a causal link between the appellant's placing of the "Post No Debit" code onto the respondent's bank account and the respondent's eventual failure to execute its road works contract not being supported by any evidence on record, the trial Magistrate misdirected herself on the evidence before her and came to an erroneous conclusion. She further misdirected herself when she awarded the respondent shs. 10,000,000/= in general damages. The second ground of appeal therefore succeeds.

Second issue; whether the respondent was absolved of the obligation to pay the outstanding shs. 37,200,000/= when it was written off by the appellant.

It is common ground that on 27th June, 2011 the outstanding debt of shs. 37,200,000/= was written off by the respondent (this is proved by the loan statement, exhibit P. Ex.5). While the respondent contends that it was written off in consideration of the appellant's acknowledgement of the loss it had occasioned the respondent when it froze its bank account rendering the funds inaccessible for purchase of material required for execution of the road works contract, it is the appellant's case that the debt was written off in accordance with the requirements of *The Financial Institutions (Credit Classification and Provisioning) Regulations, 2005* following the respondent's more than 90 days' default on terms agreed following negotiations which took place between them after 30th June, 2010, over the outstanding amount which stood at shs. 100,150,897/= at the time. In those negotiations the respondent undertook to pay shs. 41,000,000/= and have the balance of shs. 69,150,897/= rescheduled over a period of twelve months. The period was to expire sometime in June, 2011.

Regulation 11 (5) *The Financial Institutions (Credit Classification and Provisioning) Regulations, 2005* requires financial institutions to write off as loss assets against accumulated provisions, a loan portfolio classified as a loss is a non-performing credit facility where the principal or interest is due and unpaid for ninety days or more (see Regulation 6 (1) (a), within ninety days of being identified as loss, unless approval of the Central Bank to defer write-off has been obtained. Under

these regulations therefore, a loan "write-off" is just an accounting term. It is a regular exercise conducted by banks to clean up their balance sheets of bad and doubtful debts, loans that can't be collected or are unreasonably difficult to collect, as a tool to balance their books and as a regulatory measure as well as reduce their overall tax liability. The debt remains and recovery measures against the borrower may continue. However on the balance sheet of the bank, the debt will be classified as a loss which the bank is required to provision for from a loss reserve, which is a percentage of the loan amount set aside by the bank, against future and presently unidentified losses and which is thus freely available to meet losses which subsequently materialise. In effect the bank uses a part of its profit to replace the bad loans. When the loan is written off, the amount that was originally set aside for provisioning is released. That money can now be used by the bank for business processes. In contrast, a loan "waive-off" is a complete cancellation of a loan. This means that the borrower is free from that particular debt.

In light of *The Financial Institutions (Credit Classification and Provisioning) Regulations, 2005* a loan "write off" simply means re-classification as a bad debt. Being a mere adjustment on the creditor's balance books, shifting the debt from the accounts receivable column to the bad debt column, it does not change the borrower's legal liability to repay the debt and it remains recoverable, subject to *The Limitation Act*. The clock for purposes of that Act starts ticking upon the borrower's "default," which usually is the date of the borrower's last payment, in this case 16th December, 2013 when the respondent paid shs. 60,000,000/=

The learned trial Magistrate misdirected herself when she construed a debt write-off by the appellant bank as a debt forgiveness. She erroneously premised it on a finding of being an atonement for having caused the respondent's failure to complete its performance of the road works contract, which premise was not supported by the evidence on record. She misdirected herself when she found that the respondent is not indebted to the appellant. Had she properly directed herself, she would have found that it merely meant that the appellant bank no longer treated the loan as a normal asset; it was now a bad debt although any recovery would be written back. The respondent is still liable for payment of the outstanding debt of shs. 37,200,000/= Therefore the first ground of appeal succeeds too.

Third issue; whether the intended sale of the respondent's securities by the appellant is illegal;-

It was argued by counsel for the respondent and also found by the trial Court that the steps taken by the appellant towards sale of the securities were illegal. Having found that the respondent is still liable for payment of the outstanding debt of shs. 37,200,000/=, it follows that the appellant is only required to satisfy the procedures required of it under *The Mortgage Act*, for it to realise the securities. The respondent's recourse is to exercise its equity of redemption before the intended sale if it is to retrieve the title deeds free from encumbrances. The learned trial Magistrate misdirected herself when she found that the intended realisation of the security was unlawful. The Court further misdirected itself when it restrained the appellant from realisation of the security by sale or other method, and in directing the appellant to release the title deeds back to the respondent. The third ground of appeal too succeeds.

I the final result, the appeal succeeds on all grounds. Consequently, the judgment of the Court below is set aside and instead judgment is entered dismissing the suit with costs to the appellant. The appellant is awarded the costs of this appeal as well.

Delivered electronically this 28th day of August, 2023 ……Stephen Mubiru……..

Stephen Mubiru
Judge,
28th August, 2023.