

THE REPUBLIC OF UGANDA
IN THE HIGH COURT OF UGANDA SITTING AT ARUA
MISCELLANEOUS CIVIL APPLICATION No. 0001 OF 2014
(Arising from Nebbi Chief Magistrate’s Court Civil Suit No. 0051 of 2009)

CHARLES ATHEMBU APPLICANT

VERSUS

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|---|----------|-------------------------|
| 1. COMMERCIAL MICROFINANCE LIMITED | } | |
| 2. ST. PETERS REGISTERED TRUSTEES OF | } |RESPONDENTS |
| CHURCH OF UGANDA – PAIDHA, NEBBI DIOCESE | } | |

Before: Hon Justice Stephen Mubiru.

RULING

This is an application made under the provisions of sections 64 (c), 83 and 98 of *The Civil Procedure Act* and sections 17, 33, 38 (1) and (3) of *The Judicature Act* seeking the revision of a decision of the Magistrate Grade One at Nebbi by which he entered judgment against the applicant in the sum of shs. 15,575,000/=. The applicant contends that the decision was erroneous in so far as the trial magistrate, when determining the applicant’s indebtedness to the first respondent, did not take into account the fact that the applicant had made part payment of the loan. Further, the court below misdirected itself when it failed to consider evidence to the effect that the first respondent had attempted to dispose of the applicant’s property offered as security for the loan, long before the applicant had defaulted and before the suit was filed. In the result the trial magistrate failed to judiciously exercise a jurisdiction vested in him or acted in exercise of his jurisdiction illegally and with material irregularity. He therefore seeks to have the judgment set aside, setting aside the execution that ensued on basis of the impugned proceedings, an order of a re-trial and an award of the costs of this application.

In an affidavit in reply sworn on behalf of the second respondent by her chairman Mr. Rwothomio Phillip, the second respondent contends that she purchased the land in issue on 28th November 2013 at a public auction in execution of a decree of the Magistrate’s Court at Nebbi

pursuant to a judgment and decree of the court entered on 10th November 2013. The second respondent was granted possession of the land on 25th February 2014 upon which by a letter dated 4th March 2014, it granted the applicant 30 days within which to vacate the land peacefully. The applicant having refused to vacate after expiry of that period, the second respondent sought and was granted a court order of vacant possession on 1st June 2015.

The background to this application is that on 4th July 2006, the applicant took out a loan of shs. 2,000,000/= from the first applicant, repayable within a period of ten months running from 8th July 2006, at a rate of interest of 2.5% per month and a penalty fee of 2% per month, out of which he had repaid only shs. 685,000/= as at 10th August 2006. As security for the loan, he offered his unregistered plot of land measuring approximately 15 metres by 18.5 metres by 30 metres by 14.6 metres, comprising a temporary residential building, fruits and shade trees, at Zingili village, Omua Ward, Paidha Town Council in Zombo District. Under the terms of the loan agreement, the applicant was required to pay monthly instalments of shs. 250,000/=. Upon default, the first applicant filed civil suit No. 0051 of 2009 before the Grade One Magistrate at Nebbi. At the time of filing the suit, the outstanding amount had accumulated to shs. 15,575,000/=. Upon hearing the evidence, Judgement was entered against the applicant on 25th March 2011 and a warrant of attachment and sale of his land in execution of the resultant decree was issued on 10th October 2013. In his judgment, the learned trial magistrate commented;

The defendant is stopped (sic) to deny knowledge of the terms, although harsh in themselves. A bank is entitled to levy such terms in order to raise liquidity for further business transactions to its customers. I am not aware of any business entity of a financial nature of the kind that would transact in business terms and not get profits or fail to stand to its commercial profile dictates. The punitive terms in the loan contract, in my view, are to compel the borrowers to keep alive and awake to their repayment obligations...I hold that the defendant was in flagrant breach of the loan agreement.

The applicant's land was advertised for sale at page 31 of "The Daily Monitor" newspaper of 15th October 2013. The land was in the meantime valued at a market price of shs. 14,000,000/= on 21st November 2013, with a forced sale value of shs. 9,000,000/=. The second applicant on 28th November 2013 bought it at shs. 12,500,000/=.

The applicant was unrepresented at the hearing of the application. In his submissions, he argued that his timber business collapses soon after he had taken out the loan and this coupled with the fact that not long after he had secured the loan, his wife fell sick and was admitted in hospital and later she died, he was unable to pay the loan. The loan officer of the first respondent and other workers fellowship from St. Peters Church, the second respondent, and it is the one which bought his land. Sometime during 2008, he returned home only to find that his family had been evicted with guns. His household property was destroyed in the process. He was not served with prior notices of default. That was the third time he was obtaining a loan from that bank. The practice was that he would take guarantors to the first respondent, and the Chairman would sign on the loan agreements as well as the magistrate. They just showed him where to sign whenever he borrowed money. He did not know whether the loan agreement had a clause regarding the bank's power of sale since he is illiterate. His guarantor, Felix Orom Obedling, had over ten million shillings in the bank and he wondered why his property was attached instead. He contended that the first applicant should have gone to his guarantor first. He contended that the second respondent Church had interest in the land all along and they conspired with the bank to deprive him of his land. They used to hold secretive meetings for that purpose.

The first respondent neither filed an affidavit in reply nor was it represented when the application came up for hearing. In his submissions, counsel for the second respondent, Mr. Paul Manzi argued that the attachment and sale of the land to the second applicant was lawful. It followed the due process of the law. He referred to paragraph 3 (d) (i) and (ii) of the application. He considered the applicant's complaint to the effect that the first respondent had already unlawfully sold the land in the year 2008 to the second respondent who had made attempts to illegally evict the appellant from the land, as misconceived. The averment that the second respondent convened meetings on 9th May 2008 and on 10th May 2008 to mobilise money to buy the suit land were rebutted by paragraph 3 and annexure "A" of the second respondent's affidavit in reply which is the sale agreement between the second respondent and the bailiff showing that the sale actually took place on 28th November 2013. It is not true as alleged by the applicant that the land was illegally bought by the second applicant in 2008.

He submitted further that in paragraph 4 of the affidavit in reply of the second respondent, it is averred that the court issued an order for delivery of the land which is annexure “B” issued by the Chief Magistrate on 28th June 2014. When the order was issued the applicant himself wrote a letter in paragraph 5 as annexure “C” thereto requesting the second respondent to allow him a period of three months to enable him vacate the land. It is dated 25th of February 2014. The second respondent considered the request as stated in paragraph 6 of the affidavit in reply. It is marked “D” he was allowed 30 days. He still refused to vacate after that as shown in paragraphs 7 and 8 and in 9 that prompted the second applicant to file an application before the Chief Magistrate of Nebbi No. 58 of 2014. After considering the application the Chief Magistrate issued a warrant and order as “E” and “F” for vacant possession. The allegations made by the applicant therefore are false. Annexure “E” to the application although in Alur relates to a different piece of land, (the land next to the Church). The sale in execution occurred after a notice was published in the Monitor Newspaper of 15th October 2013 at page 31 which was attached as annexure “A.” The sale was on 28th November 2013 which was beyond the thirty days required by the law. The documents annexed as “B5” is a valuation of the land and at page 2 the value was shs. 14,000,000/= and the forced sale value at shs. 9,000,000/=. The second respondent bought it at shs. 12,500,000/=. The allegations that the sale was illegal or that it was made before the suit was heard and finalised are false. It was done in accordance with the procedure and after the sale the applicant approached the purchaser and requested for more time within which to vacate. The sale was done properly and cannot be faulted. He prayed that the application be dismissed with costs.

Section 83 of the *Civil Procedure Act, Cap 71* empowers this court to revise decisions of magistrates’ courts where the magistrate’s court appears to have; (a) exercised a jurisdiction not vested in it in law; (b) failed to exercise a jurisdiction so vested; or (c) acted in the exercise of its jurisdiction illegally or with material irregularity or injustice. It entails a re-examination or careful review, for correction or improvement, of a decision of a magistrate’s court, after satisfying oneself as to the correctness, legality or propriety of any finding, order or any other decision and the regularity of any proceedings of a magistrate’s court. It is a wide power exercisable in any proceedings in which it appears that an error material to the merits of the case or involving a miscarriage of justice occurred, but after the parties have first been given the

opportunity of being heard and only if from lapse of time or other cause, the exercise of that power would not involve serious hardship to any person.

The controversy between the parties to this application stems from the manner in which the trial magistrate construed and proceeded to enforce the loan agreement. At Common Law, the general rule is of freedom of contract. Courts have shown a consistent reluctance to interfere with commercial contracts signed by parties of broadly similar bargaining power, such as where negotiations take place between commercial parties represented by experienced commercial lawyers. The position is different where the facts suggest an oppressive imposition of one party's will over the other. In *Alec Lobb (Garages) Ltd v. Total Oil Ltd*, [1983] 1 All ER 944, [1983] 1 WLR 87 Peter Millett QC J held:

To establish that a contract was unconscionable, a party had to have made an unconscientious use of its superior position or superior bargaining power to the detriment of someone suffering from some special disability or disadvantage. This weakness had to be exploited in some morally culpable manner, leading to an oppressive transaction. There must be some impropriety, both in the conduct of the stronger party and in the terms of the transaction itself, but the former may often be inferred from the latter in the absence of an innocent explanation.....it is probably not possible to reconcile all the authorities, some of which are of great antiquity, on this head of equitable relief, which came into greater prominence with the repeal of the usury laws in the 19th century. But if the cases are examined, it will be seen that three elements have almost invariably been present before the court has interfered. First, one party has been at a serious disadvantage to the other, whether through poverty, or ignorance, or lack of advice, or otherwise, so that circumstances existed of which unfair advantage could be taken: see, for example, *Blomley v. Ryan* (1954) 99 CLR 362, where, to the knowledge of one party, the other was by reason of his intoxication in no condition to negotiate intelligently; secondly, this weakness of the one party has been exploited by the other in some morally culpable manner: see, for example, *Clark v. Malpas* (1862) 4 De G.F. and J. 401, where a poor and illiterate man was induced to enter into a transaction of an unusual nature, without proper independent advice, and in great haste; and thirdly, the resulting transaction has been, not merely hard or improvident, but overreaching and oppressive. Where there has been a sale at an undervalue, the undervalue has almost always been substantial, so that it calls for an explanation, and is in itself indicative of the presence of some fraud, undue influence, or other such feature. In short, there must, in my judgment, be some impropriety, both in the conduct of the stronger party and in the terms of the transaction itself (though the former may often be inferred from the latter in the

absence of an innocent explanation) which in the traditional phrase ‘shocks the conscience of the court,’ and makes it against equity and good conscience of the stronger party to retain the benefit of a transaction he has unfairly obtained.

Equity interferes in many cases of harsh or unconscionable bargains. “Unconscionable” is defined in *The Shorter Oxford English Dictionary*, Third Edition, Volume II, page 2288, when used with reference to actions etc. as “showing no regard for conscience; irreconcilable with what is right or reasonable.” An unconscionable bargain would, therefore, be one which is irreconcilable with what is right or reasonable. Equity interferes with harsh or unconscionable contracts entered into with poor and ignorant persons who had not received independent advice (See *Chitty on Contracts*, Twenty-fifth Edition, Volume I, paragraphs 4 and 516).

In determining unconscionability, court looks to the conduct of the stronger party in attempting to enforce, or obtain the benefit of a dealing with a person under a special disability in circumstances where it is not consistent with equity or good conscience that he should do so. The adverse circumstances which may constitute special disability for the purposes of the principles relating to relief against unconscionable conduct may take a wide variety of forms and are not susceptible to being comprehensively catalogued (see *Commercial Bank of Australia Ltd v. Amadio* (1983) 46 ALR 402). In *Clark v. Malpas*, (1862) 54 ER 1067, the court found a contract to be an unconscionable bargain where a poor and illiterate man was induced to enter into a transaction of an unusual nature, without proper independent advice, and in great haste; and the resulting transaction has been, not just hard or improvident, but overreaching and oppressive. Where a case was strong enough on its face in terms of conduct and terms, unconscionable conduct could be inferred if there was no explanation offered to displace that inference (see *Portman Building Society v Dusangh and Others*, 2000] Lloyd’s LR 19; [2000] 2 All ER (Comm) 221). When looking at cases of unconscionable conduct, the modern equivalent of “poor and ignorant” might be “a member of the lower income group ... less highly educated” (see *Cresswell v. Potter*, [1978] 1 WLR 255). Similarly in *Fry v. Lane, re Fry, Whittet v Bush*, [1886-90] All ER Rep 1084 it was held that where a purchase is made from a poor and ignorant man at a considerable undervalue, the vendor having no independent advice, a Court of Equity will set aside the transaction. This will be done even in the case of property in possession, and *a fortiori* if the interest be reversionary. The circumstances of poverty and ignorance of the vendor, and

absence of independent advice, throw upon the purchaser, when the transaction is impeached, the onus of proving, in Lord Selborne's words, that the purchase was "fair, just, and reasonable."

The contract between the applicant and the first respondent was technically a mortgage. Any contract which, by way of security for the payment of a debt, confers an interest in property defeasible or destructible upon payment of such debt, or appropriates such property for the discharge of the debt, must necessarily be regarded as creating a mortgage or charge, as the case may be (see *Federated Homes Ltd v. Mill Lodge Properties Ltd*, [1980] 1 WLR 594; [1980] 1 All ER 371). While testifying in his defence regarding the circumstances surrounding the execution of the mortgage and attempted foreclosure thereafter, the applicant stated;

When I was getting the loan I signed some papers. I did not go to school. The papers were not explained to me. I could only sign the papers. I trusted the officers on the documents and I was in need of a loan.....St. Peters Church wants me to vacate the mortgaged plot of land. The loan officer of the plaintiff is a member of the church administration. He advised the church to buy the plot. I was put on pressure to sell the land by the bank manager. I was arrested at the instructions of the manager and detained at the bank premises. I was released at 6.30 pm. I was released on police bond that evening. I wanted to sell off part of the plot to repay the loan. I did not sell however I was taken to police by the bank around April –May 2008. The bank was advised to go civil. I made an agreement at the police. It is dated 29th April 2008. It was an agreement to sell to the bank the mortgaged plot at shs. 5,000,000/=. I signed the agreement. I authorised the Chairman L.C1 to sell to the bank on my behalf. (The agreement is then tendered in evidence)... on 23rd May 2008 I got the bank had sold my land. They had entered my land and broken the offence. There was no court broker. It was the police and the bank officials and the police who entered the plot. The bank had not taken me to court...I did not sell the mortgaged property to the bank.... I received an eviction notice by the bank. It is dated 13th May 2008 and I received it on 14th May 2008.....(The eviction notice is then tendered in evidence).

This aspect of the applicant's evidence stood unshaken by cross-examination. The circumstances as he narrated them were suggestive of unconscionability in the contract. The determination of whether or not a contract or term is or is not unconscionable is made in the light of its setting, purpose and effect. Relevant factors include weaknesses in the contracting process. A bargain is not unconscionable though merely because the parties to it are unequal in bargaining position, or even because the inequality results in an allocation of risks to the weaker party. But gross inequality of bargaining power, together with terms unreasonably favourable to the stronger

party, may confirm indications that the transaction involved elements of deception or compulsion, or may show that the weaker party had no meaningful choice, no real alternative, or did not in fact assent or appear to assent to the unfair terms. It is necessary for the party who seeks relief to establish unconscionable conduct, namely that unconscientious advantage has been taken of his disabling condition or circumstances.

To establish that a contract was unconscionable, a party has to have made an unconscientious use of its superior position or superior bargaining power to the detriment of someone suffering from some special disability or disadvantage. This weakness has to have been exploited in some morally culpable manner, leading to an oppressive transaction. There must be some impropriety, both in the conduct of the stronger party and in the terms of the transaction itself, but the former may often be inferred from the latter in the absence of an innocent explanation (see *Alec Lobb (Garages) Ltd v Total Oil Ltd*, [1983] 1 All ER 944, [1983] 1 WLR 87). The test is whether the conditions and the terms of interest are so unconscionable as to shock the conscience of the Court (see *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd*, [1983] 2 AC 803, [1982] 1 All ER 108 and *Central Inland Water Transport Corporation v. Brojo Nath Ganguly* [1986] 3 S.C.C. 156). If the cases are examined, it will be seen that three elements have almost invariably been present before the court has interfered. First, one party has been at a serious disadvantage to the other, whether through poverty, or ignorance, or lack of advice, or otherwise, so that circumstances existed of which unfair advantage could be taken: secondly, this weakness of the one party has been exploited by the other in some morally culpable manner: and thirdly, the resulting transaction has been, not merely hard or improvident, but overreaching and oppressive. If a contract or term thereof is unconscionable at the time the contract is made, a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result. Having realised that the contract terms were “harsh in themselves,” the trial magistrate had to decide whether or not they were unconscionable in the circumstances and thereafter select one of the available options, which he did not do.

On the facts of this case, the applicant entered into a commercial transaction in a situation where the parties were of broadly dissimilar bargaining power. The gross inequality of bargaining

power resulted in the applicant signing a contract requiring him to pay a rate of interest of 2.5% per month (which translates into 53.46 per annum) and a penalty of 2% per month of default (which translates into 42.768 per annum), on top of the shs. 2,000,000/= he borrowed. Considered together with terms so unreasonably favourable to the first applicant, this may be indicative of the fact that the transaction involved elements of deception or compulsion, or that the applicant as the grossly weaker party had no meaningful choice or real alternative, most especially since there was no evidence adduced during the trial that he obtained independent advice before entering in to a transaction of terms tending to the usurious. The trial magistrate instead considered the transaction as one in which the first applicant was “entitled to levy such terms in order to raise liquidity for further business transactions to its customers” and that it was consistent with the practice of business entities “of a financial nature of the kind...[to] get profits or fail to stand to [their] commercial profile dictates.” Had he properly directed himself, he would have considered the possibility of invoking instead the provisions of section 26 (1) of *The Civil Procedure Act* where if court finds that an agreement for the payment of interest sought to be enforced, provides for a rate of interest that is harsh and unconscionable which ought not to be enforced by legal process, to give judgement for the payment of interest at such a rate as it may think just. By this provision, legislation has provided for courts’ interference to prevent one party to a contract from taking undue or unfair advantage of the other. The trial magistrate was not alive to this at all.

Secondly, the trial magistrate clearly misdirected himself in the import of the penalty clause in the loan agreement. There was a triable issue as to whether the clause was a penalty considering that a particular clause might be commercially justifiable provided that its dominant purpose was not to deter the other party from breach. At common law, clauses designed to deter parties from breaching a contract by penalising poor performance (known as penalty clauses) are unenforceable (see *Dunlop Pneumatic Tyre Company Ltd v. New Garage and Motor Company Ltd [1915] AC 67*). Unlike liquidated damages clauses, the purpose of penalty clauses is to punish a party for its actions. A penalty provision has been regarded as unenforceable or, perhaps void, *ab initio*. Its main purpose, according to the authorities, is to prevent a claimant from recovering a sum of money which bears little or no relationship to the loss actually suffered by the claimant as a result of the defendant’s breach. A liquidated damages clause will be enforced

where the court finds that the harm caused by the breach is difficult to estimate, or where the amount of liquidated damages is reasonable compensation and not disproportionate to the actual or anticipated damage. The intent of liquidated damages is simply to measure damages that are hard to prove once incurred. If the liquidated damages are disproportionate, they can, however, be declared a penalty. The clause is then void, and recovery will be limited to the actual damage that results from the breach.

Lord Diplock's judgment in *Scandinavian Trading Tanker Co AB v. Flota Petrolera Ecuatoriana* [1983] 2 AC 694, defined a penalty clause thus;

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.

Where the damages which may arise out a breach of contract are in their nature uncertain, the law permits the parties to agree beforehand the amount to be paid on such breach. Whether the parties have so agreed or whether the sum agreed to be paid on the breach is really a penalty must depend on the circumstances of each particular case. There are, however, certain general considerations which have to be borne in mind in determining the question. If, for example, the sum agreed to be paid is in excess of any actual damage which can possibly, or even probably, arise from the breach, the possibility of the parties having made a bona fide pre-estimate of damage has always been held to be excluded, and it is the same if they have stipulated for the payment of a larger sum in the event of breach of an agreement for the payment of a smaller sum.

There are cases, however, in which the Courts have interfered with the free right of contract, although the parties have specified the definite sum agreed on by them to be in the nature of liquidated damages, and not of a penalty. Parties to commercial contracts may agree that, if a contractual provision is breached, the defaulting party must pay the innocent party a specified

sum of money. The penalty rule developed to protect the weaker contracting party from oppression by its stronger counterpart. If the Court, after looking at the language of the contract, the character of the transaction, and the circumstances under which it was entered into, comes to the conclusion that the parties have made a mistake in calling the agreed sum liquidated damages, and that such sum is not really a rational pre-estimate of loss within the contemplation of the parties at the time when the arrangement was made, but a penal sum inserted as a punishment on the defaulter irrespective of the amount of any loss which could at the time have been in contemplation of the parties, then such sum is a penalty, and the defaulter is only liable in respect of damages which can be proved against him. For example in *Dunlop Pneumatic Tyre Company Ltd v. New Garage and Motor Company Ltd*, [1915] AC 67, the appellants contracted through an agent to supply tyres. The respondents contracted not to do certain things, and in case of breach concluded: 'We agree to pay to the Dunlop Pneumatic Tyre Company, Ltd. the sum of 5 l. for each and every tyre, cover or tube sold or offered in breach of this agreement, as and by way of liquidated damages and not as a penalty.' The House, in discussing penalty clauses, drew a distinction between a payment on breach stipulated as in terrorem of the offending party and a genuine covenanted pre-estimate of damage, and summarised the law. Lord Dunedin said:

- (1) Though the parties to a contract who use the words 'penalty' or 'liquidated damages' may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The court must find out whether the payment stipulated is in truth a penalty or liquidated damages.
- (2) The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine pre-estimate of damage.
- (3) The question whether a sum stipulated is a penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of at the time of the making of the contract, not as at the time of the breach.
- (4) To assist this task of construction various tests have been suggested which, if applicable to the case under consideration, may prove helpful or even conclusive. Such are:
 - (a) It will be held to be a penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss which could conceivably be proved to have followed from the breach.

- (b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid.
- (c) There is a presumption (but no more) that it is a penalty when ‘a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage.’ On the other hand:
- (d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties.’

The critical factor in determining the enforceability of liquidated damages clauses has been whether, at the time the contract was entered into, the level of liquidated damages reflected the parties’ genuine pre-estimate of losses likely to be suffered in the event of a breach of contract. If so, the clause would be enforceable. If not, the damages would be viewed as penal and the clause would be unenforceable. Whatever be the expression used in the contract in describing the payment, the question must always be whether the construction contended for rendered the agreement unconscionable and extravagant, and one which no Court ought to allow to be enforced (see *Webster v. Bosanquet*, [1912] AC 394).

On the other hand, in *Lordsvale Finance Plc v. Bank of Zambia*, [1996] QB 752, where a facility agreement opened by a bank in favour of the defendant provided that in the event of default the defendant should pay interest during the period of default at an aggregate rate equal to the cost to the bank of obtaining the deposits required to fund its participation, an agreed margin and an additional unexplained 1%. The customer said that the 1% fee was a penalty and unenforceable. The court disagreed and decided that the term provided for a modest increase. It was not a penalty and therefore not invalid. The court analysed the concept of a penalty as follows:

Whether a provision is to be treated as a penalty is a matter of construction to be resolved by asking whether at the time the contract was entered into the predominant contractual function of the provision was to deter a party from breaking the contract or to compensate the innocent party for breach. That the contractual function is

deterrent rather than compensatory can be deduced by comparing the amount that would be payable on breach with the loss that might be sustained if breach occurred. A simple dichotomy between a genuine pre-estimate of damages and a penalty does not always cover all the possibilities. Although the payment of liquidated damages is 'the most prevalent purpose' for which an additional payment on breach might be required under a contract.....the jurisdiction in relation to penalty clauses is concerned not primarily with the enforcement of inoffensive liquidated damages clauses but rather with protection against the effect of penalty clauses. There would therefore seem to be no reason in principle why a contractual provision the effect of which was to increase the consideration payable under an executory contract upon the happening of a default should be struck down as a penalty if the increase could in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach.....where, however, the loan agreement provides that the rate of interest will only increase prospectively from the time of default in payment, a rather different picture emerges. The additional amount payable is *ex hypothesi* directly proportional to the period of time during which the default in payment continues. Moreover, the borrower in default is not the same credit risk as the prospective borrower with whom the loan agreement was first negotiated. Merely for the pre-existing rate of interest to continue to accrue on the outstanding amount of the debt would not reflect the fact that the borrower no longer has a clean record. Given that money is more expensive for a less good credit risk than for a good credit risk, there would in principle seem to be no reason to deduce that a small rateable increase in interest charged prospectively upon default would have the dominant purpose of deterring default. That is not because there is in any real sense a genuine pre-estimate of loss, but because there is a good commercial reason for deducing that deterrence of breach is not the dominant contractual purpose of the term.

It becomes clear that the issue of whether such a clause is a liquidated damages clause or penalty clause is not one to be glossed over as the learned trial magistrate did. The trial magistrate never addressed his mind at all to the question whether the penalty clause created a secondary obligation which imposed a detriment on the applicant out of all proportion to any legitimate interest of the first respondent in the enforcement of the primary obligation. The first respondent could possibly have no proper interest in simply punishing the applicant. The interest of the first respondent was in performance or in recovery of interest on the amount lent. Instead of determining whether the clause reflected the parties' genuine pre-estimate of losses likely to be suffered in the event of breach of the contract, the learned trial magistrate concluded that it was a

punitive term in the loan contract designed “to compel the borrowers to keep alive and awake to their repayment obligations.” This was clearly a misdirection since penalty clauses are unenforceable.

Lastly, the trial magistrate misdirected himself regarding the reckonable period for calculation of the amount due under the loan agreement. In *Westlink Uganda Limited v. Magezi Charles H.C. Civil Suit No. 140 of 2007*, after a default judgment had been entered, the plaintiff sought to recover interest of 20% per month beyond the agreed contract period of one month and the learned Judge while disallowing the interest stated as follows:

It is clear to me from the records that the loan transaction had a specific period within which to be paid with interest. The parties agreed that for a period of one month the defendant would pay interest on the loan amount at the rate of 20%. This in practical terms means that one month after the loan transaction the plaintiff was entitled to a refund to him of the Shs. 2,000,000/= with a profit of Shs. 400,000/=. In those circumstances, the plaintiff’s claim which includes purported interest beyond the contractual period cannot be accepted as at the end of the contract period of one month the contract elapsed and the plaintiff was entitled to sue for breach of contract of the loan amount.....if the plaintiff wants interest beyond the contract period, the solution lies in including a penalty clause in the loan agreement for delayed payment.

In the instant case, although the loan period was only ten months long (ending during or around June 2007), the learned trial magistrate awarded a quantum of shs. 15,575,000/= which not only covered the period up to 5th September 2009, but also incorporated a rate of interest of 53.46% per annum and a penalty of 42.768% per annum, without first determining whether the former was conscionable or not and whether the latter was a penalty or not. Regarding the subsequent sale of the applicant’s land to the second respondent, it is stated by Chitale and Rao in their *The Code of Civil Procedure Act V of 1908* 6th Ed. at p. 762, that;

A judicial sale, unlike a private one, is not complete immediately it takes place. It is liable to be set aside on appropriate proceedings . . . If no such proceedings are taken, or if taken are not successful, the sale will then be made absolute..... Questions as to the validity of private sales by auction-purchasers or judgment-debtors before the date of confirmation may also arise. In order to settle the law bearing on such questions, this section lays down that though the property does not vest in the auction-purchaser till the date of confirmation, once the sale is confirmed and becomes absolute, the title of the auction purchaser shall relate back to the date of the sale itself.

This principle has been applied in cases such as *Lawrence Muwanga v. Stephen Kyeyune S.C. Civil Appeal No. 12 of 2001, [2002] KALR 144; Allan Nsubuga Ntanoga v. Uganda Micro Finance Ltd and 4 Others H.C Misc. Application No. 0426 of 2006* and *Francoise Mukyo v. Rebecca Mawanda and another, C.A Civil Appeal No. 15 of 2008*. The fact that the property in the instant case was sold and a purchaser placed in possession does not preclude court from enquiry into the merits of the sale and in fact setting aside such a sale. The applicant placed before the trial court facts, unchallenged by cross-examination and admitted in the testimony of P.W.1 under cross-examination, showing that the judicial sale was preceded by a sale of the same property by the mortgager to itself during May 2008, under a purported power of sale by mortgager without resort to court. He also testified that the Loan Officer of the first applicant is a member of the second respondent's administration. These circumstances lend credence to the applicant's contention of complicity of the second respondent in what could easily be a mere cover up of a what is in fact a direct sale by the first respondent to the second respondent rather than a genuine sale at a public auction. The sale cannot be final until these issues are cleared in a judicious process. This is all a manifestation of material irregularity and injustice.

In light of all the foregoing, it becomes abundantly clear that the cumulative effect of the misdirections by the trial magistrate manifests a clouded appreciation of the evidence that was laid before him that is tantamount to obstruction of a full and fair adjudication of the case to which the applicant was entitled. With due respect, the manner in which the trial magistrate went about the evaluation of the evidence before him was erratic or precipitate and wholly unsatisfactory as to constitute a mistrial resulting in a miscarriage of justice. The outcome of the trial was severely compromised by the inept evaluation of evidence, so gross that it fell short of the expected standards of a fair trial. It is therefore only fair that the suit be tried de novo before another magistrate of competent jurisdiction, and I so order. In the meantime the judgment and decree of the court below and the subsequent sale are hereby set aside. The applicant's possession of the land should be restored pending the outcome of the re-trial. The costs of this application are awarded to the applicant.

Dated at Arua this 22nd day of June 2017.

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Stephen Mubiru
Judge
22nd June 2017.