IN THE HIGH COURT OF ZAMBIA **2006/HN/330**

HOLDEN AT NDOLA

(Civil Jurisdiction)

BETWEEN:

PEMBA LAPIDARIES **1ST PLAINTIFF**

LAPEMBA TRADING LIMITED **2ND PLAINTIFF**

AND:

INDUSTRIAL CREDIT COMPANY LIMITED **DEFENDANT**

CORAM: SIAVWAPA J.

FOR THE PLAINTIFFS: MRS. MWAPE OF MESSRS J.B. SAKALA & CO

FOR THE DEFENDANT: MR. CHILESHE OF MESSRS LLOYD, JONES & COLLINS

J U D G M E N T

AUTHORITIES AND REFERENCE SOURCES REFERRED TO

1. Halsbury's Laws of England 4th edition Volume 32
2. Online Business Dictionary
3. The Free Online Legal Dictionary
4. Re Molton Finance Limited [1967] 3 ALL ER 844 (C A)

The Plaintiffs herein are both bodies corporate incorporated in the Republic of Zambia with their registered offices in Ndola.

By their joint writ of summons dated 29th November 2006, their claim against the Defendant is for the followings reliefs;

(1) Damages for trespass to and or conversion of the Plaintiffs' properties, plant, equipment and chattels at the premises known as subdivision H10 of farm No. 748 NJO at Ndola which items were not subject of the leased equipment which the Plaintiffs obtained from the 1st Defendant
(2) Loss of business arising out of (1) above
(3) Damages for denying the Plaintiffs the equitable right to redeem the mortgage on subdivision H10 of farm No. 748 Ndola the property of the 2nd Plaintiff which was mortgaged to the 1st Defendant
(4) In the alternative an order for the return of the mortgaged property and all the movable assets of the Plaintiffs
(5) Damages for selling the mortgaged property and the leased equipment at under valued prices
(6) An account stated after the sale of the mortgaged property to two purchasers and the leased and un leased assets to the 2nd Defendant
(7) Any other relief or order as the Court may deem equitable
(8) Interest and costs

The brief facts of the case are that in April and May 2001, the 1st Plaintiff and the 1st Defendant entered into two Lease Agreements by which a number of pieces of plant and equipment were leased out by the Plaintiffs to secure the loans obtained from the 1st Defendant. The property known as subdivision H10 of farm No. 748, belonging to the 2nd Plaintiff was used as additional security to both leases.

The 1st Defendant accordingly advanced certain sums of monies to the 1st Plaintiff but that the 1st Plaintiff defaulted leading to the foreclosure on the property known as subdivision H10 of farm No. 748 which property the 1st Defendant sold to recover the monies due on the leases. In the process other movable properties belonging to the 1st Plaintiff were sold and it is on these brief facts that the Plaintiffs have founded their claim.

I need to mention that in due course, even before commencement of trial the parties, by consent had the 2nd Defendant removed from the proceedings thereby leaving the 1st Defendant as the sole Defendant in the matter.

The Plaintiffs' sole witness and the only witness called in the case, Mr. Mulenga Kasenge Kaoma, who was the 1st Plaintiff's Administration Manager from 1999 testified that between 10th and 17th April 2001, the 1st Plaintiff decided to seek a loan or a lease back of its equipment to raise working capital. Subsequently, he and the technical director approached the 1st Defendant where they had a fruitful discussion with one Cosmas. They submitted an application in which a Mitsubishi Rodeo motor vehicle, a Power ware UPS and three Imahashi Faceting machines were leased out to the 1st Defendant for a sum of US $ 45, 000.00.

On 27th April 2001, he collected a cheque for US $ 42, 120. 00 as the 1st Defendant had collected US $ 2, 880.00 from the sum of the lease. He said that as at 19th April 2002, the amount due to the 1st Defendant was US $ 41, 315.00.

On 23rd May 2001, another application was lodged with the 1st Defendant for a sum of US $ 150, 000.00 as the earlier amount was inadequate to enable the 1st Plaintiff to participate in the Hong Kong International Gemstone fair scheduled for August/September 2001. He said that on the second application, the 1st Defendant only gave them US $ 100, 000.00 with a promise that the balance would be paid in due course. He collected a cheque for US $ 93, 600.00 following the 1st Defendant's collection of US $ 6, 400 as its management fees.

He said that because the 1st Defendant failed to pay the US $ 50, 000.00 on the second lease, the 1st Plaintiff failed to attend the fair in Hong Kong as it had difficulties in sourcing for raw materials and subsequently also failed to pay back the 1st Defendant. He further said that the total balance on the two leases due for payment as at 16th January 2004 was US $ 93, 854.78.

He also explained that because the 1st Defendant had no property, it was conducting its operations on subdivision H10 of farm No. 748 belonging to the 2nd Plaintiff, a sister company to the 1st Defendant, which property was also used as additional collateral for the two leases. He said that they were shocked to learn that the said property had been sold to one Olga Morelli in 2003 for US $ 60, 000.00 without the knowledge of the 1st Plaintiff and without a letter of demand from the 1st Defendant as per procedure of financial institutions.

He said it was wrong for the 1st Defendant to force Mr. Neils Erickson to sign a letter exhibited at pages 24 and 25 in the Plaintiff's supplementary bundle of documents when the property had already been sold and the leases paid out by the US $ 60, 000.00 paid by Mrs Morelli which the 1st Defendant did not credit to the account of the 1st Plaintiff to reduce on the balances on the two leases.

He further said that the 1st Defendant under valued the property as it had been purchased for US $ 79, 800.00 in 1997 and that extensive renovations were carried out at a cost of US $ 119, 000.00. In that regard he said that the 1st Plaintiff had suggested through a letter to Messrs Lloyd Siame and company that the property could only be sold for US $ 200, 000.00. Further, he said that the 1st Defendant, on 6th August 2004, foreclosed the 1st Plaintiff's business without any demand letter or court order and impounded machinery which was not leased including spare parts, loose tool, office equipment, furniture, fittings, lapidary tables, cut and polished stones and raw materials.

He said that the current value of the stones that were lost in the custody of the 1st Defendant was US $ 259, 869.00 and that had the 1st Defendant not foreclosed the 1st Plaintiff's property the 1st Plaintiff would have earned US $ 550, 000.00 from confirmed orders. He further said that the equipment sold to Mr. Phesto Musonda for US $ 45, 000.00 was valued at US $ 636, 872.00 and that its current value was US $ 796, 090.00.

He contended that the 1st Defendant and Mr. Phesto Musonda entered the property known as subdivision H10 of farm No. 748 without the knowledge or consent of the 1st Plaintiff and that the 1st Defendant allowed Mr. Musonda to start using the machinery which was not leased causing business loss to the 1st Plaintiff in the sum of US $ 1, 049, 620.00 annually. He said that on 2nd March 2006, Olga Morelli obtained a court order to evict Mr. Musonda and that in the eviction process, all the equipment, furniture and fittings were dumped outside the building and rendered useless.

It was his further contention that, six years since the 1st Plaintiff lost business it would be impossible to rebuild its previous reputation in the stone business.

In cross-examination, he said that the Plaintiffs were sister companies with the same directors and that the 1st Plaintiff borrowed the money voluntarily. He denied the suggestion that the 2nd Plaintiff was owned by the 1st Plaintiff. He however, conceded that in a leasing agreement the borrower offers a chattel for sale to a financing company thereby transferring the ownership and title of the chattel to the financing company in return for cash.

He also admitted that there was a binding contract between the 1st Plaintiff and the 1st Defendant exhibited at pages 15 and 16 of the Plaintiffs' bundle of documents with page 16 being the additional security of subdivision H10 of farm No. 748 which was

owned by the 2nd Plaintiff. He said that the lease period was 24 months from 23rd April 2001 to 24th April 2003 but that the 1st Plaintiff defaulted. He further said that the 1st Plaintiff also defaulted on the second lease of US $ 100, 000.00. He further admitted that the second lease carried personal guarantees by the 1st Plaintiff's directors who were equally in default at the end of the lease period.

He also said that there was an outstanding amount of US $ 115, 719.63 as at 20th April 2004. He went on to admit that the signing of the document at page 24 of the Plaintiff's bundle of documents was in the interest of the 1st Plaintiffs and its directors as it released them from the obligations under the lease. He said that nobody had offered more than US $ 60, 000. 00 for subdivision H10 of farm No. 748 and that at the date of the sale agreement for the property, the Plaintiffs and their directors were three months in default of the Lease Agreements and that the 1st Defendant was at liberty to enforce its equitable mortgage.

He admitted that there was nothing wrong with the sale agreement as the 1st Defendant was exercising its rights over the property and further that had the sale of the building failed the 1st Defendant would have been entitled to sell the leased equipment and in the last resort, move against the Plaintiffs' directors personally.

With regard to the proceeds of the sale of the property, he said that the recipients of the money were Messrs Lloyd Siame and

company and that there was no evidence to show that the 1st Defendant had received the money.

As regards the value of the property he admitted that the US $ 200, 000.00 was fixed by the Plaintiffs and that a year later, Mr. Neil Erickson accepted the value of the property as US $ 60, 000.00. He also said that according to his letter, he handed over the keys to the property voluntarily. He admitted further that the 1st Defendant recovered only US $ 45, 000.00 from US $ 55, 000.00 and declared no further claim from the Plaintiffs. He further conceded that the property in question was sold with the knowledge of the Plaintiffs.

At the close of the case for the Plaintiffs, Mr Chileshe indicated that rather than call witnesses, he would file written submissions on the law as the facts were not in dispute. Unfortunately however, no submission was received from Mr. Chileshe.

In her submission, Mrs Mwape said that the facts of the Lease Agreements was not in dispute save for the procedure the 1st Defendant used to recover the monies owing on the leases upon the Plaintiffs' default. In this regard, she argued that it was irregular for the 1st Defendant to foreclose the Plaintiffs' property without having issued a demand notice or obtained a court order. She further argued that a mortgagee must give notice or obtain a court order before foreclosing to give the mortgagor an opportunity to redeem the mortgage. She referred the Court to Halsbury's Laws of England 4th Edition, Volume 32 at paragraphs

407, 571 and to the learned author of A Short Treatise on Mortgages.

It was also argued that it was irregular for the 1st Defendant to impound all the equipment including those that were not leased and further that when the property was first sold, the proceeds were not credited to the Plaintiffs' account.

As admitted by Mrs. Mwape in her submissions, there is no dispute that the Plaintiffs and the 1st Defendant executed two financing Lease Agreements and that the Plaintiffs defaulted on both Leases. What is in dispute is whether the 1st Defendant's method of enforcing its rights on the Leases was contrary to the law.

The two Agreements namely; USD/ME/290/27 dated 27th April 2001 and USD/ME/305/15 dated 15th June 2001 have similar provisions except as to the value and the equipment leased. In both Leases however, an equitable mortgage was created in favour of the Defendant on subdivision H10 of farm No. 748 Kabelenga Avenue as additional security. It is further noted that both Leases had durations of 24 months with rentals due monthly in advance.

In a nutshell the nature of the two Leases was such that the 1st Plaintiff, being in need of working capital, sold off some of its equipment to the Defendant for US $ 45, 000.00 and US $ 100, 000.00 respectively. Subsequently, the Defendant leased back

the said equipment to the Plaintiff at fixed monthly rentals for a period of 24 Months (Clause 10.0 refers).

Clause 12.0 empowers the lessor to repossess the leased equipment without giving notice or doing anything else in the event of default by the lessee on the rentals or any other sum due within five days of the same becoming due thereby bringing the lease to an end. Notwithstanding that the Defendant neither called witnesses nor filed in submissions, it seems clear from Mr. Chileshe's line of cross-examination of the only witness for the Plaintiffs that the Defendant placed heavy reliance on clause 12.0 for its actions and I do not find fault in the Defendant's actions as they relate to the leased equipment.

There is however, the issue of the foreclosure on the property that was used as additional security and it had been argued that the foreclosure was irregular as no demand notice or court order was issued and the mortgagor was not given an opportunity to redeem the loan. The court was referred to paragraphs 407 and 571 of Halsbury's Laws of England Volume 32 4th edition and the learned authors of Short Treatise on Mortgages.

I have taken time to look at the cited authorities and other references on the effect of an equitable mortgage and what is clear from the said authorities and references is that an equitable mortgage does not convey legal title to the mortgagee. It is said to be imperfect and not meeting the requirements for a legal mortgage thereby requiring an agreement to make it perfect.

According to the **online Business Dictionary**, in English Law, ***"an equitable mortgage is created by the deposit of title deeds by the owner of an estate with a person from whom he has borrowed money with an accompanying agreement to execute a regular mortgage, or by the mere deposit, without any verbal agreement respecting a regular security."*** It goes on to state that; ***"where a legal or equitable mortgage is the security interest created or arising under security financial collateral arrangement on terms that include a power for the collateral taker to appropriate the collateral, the collateral taker may exercise that power in accordance with the terms of the security financial collateral arrangement without any order."***

The above cited quotations make it undoubtedly clear that an equitable mortgage must be accompanied by an agreement or a provision that empowers the collateral-taker or mortgagee to either execute a legal mortgage or to appropriate the collateral without which legal title remains with the mortgagor and the mortgagee is devoid of any power to appropriate or effect a foreclosure on the property without a Court order.

I am fortified in taking the above position by the following definition of foreclosure from the Online Business Dictionary;

> ***"Strict foreclosure refers to the procedure pursuant to which the Court ascertains the amount due under the mortgage orders its payment within a certain limited time and prescribes that in default of such payment, a debtor will permanently lose his or her equity of redemption, the right to recover the property upon payment of the debt, interest and costs. The title of the property is conveyed to the creditor on default of payment, without any sale of the property."***

It is therefore, the position at law that an equitable mortgage creates a charge on the mortgaged property that gives the mortgagee or creditor the right to seek the aid of the judicial process to recover the loan in the event of default. This is in accordance with paragraph 405 of Halsbury's Laws of England Volume 32, fourth edition at page 189 which states as follows;

> ***"An equitable mortgage is a contract which creates a charge on the property but does not convey any legal estate or interest to the creditor; such a charge amounts to an equitable interest. Its operation is that of an executor assurance which, as between the parties, and so far as equitable rights and remedies are concerned, is equivalent to an actual assurance, and is enforceable under the court's equitable jurisdiction."***

In **Re Molton Finance Limited** the Court of Appeal put it thus;

> ***"When an equitable mortgage or charge is created by deposit of title deeds there is an implied contract that the mortgagee or charge may retain the deeds until he is paid."***

This means that a mortgagee can hold on to the title deeds until the payment of the debt but without power to dispose of the property until and unless a court order for foreclosure is obtained. To underscore this position in the United States of America, three operative theories have emerged namely; the lien theory, the title theory and the hybrid theory applied by different States.

In the States that apply the lien theory, a mortgage is treated as an instrument granting security rights to the lender with the legal title remaining with the borrower at all times. In these states, the lender will usually resort to a judicial foreclosure and obtain a court order authorising the sale of the property to satisfy the debt. On the other hand in States that apply the title theory, a borrower transfers the legal title to the lender who holds it in trust for the borrower under a deed of trust. In these States, foreclosure is non judicial as the lender already has legal title.

In States that apply the hybrid theory, title is transferred to the lender through a mortgage rather than a deed of trust with non judicial foreclosure still acceptable. This hybrid theory in the

United States is more or less what is called a legal mortgage under the common law system.

Transcending all these theories however, is the borrower's right of equity of redemption and to that effect, Mrs. Mwape has argued on behalf of the Plaintiffs that the Defendant acted in breach of the Plaintiffs' right to equity of redemption when it purportedly foreclosed on the property in Kabelenga Avenue.

As already seen from the references and authorities cited earlier, an equitable mortgage does not convey any legal title in the mortgaged property to the mortgagee and consequently no power of sale vests in the mortgagee. Further, paragraph 407 of Halsbury's Laws of England Volume 32 fourth edition at page 190, attaches the equity of redemption to all mortgages and provides among other things that;

"***Any provision inserted in the mortgage to prevent redemption on payment of the debt or performance of the obligation for which the security was given is termed a clog or fetter on the equity of redemption and is void."*** It goes on to state that; "***The right to redeem is so inseparable an incident of a mortgage that it cannot be taken away by an express agreement of the parties that the mortgage is not redeemable or that the right is to be confined to a particular time or to a particular description of persons."***

In this case, the two Agreements that the parties signed were lease-backs of equipment by the Defendant and the assets specified in the schedules to the two Agreements formed the core of the security for the Defendant. The property referred to as H10 Kabelenga Avenue, which is at the centre of the dispute, was used as additional security by way of creating an equitable

mortgage over it for both Agreements. The equitable mortgage was created by a deposit of title deeds of the property with the Defendant. There was no deed of trust executed by the parties over the said property effectively leaving the legal title to the property with the 2nd Plaintiff at all times.

On the basis of the law relating to equitable mortgages discussed above, it follows that the Defendant had no power to foreclose the property without having recourse to the judicial process and obtaining a court order. I therefore, accept Mrs Mwape's argument that the Defendant acted irregularly by foreclosing on the said property and subsequently selling it without first obtaining a court order.

I further wish to point out that in its purported foreclosure on the property, the Defendant can not rely on the provisions of the two Agreements and in particular clause 12.0 as the said Agreements apply solely to the equipment which was subject of the lease-backs and not the property in issue which was to be governed solely by the law governing equitable mortgages which has already been sufficiently exposed in this judgment.

As regards the equity of redemption, there is again no doubt that by selling the property to a third party without a court order, the Defendant seriously violated the 2nd Plaintiff's right to the equity of redemption which, as already stated, is non negotiable as it is incidental to any mortgage created and more so an equitable mortgage which does not convey any legal title to the lender.

Finally, there is the claim based on the sale of other equipment and various quantities of both polished and raw precious stones of various types which were not subject of the lease-back Agreements. This appears to me to be a serious misapprehension of the law relating to collateral on the part of the Defendant. I take this view because, security taken by way of a lease-back attaches specifically to the items listed and scheduled. Default on the part of the lessee can never entitle the lessor to cease other items that are not attached to the lease. It was therefore, a gross violation of the Lease Agreements themselves for the Defendant to cease and sell the items that were not part of the Lease Agreements.

I therefore, find that because of the erroneous sale of the Plaintiffs' properties which were not part of the Lease Agreement, the Plaintiffs' business was made to suffer serious damage from which they might never recover

On the totality of the evidence before me, I cannot but find in favour of the Plaintiffs and award them the following;

1. Damages for loss of the property known as subdivision H10 of farm No.748 in Kabelenga Avenue
2. Damages for all the equipment and materials that were sold by the Defendant not being part of the Lease-back Agreements
3. Damages for loss of business

The above awards shall be assessed by the Deputy Registrar with interest and costs to follow the event.

DATED THE------DAY OF JANUARY 2011

J.M. SIAVWAPA

JUDGE