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

by

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

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

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<tr>
<td>EACLJ</td>
<td>EAST AFRICAN CENTRE FOR LAW &amp; JUSTICE</td>
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<td>KLRC</td>
<td>KENYA LAW REFORM COMMISSION</td>
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<td>NCR</td>
<td>NATIONAL CREDIT REGULATOR</td>
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<td>OHADA</td>
<td>ORGANISATION POUR L'HARMONISATION EN AFRIQUE DU DROIT DES AFFAIRES</td>
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<tr>
<td>UCC</td>
<td>UNIFORM COMMERCIAL CODE</td>
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<tr>
<td>UK</td>
<td>UNITED KINGDOM</td>
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<td>UNCITRAL</td>
<td>UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW</td>
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CHAPTER ONE
SECURITY: KEY COMPONENT FOR ACCESSING FINANCE IN KENYA

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

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

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

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

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\(^1\) Karumba and Wafula Collateral Lending 2.
\(^2\) Van Erp Property and real security 647.
\(^3\) UN UNCITRAL Guide paragraph 5; page 46.
\(^4\) Ellis et al Gender 46, 47.
\(^6\) Sacks 1982 SALJ 605.
\(^7\) Allen Right to Property 1.
\(^8\) Kenya Vision 2030 http://www.vision2030.go.ke/index.php/home/library (Date of use 2nd September 2014).
can provide good security for loans, certain deficiencies in the Kenyan law make it unattractive to lenders and therefore the need for reform.

1.2 OVERVIEW OF KENYAN AND SOUTH AFRICAN LEGAL SYSTEMS

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

Kenyan law is premised on the English common-law system, which originates from English customs and beliefs. Over time, the nation has developed its own legal system12 based on its Constitution, written laws and judicial decisions. Acts of Parliament of the United Kingdom, common law, doctrines of equity and statutes of general application have also shaped the Kenyan legal system.13 African customary law guides Kenyan courts in civil matters where a party is affected by it so long as it is not repugnant to justice and morality or inconsistent with written law.14 The *Constitution of Kenya* 2010 further provides that the general rules of international law15 and any treaty or convention that Kenya has ratified form part of Kenyan law.16

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

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9 Husa *Legal Families* 491.
10 David and Brierley *Major Legal Systems* 21, 23.
12 See Laster *Law as Culture* 91; Shah *Kenya* 223.
13 See S 3(1) *Judicature Act* (Cap 8).
15 Article 2 (5).
16 Article 2 (6).
17 See Du Plessis *South Africa* 814; Mostert *Constitutional Protection* 34, 35.
19 Zimmermann *Double Cross* 4.
property law is based mainly on Roman-Dutch law, but procedural and insolvency law is strongly under the influence of English law.20

1.3 JUSTIFICATION FOR COMPARING THE KENYAN AND SOUTH AFRICAN LEGAL SYSTEMS

Kenya and South Africa are members of the Commonwealth21 where comparative law plays a major role in legal development and has shaped the rights to property in these jurisdictions.22 Through this study, Kenyan decision makers, especially judges, will gain knowledge on South African law governing interests in movables that could assist them in resolving difficult questions of law.23 In this way case law (an important source of law in common-law jurisdictions) will be developed.24

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

Lastly, South Africa has been the largest economy in Sub-Saharan Africa until it was recently surpassed by Nigeria.27 Despite this, South Africa is still an economic powerhouse and is regarded by investors as the gateway to African countries.28 Kenya is also a vital commercial and financial hub for Eastern and Central Africa.29 This study could form the basis for assessing the possibility and desirability of unification or harmonization30 of laws in the two regions in order

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20 Zimmermann Double Cross 6.
21 http://thecommonwealth.org/member-countries (Date of use: 1st July 2014).
22 Gutteridge Introduction 27.
23 Michaels Comparative Law 1.
24 Glenn Aims of Comparative Law 69.
25 Du Plessis South Africa 814.
26 Gutteridge Introduction 161.
30 Michaels Comparative Law 2.
to enhance trade. This unification has already taken effect amongst seventeen states in the West and Central African region through the OHADA initiative.\(^{31}\)

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

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

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

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

\(^{31}\) http://www.ohada.com/ (Date of use: 2\(^{nd}\) September 2014).

\(^{32}\) This approach stems from a belief that similar problems have similar solutions across legal systems though they are resolved differently, Örücü *Methodology* 443.

\(^{33}\) This approach entails comparing legal systems whose doctrinal structures are different but serve the same function, Michaels *Comparative Law* 2.
1.8 LITERATURE REVIEW


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

Chapter 3 provides an in-depth discussion of the different security interests created over movables in Kenya and the factors that affect their creation. The aspects that render these security interests unattractive to lenders are also highlighted. Chapter 4 discusses the security interests over movables recognised in South Africa and it identifies the similarities and/or differences in the two jurisdictions. Chapter 5 discusses how the challenges identified in Kenya
are addressed in South Africa and whether similar solutions can be employed in Kenya. Chapter 6 draws a conclusion based on the foregoing discussions and provides recommendations.
CHAPTER TWO
NATURE OF REAL RIGHTS AND BASIC PRINCIPLES INVOLVED

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

Ownership (ius in re propria) is the greatest possible interest in a thing37 since the owner has exclusive control over it.38 One can have a real right over another person’s property; this right is considered to be less than ownership and thus the person holds a limited real right (ius in re aliena).39 A security right (civil-law system) or security interest (common-law system) is a limited real right. The term “security interest” will be used since the paper focuses on Kenyan law which is premised on common law. I progress to discuss the nature of real rights; real security interests over movables; their advantages; and the basic principles governing these interests. South African law forms the basis of the discussion and I strive to show where it differs from Kenyan law.

2.1 NATURE OF REAL RIGHTS
Ojienda and Rachier40 define a real right as an affirmative claim that one asserts against another in relation to a particular situation, object or thing where the person vested with the right has an interest. South Africa has no closed legal system of real rights (numerus clausus) as new rights can be created.41 Various theories have been formulated to determine whether a right is real or personal including the subtraction from the dominium test.42 This test requires

34 Laibuta Commercial Law 421.
35 Badenhorst, Pienaar and Mostert Law of Property 1; See also Pienaar and Van der Schyff 2007 Law, Environment and Development Journal 188.
36 Hepburn Principles 3.
37 Ojienda and Rachier Conveyancing Practice 4.
38 Limitations may be imposed by laws of general application such as the South African Neighbour law or Kenyan tort law on nuisance.
39 Mostert and Pope (eds) Principles of Property 42.
40 Conveyancing Practice 3.
41 Milo Property Rights 734; De Waal 1999 EJCL http://www.ejcl.org/33/abs33-1.html (Date of use: 23rd September 2014).
42 Badenhorst, Pienaar and Mostert Law of Property 55.
one to look not so much to the right, but to the correlative obligation. If the obligation amounts to a burden upon the land (a subtraction from the *dominium*) then the corresponding right is a real right and registrable.43

Although the list of rights is not closed at Common law, it is difficult to introduce new rights.44 This principle seems secure in common law, but not in equity, which recognizes other property rights that common law does not.45 English courts have formulated the closed list approach46 and the criteria approach47 to determine real rights. There is insufficient information as to whether the issue of new rights has been tested in Kenyan courts. In the absence of Kenyan case law, the English-law position would help to determine whether a particular right is a property right.

The distinction between real48 and personal49 rights is important in South Africa as it lays the foundation for the patrimonial law to be divided into either the law of things or the law of obligations.50 It also determines whether a particular right is registrable, since only real rights can be registered.51 In Kenya, the terms real and personal rights relate to the action that one can institute to protect his interests over real and personal property.52 Real property is protected by a real action53 while personal property is protected through a personal action.54

2.1.1 NATURE OF REAL SECURITY INTERESTS

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

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43 *Ex Parte Geldenhuys* 1926 OPD 155.
44 See Milo *Property Rights* 734; Swadling *Property* 4.09- 4.12 and 4.114- 4.115.
45 Swadling *Property* 4.26- 4.28.
46 *Hill v Tupper* (1863) 2H & C 121, 127-128, 159 ER 51, 53.
47 *National Provincial Bank v Ainsworth* (1965) AC 174, HL.
48 A right to a thing.
49 A right to performance that can be exercised only against a specific individual.
51 Van der Walt 1992 *THRHR* 172.
52 Swadling *Property* 4.13- 4.16.
53 An action that can be exercised against everyone since the real right imposes duties of abstention to the entire world and the remedy is recovery of a specific thing (*res*).
54 An action that is exercised against a particular person who is the subject of the obligation and the remedy is usually specific performance or damages for the loss suffered. Mattei *Basic Principles* 9.
English-law term “mortgage” has been accepted. For a mortgage to be in place there must be an obligation (principal debt) to be secured; the mortgage must attach to the property of another; and a real security interest must be created.

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

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

2.1.1.3 Creation of security interest
Real security interests can be created through an agreement (express mortgages), by operation of law (tacit or legal mortgages) or through judicial attachment.

2.1.2 BASIC PRINCIPLES OF REAL SECURITY INTERESTS
The specificity principle requires the property being mortgaged to be easily identifiable and this is a challenge where movable property cannot be identified with precision. The publicity principle requires that an outsider ought to be able to infer from external indications that there

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56 Pienaar and Steven Rights 759.
57 Scott and Scott Wille’s Law 4.
58 See Pienaar and Steven Rights 759, 760
59 Badenhorst, Pienaar and Mostert Law of Property 359.
60 Scott and Scott Wille’s Law 6.
61 Badenhorst, Pienaar and Mostert Law of Property 359.
62 Badenhorst, Pienaar and Mostert Law of Property 360.
63 See De Lacy Evolution 4; Pienaar and Steven Rights 759.
64 Fleisig, Safavian and De la Peña Reforming Collateral 27.
exists a real right to the property or that a real right is transferred or extinguished.\textsuperscript{65} The form of publicity depends on the nature of the asset, but it is mainly through transfer of possession or by filing or registering the interest at a registry or trade journal.\textsuperscript{66} The principle of perfection requires the creditor to take certain steps to ensure his security is effective against third parties if the debtor becomes insolvent.\textsuperscript{67} Perfection can be achieved through transfer of possession to the creditor, through filing or registration; or by exercising control over the object.\textsuperscript{68}

\textbf{2.2 ADVANTAGES OF REAL SECURITY INTERESTS}

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

\textbf{CONCLUSION}

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

\textsuperscript{65} Ferran and Ho \textit{Corporate Finance} 301; Pienaar and Steven \textit{Rights} 761
\textsuperscript{66} Wood \textit{Comparative Law} 3-006.
\textsuperscript{67} Mostert and Pope (eds) \textit{Principles of Property} 74.
\textsuperscript{68} Beale \textit{et al} \textit{Law of Security} 9.01, 9.02.
\textsuperscript{69} Muñoz \textit{Personal Security} 12.
\textsuperscript{70} Muñoz \textit{Personal Security} 13.
CHAPTER THREE
SECURITY INTERESTS CREATED OVER MOVABLE PROPERTY IN KENYA

3 INTRODUCTION
Kenyan law on security over movables is encompassed in commercial law\(^{71}\) while the protection of personal property rights is governed by the law of torts.\(^{72}\) Various forms of real security interests can be created in Kenya and each undergoes various formalities of creation and perfection as discussed herein after.

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

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

\(^{71}\) Samuel *Common Law* 183.
\(^{72}\) Swadling *Property* 4.01.
\(^{73}\) S 2.
\(^{74}\) S 2.
\(^{75}\) S 2.
\(^{76}\) S 23(1).
\(^{77}\) S 7.
\(^{78}\) S 13.
An instrument must be attested by at least one witness, be stamped with duty and registered with the Registrar-General. Registration is done through the filing of the instrument and two affidavits sworn by the grantor and a witness. The need to swear two separate affidavits is not clear. An instrument that does not satisfy these formalities may be deemed invalid. Registration must be within twenty-one days from the date of execution, unless leave of court is obtained to register out of time. Registration takes approximately fourteen days since Kenya’s documents based registration system is cumbersome and inefficient. Digitization of the Companies Registry was undertaken that saw over 20 million pages of documents being scanned and stored to allow for online searches. To date, online searching cannot be done and search results take between 4 to 5 days to be obtained.

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

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

79 S 15.
80 S 38 of Stamp Duty Act (Cap 480).
81 S 5.
82 S 5.
83 See Geoffrey Njenga v Godffrey W. Karuri and another Civil Case No. 95 of 1998.
84 S 6.
86 Kobia July 2010 https://sites.google.com/a/ict.go.ke/tandaa/activities/companyregistry (Date of use: 28th July 2014).
87 S 7(4).
89 S 10.
90 S 35.
judgement, surplus proceeds are payable to the purchaser contrary to common law where the debtor is entitled to the surplus and not the purchaser.

3.2 OTHER SECURITY INTERESTS CREATED IN KENYA

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

3.2.1 PLEDGE

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

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

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91 S 39 (1).
92 S 39 (4).
93 Swadling Property 4.132.
94 Ogola Business Law 288.
95 Beale et al Law of Security 5.43, 5.44.
96 The pledged article is under the pledgee’s actual control.
97 McCormack Pressured 86.
98 Smith Security 5.68.
99 Baskind, Osborne and Roach Commercial Law 30.
100 De Lacy Reform of UK Law 9, 10.
101 Coleman Tax Avoidance 5-8.
102 Smith Security 5.68.
103 Beale et al Law of Security 5.06.
expressly provides for this.\textsuperscript{104} Only a default notice needs to be issued before exercising the right.\textsuperscript{105} Since the \textit{Chattels Act} (Cap 28) contains blanket provisions for creating an instrument including a pledge, I assume that the registration formalities therein should be complied with. Registration of a pledge instrument would deviate from common law where this is not required. Kenyan advocates do not as a matter of practice register pledge instruments and this conflict between the statutory- and common-law positions may cast doubt on the validity of an unregistered pledge instrument in Kenya.

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

\begin{thebibliography}{99}
\footnotesize
\item Beale et al \textit{Law of Security} 5.09.
\item Laibuta \textit{Commercial Law} 232.
\item Oguoko, Michira and Gisesa\hfill
\url{http://www.standardmedia.co.ke/?articleID=2000080901&story_title=inside-the-murky-world-of-shylocks&pageNo=1} (Date of use: 14\textsuperscript{th} October 2014).
\item This amount ought to be enhanced.
\item S 2.
\item S 8 (1), (10).
\item S 11; Second Schedule.
\item S 13.
\item S 15.
\item Diamond \textit{Security over Movables} 26.
\end{thebibliography}
3.2.2 LIEN

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

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

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

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114 Bradgate and White Commercial Law 326.
115 Bradgate and White Commercial Law 326; Tappenden v Artus [1964] 2 QB 185.
116 Albermarle Supply Company v Hind Company (1928) 1 KB 307.
118 Relates to indebtedness arising from a particular transaction.
119 Goods are retained until any obligations owed to the lienee generally are discharged by the owner.
120 Jones Treatise 1048.
121 Smith Security 335.
122 Beale et al Law of Security 5.78, 5.79.
123 See McCormack Secured Credit 44; Re Cossett (Contractors) Ltd [1998] Ch 495.
124 Bradgate and White Commercial Law 327.
125 See Montagu Summary 2; McCormack Pressured 87.
creditor is not required. An example is the equitable lien conferred upon a seller of intangible property such as shares or intellectual property to secure the price.\textsuperscript{126} A court order is required before enforcing this lien.\textsuperscript{127}

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

\textbf{3.2.3 LETTER OF HYPOTECATION}

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

\textbf{3.2.4 MORTGAGE}

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

\begin{footnotesize}
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\item[126] Bradgate and White \textit{Commercial Law} 327.
\item[127] See Ogola \textit{Business Law} 289; Smith \textit{Security} 5.8.
\item[128] Ogola \textit{Business Law} 289.
\item[129] S 105 (1).
\item[130] S 106.
\item[131] Civil Appeal No. 53 of 1968.
\item[132] Field Fisher Waterhouse July 2011 \url{http://www.fieldfisher.com/media/1689850/Security-Over-Goods.pdf} (Date of use: 20\textsuperscript{th} November 2014).
\item[133] Ogola \textit{Business Law} 358.
\item[134] \textit{Dodhia case.}
\end{itemize}
\end{footnotesize}
payment of the debt. However, possession remains with the mortgagor while the mortgagee is conferred with a right to seize and sell the goods in the case of default if the agreement stipulates this. The Chattels Act (Cap 28) prescribes the chattels mortgage format. The courts will not uphold any agreement that acts as an obstacle to the debtor’s right of redemption. Equitable mortgages do not require registration since they are created when the title documents are deposited with the mortgagee together with a memorandum of deposit and enforcement is through a court order. The Merchant Shipping Act (Cap 389) governs the mortgaging of a ship or a share in ship while the Kenya Civil Aviation Authority is mandated under section 7 (1)(u) of the Civil Aviation Act 21 of 2013 to register rights and interests in aircraft although the Act does not presently contain provisions on registration.

3.2.5 CHARGE

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

A fixed charge is created over permanent assets such as land and the chargor cannot deal with them without the chargee’s approval. A floating charge is created over a fluctuating body of assets, of which a chargor can deal with in the ordinary course of business without the

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135 See Smith Security 5.74; Sihombing Goods 152.
136 Sihombing Goods 152.
137 Smith Security 5.74.
138 S 95.
139 S 96 (9) (c).
140 S 96 (1) Companies Act.
141 S 51 (2) Co-operatives Act.
142 S 102 Companies Act.
143 S 99 Companies Act; s 52 (2) Co-operatives Act.
144 Laibuta Commercial Law 439.
145 Ogola Business Law 207.
146 Re Cosslett (Contractors) Limited [1998] Ch 495, 510C-D.
chargee’s consent\textsuperscript{147} including creating other interests that may rank above the floating charge\textsuperscript{148} until crystallization occurs. Crystallization refers to conversion of a floating charge into a fixed charge when the chargor is liquidated or he is in default and the chargee takes steps to enforce his security.\textsuperscript{149} The crystallization event is usually not publicised therefore third parties are often misled into believing that the floating charge is still in existence and that the chargor is able to continue trading.\textsuperscript{150}

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

3.2.6 ASSIGNMENT

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

\begin{footnotes}
\textsuperscript{147} See Omar Law relating to security 14, 15; Re Yorkshire Woolcomber’s Association Limited [1903] 2Ch 284, at 295.
\textsuperscript{149} Gichuki Financial 204, 207.
\textsuperscript{150} Locke 2008 CILSA 150.
\textsuperscript{151} Calnan What’s Wrong 182.
\textsuperscript{152} KLRC http://www.kenyalawresoucecenter.org/2011/07/companys-lien.html (Date of use: 16th December 2014).
\textsuperscript{153} S 103 (1) Companies Act; s 54 Co-operatives Act.
\textsuperscript{154} S 3.
\textsuperscript{155} S 130 (1).
\textsuperscript{156} S 130(1), 131 Transfer of Property Act, 1882 (repealed).
\textsuperscript{157} (1828) 38 ER 475.
\end{footnotes}
3.3 OTHER CHALLENGES EXPERIENCED IN KENYA

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

CONCLUSION

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

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\(^{158}\) See Masoud *Insolvency Law OLJ* 198; S 38(1) *Bankruptcy Act*.
\(^{159}\) Masoud *Insolvency Law OLJ* 199.
CHAPTER FOUR
SECURITY INTERESTS CREATED OVER MOVABLES IN SOUTH AFRICA

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

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

160 Scott and Scott Wille’s Law 39.
161 Badenhorst, Pienaar and Mostert Law of Property 360.
162 Pienaar and Steven Rights 759.
163 See Vasco Dry Cleaners v Twycross 1979 (1) SA 603 (A). This principle is also recognised in Kenya though the term “constitutum possessorium” is not used.
164 See Ikea Trading and Design AG v BOE Bank Ltd 2005 (2) SA 7 (SCA) 21; Pienaar and Steven Rights 763, 764.
165 Reid and Van Der Merwe Themes 647.
166 Neder Bank Ltd v ABSA Bank Ltd 1998 (2) SA 830 (W); See paragraph 3.2.1.
167 Scott and Scott Wille’s Law 58, 59.
168 Pienaar and Steven Rights 764.
Most pledge agreements include *parate executie* (summary execution) clauses which allow the pledgee to sell the pledged property upon default, without recourse to the court. In *Findevco (Pty) Ltd v Faceformat SA (Pty) Ltd*, the court suggested that these clauses could be unconstitutional, but this decision has been challenged and criticised as being ill considered and wrong. The Supreme Court of Appeal in *Bock v Duburo Investments (Pty) Ltd* and in *Juglal v Shoprite Checkers t/a OK Franchise Division* did not follow the *obiter dictum* of the *Findevco* case. However, for the position in the *Bock* and *Juglal* cases to be upheld in South Africa, there is need for the Constitutional Court to make a decision confirming that such a clause is not unconstitutional. It therefore means that the present South African position is similar to the Kenyan position, which recognises summary execution clauses in security agreements.

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

### 4.1.2 NOTARIAL BOND

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

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169 2001 (1) SA 251 (E).
170 Cook and Quixley 2004 *SALJ* 719; see Scott 2002 *THRHR* for a rebuttal of the arguments set out in the discourse by Cook and Quixley.
171 [2003] 4 All SA 103 (SCA).
172 2004 (5) SA 248 (SCA).
173 Cook and Quixley 2004 *SALJ* 723.
174 *Dodhia case* Civil Appeal No. 53 of 1968.
175 Pienaar and Steven *Rights* 766.
176 Paragraph 3.2.1.
177 Pienaar and Steven *Rights* 766.
178 S 102 *Deeds Registries Act 47 of 1937*.
179 Jansen 2003 *JBL* 155.
The bond holder may be authorised to possess the property through a perfecting clause in the bond agreement or under a court order. A general bondholder without possession of the property may lose the bond if the property is alienated without his consent and the bond will not bind a third party who acquires the property. There is no prescribed form for a notarial bond although it must be attested by a notary public and registered within three months of its execution, which is considered a long period.

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

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

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181 Badenhorst, Pienaar and Mostert Law of Property 388.
182 Mostert and Pope (eds) Principles of Property 322.
183 S 61 Deeds Registries Act 47 of 1937.
184 Sacks 1982 SALJ 633.
185 Badenhorst, Pienaar and Mostert Law of Property 385.
186 Badenhorst, Pienaar and Mostert Law of Property 385.
187 Scott 1995 THRHR 673.
188 Scott 1995 THRHR 673.
189 1992 (3) SA 60 (A).
190 Badenhorst, Pienaar and Mostert Law of Property 386.
The SMMP Act 57 of 1993 was enacted to regulate the legal consequences of registration of a notarial bond over specified movable property and to repeal the Notarial Bonds (Natal) Act 18 of 1932.\(^{191}\) It creates a special notarial bond over specified movable corporeal property and confers a real security right on the bondholder once the bond has been registered.\(^{192}\) The property is deemed to be pledged to the mortgagee as effectually as if the property had been pledged and delivered to the mortgagee.\(^{193}\) The SMMP Act 57 of 1993 creates a “fictitious” pledge\(^{194}\) and therefore the principles applicable to pledges also apply to this bond.\(^{195}\)

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

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

\(^{191}\) Badenhorst, Pienaar and Mostert Law of Property 386.
\(^{192}\) Pienaar and Steven Rights 766.
\(^{193}\) S 1(1) of SMMP Act.
\(^{194}\) Scott 1995 THRHR 680.
\(^{195}\) Mostert and Pope (eds) Principles of Property 323.
\(^{196}\) See Mostert and Pope (eds) Principles of Property 323; Ikea Trading and Design AG v BOE Bank Ltd 2005 (2) SA 7 (SCA).
\(^{197}\) Locke 2008 CILSA 141.
\(^{198}\) Paragraph 3.1.1.
\(^{199}\) S 1 (2).
\(^{200}\) Terblanche Simulated Contracts 19.
\(^{201}\) Pienaar and Stevens Rights 767.
\(^{202}\) Pienaar and Stevens Rights 767.
4.1.3 LIEN

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

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

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

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203 See Van der Merwe *Law of Property* 236; Pienaar and Steven *Rights* 779; Scott *Lien* 31 para 50.
204 Scott *Lien* 54-56.
205 Wiese views that debtor-and creditor liens can be a real lien too, see Wiese 2011 *CILSA* 86.
206 Wiese 2011 *CILSA* 81, 86.
207 Pienaar and Steven *Rights* 776, 783, 785.
208 See Wiese 2011 *CILSA* 90; Scott *Lien* 35 para 53.
209 Wiese 2011 *CILSA* 90.
210 A person is deemed to have constructive possession (or possession in law) where another person representing him has actual possession, Rapalje and Lawrence *Dictionary* 980.
211 Beale *et al* *Law of Security* 5.71, 5.76.
212 See Wiese 2011 *CILSA* 90; *Nino Bonino v De Lange* 1906 (T) 120, 122.
213 Wiese 2011 *CILSA* 90.
214 Scott *Lien* 59 para 82.
both South Africa and Kenya, the lienee cannot use the property for his benefit unless there is an agreement with the owner to that effect.215

4.1.4 CESSION IN SECURITATEM DEBITI

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

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

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

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215 See Scott Lien 32 para 50; Beale et al Law of Security 5.68.
216 Scott Cession 13, 28.
217 Nienaber and Gretton Assignment 789.
218 Nienaber and Gretton Assignment 788.
219 1995 2 SA 750 (A).
220 See Scott Cession 49; Nienaber and Gretton Assignment 791.
221 Scott Cession 49.
222 Scott Cession 21, 22, 24.
223 See Scott Cession 53, 54.
224 Scott Cession 63.
225 Nienaber and Gretton Assignment 794. See also Illings (Acceptance) Co (Pty) Ltd v Ensor NO 1982 (1) SA 570 (A) 578F-G.
226 Badenhorst, Pienaar and Mostert Law of Property 400, 401.
227 Paragraph 3.2.6.
Security over claims can be in form of a pledge\textsuperscript{228} or an out-and-out cession (fiduciary security cession).\textsuperscript{229} The latter is a fiduciary act that is governed by contract law\textsuperscript{230} and entails transferring a right to the cessionary coupled with a fiduciary agreement.\textsuperscript{231} The pledge construction, initially postulated in \textit{National Bank of SA Ltd v Cohen’s Trustee},\textsuperscript{232} means that cession \textit{in securitatem debiti} has the effect of pledging a claim (personal right) to the cessionary while the cedent retains the ‘bare dominium’ or a ‘reversionary interest’ in the claim against the principal debtor.\textsuperscript{233} The pledgee can only enforce his right after the pledgor defaults and the pledgor has the right to redeem his property by paying the outstanding debt at any time before the pledged item is sold.\textsuperscript{234}

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

\textbf{4.1.5 LANDLORD’S TACIT HYPOTHEC OVER THE MOVABLES OF THE LESSEE}

This hypothec arises by operation of law when a tenant’s rent is in arrears although the landlord is not accorded an automatic real security.\textsuperscript{238} It is accessory to the payment of rent and once this obligation is met, the hypothec terminates.\textsuperscript{239} Movable property that is hypothecated by a notarial bond under the \textit{SMMP Act} 57 of 1993, or that relates to an instalment sale transaction under the \textit{Credit Agreements Act} 75 of 1980 (repealed and replaced by the \textit{National Credit Act}\textsuperscript{228} Paragraph 4.1.1
\textsuperscript{229} Scott \textit{Cession} 93-95.
\textsuperscript{230} Scott \textit{Cession} 94.
\textsuperscript{231} Scott \textit{Cession} 94.
\textsuperscript{232} 1911 AD 235. \textit{Grobler v Oosthuizen} 2009 (5) SA 500 (SCA) 510I also upheld the pledge construction.
\textsuperscript{233} The \textit{Grobler} case paragraph 15.
\textsuperscript{234} Scott 2013 SA Merc LJ 523.
\textsuperscript{235} See \textit{Lief NO v Dettmann} 1964 (2) SA 252; \textit{Trust Bank of Africa Ltd v Standard Bank of SA Ltd} 1968 (3) SA 166 (A).
\textsuperscript{236} Scott 2013 SA Merc LJ 515.
\textsuperscript{237} See Scott 2013 SA Merc LJ 517, 518; Scott \textit{Cession} 95.
\textsuperscript{238} Joubert \textit{Tacit Hypothecs} 455.
\textsuperscript{239} Joubert \textit{Tacit Hypothecs} 455.
34 of 2005) (hereinafter NCA 34 of 2005), is not subject to the landlord’s tacit hypothec\textsuperscript{240} unless the landlord’s hypothec was perfected before the notarial bond was registered.\textsuperscript{241}

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

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

\textsuperscript{240} S 2(1) SMMP Act.
\textsuperscript{241} S 2(2) SMMP Act.
\textsuperscript{242} 1929 AD 266.
\textsuperscript{243} Badenhorst, Pienaar and Mostert \textit{Law of Property} 405, 406
\textsuperscript{244} 2003 (2) SA 495 (SCA).
\textsuperscript{245} Badenhorst, Pienaar and Mostert \textit{Law of Property} 406.
\textsuperscript{246} Badenhorst, Pienaar and Mostert \textit{Law of Property} 405.
\textsuperscript{247} S 3(1) \textit{Distress for Rent Act} (Cap 293).
\textsuperscript{248} S 40 \textit{Bankruptcy Act} (Cap 53).
\textsuperscript{249} S 16(1).
\textsuperscript{250} S 4(1).
\textsuperscript{251} S 9 and 11.
4.1.6 CREDIT GRANTOR'S TACIT HYPOTHEC OVER MOVABLES SUBJECT TO THE CREDIT AGREEMENT

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

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

CONCLUSION

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

252 See S 84(1) Insolvency Act 24 of 1936.
253 Joubert Tacit Hypothecs 464.
255 S 3 (1).
256 S 3 (4).
257 S 3(5).
CHAPTER FIVE
SOLUTIONS FROM SOUTH AFRICA AND OTHER LEGAL SYSTEMS FOR
REFORMING SECURITY BY MEANS OF MOVABLES IN KENYA

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

5.1 LESSONS FROM SOUTH AFRICA AND OTHER LEGAL SYSTEMS

5.1.1 UNIFICATION OF LAWS AND REGULATION
Most of the laws applicable to this topic in Kenya are relics from our British colonial past and
require reforming and modernizing. The numerous statutes that presently establish various
financial institutions258 need to be repealed and consolidated into a single act such as the NCA
34 of 2005 that consolidates the law governing the consumer credit industry in South Africa.
This Act also establishes the National Credit Regulator (NCR) which has the mandate of
regulating the consumer credit industry and providing education, undertaking research and
policy development, and registering credit providers amongst others.259 I therefore suggest that
the Central Bank of Kenya’s bank supervisory unit260 be transformed into a fully fledged
regulatory authority, similar to the NCR.

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

258 Chapter 3.
259 NCR http://www.ncr.org.za/index.php?option=com_content&view=article&id=38 (Date of Use: 2nd
November 2014).
260 Paragraph 3.3.
conventions governing interests over specific assets such as ship and aircraft. Countries such as the United States of America, Canada, New Zealand and Australia have reformed and unified their personal property law. Article 9 of the American *Uniform Commercial Code* (*UCC*) is a model law for secured transactions that creates one security device which integrates all security interests thus simplifying the law. The United Kingdom (UK) embarked on reforming its laws relating to company security interests and the results of these reforms have been embodied mainly in the *Companies Act 2006* (c. 46) and the *Enterprise Act 2002* (c. 40). Kenya can benefit from reviewing and analyzing the reforms undertaken in these jurisdictions to facilitate its own reform.

### 5.1.2 REGISTRATION SYSTEM

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

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

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261 Canada enacted the *Personal Property Securities Act*.
262 New Zealand enacted the *Personal Property Securities Act 1999*.
263 Australia enacted the *Personal Property Securities Act 2009*.
264 Law Commission Final *Company Security*.
267 Fleisig, Safavian and De la Peña *Reforming Collateral* 38.
268 Law Commission *Registration* 16.
270 Paragraph 3.3.
property, motor vehicles, ship and aircraft among others. The specialized registries notify the companies or co-operatives registry of all entries registered thereat by a company or cooperative society without requiring the secured creditor to go through a similar rigorous process of registration at the latter registries.

5.1.3 INSOLVENCY LAWS

The Insolvency Act 24 of 1936, also accords preference to certain claims during insolvency just as in Kenya.270 However, statutory obligations271 are settled after secured creditors,272 funeral and death-bed expenses,273 costs of sequestration and execution274 and salaries and wages of employees.275 The UK adopted a recommendation of its Law Commission in section 251 of the Enterprise Act 2002 (c. 40) that does away with crown preference at insolvency. The monies due to the State are now required to be placed in a fund that is available for distribution amongst unsecured creditors.276 Kenya could benefit from this provision.

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

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270 Paragraph 3.3.
271 S 99.
272 S 95.
273 S 96.
274 S 97, 98.
275 S 98A.
276 S 252 Enterprise Act.
277 S 124 Insolvency Act 24 of 1936.
278 Masoud Insolvency Law OLJ 199.
5.1.4 AMENDMENT TO THE CHATTELS ACT (CAP 28)
The specificity requirement\(^{280}\) should be abolished since countries with modern secured transactions laws do not require a specific description of the property, but rather allow the parties to describe the property in any manner they deem fit.\(^{281}\) Furthermore the process of creating security interests under this Act must be simplified, by doing away with the two affidavits that are presently sworn. The requirement for renewal of an instrument after every five years\(^{282}\) should also be dispensed with. The Act should prescribe the form of the various instruments that can be created to ensure uniformity.\(^{283}\) This Act and others such as the Pawnbrokers’ Act (Cap 529) should be realigned to the governance structure under the 2010 Constitution.\(^{284}\) Any surplus from sale of a chattel under the Act should be paid to the debtor or any person entitled to it.

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

\(^{280}\) Paragraph 3.1.1.
\(^{281}\) Fleisig, Safavian and De la Peña Reforming Collateral 29.
\(^{282}\) Paragraph 3.1.1.
\(^{283}\) Paragraph 3.1.1.
\(^{284}\) Paragraph 3.1.1.
\(^{285}\) Paragraph 3.2.5.
\(^{286}\) Reforming Collateral 40.
\(^{287}\) Law Commission Report xi, 27.
5.1.6 AMENDMENTS TO THE COMPANIES ACT (CAP 486)
All business entities in Kenya should be allowed to create a floating charge. The proposed Companies Bill 2010\textsuperscript{288} proposes the creation of a one-person company.\textsuperscript{289} The Companies Act (Cap 486) currently requires that a private company must have at least two members. This provision would allow all businesses to be able to create floating charges. However, individuals would still not benefit from this and therefore a security device similar to the South African general notarial bond should be created. The Act should also provide for the registration of a notice of crystallization of a floating charge.

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

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

\textsuperscript{288} This Bill awaits the second reading stage.
\textsuperscript{289} Article 5.
\textsuperscript{290} Paragraph 3.3.
CHAPTER SIX
CONCLUSION

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

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

If a total overhaul would not be possible in the short term, the KLRC could analyze the findings and recommendations made by the UK Law Commission in its various reports that identified problems that are very similar to what Kenya is presently experiencing probably due to our colonial links with the UK. The reforms should include consolidation of the laws pertaining to financial institutions and credit providers into one Act of Parliament. The supervisory role of these financial institutions should also be transferred to an authority that will regulate the consumer credit industry. Furthermore, Shylock businesses should be outlawed in Kenya and all credit providers including pawn brokers ought to be licensed and regulated. As to the recommendations specifically dealing with security law, I suggest that attention should be paid to all aspects of security interests over movable property with an aim of unifying and simplifying the system. To achieve this, I recommend that the following issues be addressed:
1 The law should be amended to allow individuals and all business entities to create a general security interest over all their assets similar to the floating charge.\textsuperscript{291}

2 Kenyan law should be amended to allow for the registration of all transactions that have the effect of creating security over movable property including liens, assignment and \textit{quasi}-security interests. This should be done in order to safeguard the interests of third parties by publicizing the existence of these interests.\textsuperscript{292}

3 The Kenyan registration system should shift to the notice filing system and the registries should be fully automated and accessible online at any time by any member of the public who requires the information without restriction.\textsuperscript{293}

4 There should be synchronization of the companies’ and cooperative societies’ registry with specialized registries. In this case, the latter should be required to notify the central registry of all interests filed therein without requiring the secured lender to register the interest in both registries.\textsuperscript{294}

5 The registration system should be amended to allow for a reservation or blocking of priority rankings during the prescribed period of registering a security in order to prevent other interests to be registered during that time.\textsuperscript{295}

6 The proposed amendments\textsuperscript{296} to the \textit{Chattels Act} (Cap 28), \textit{Pawnbrokers Act} (Cap 529) and \textit{Companies Act} (Cap 486) should be undertaken.

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

\textsuperscript{291} Paragraph 3.1.5
\textsuperscript{292} Paragraph 5.1.2.
\textsuperscript{293} Paragraph 5.1.2.
\textsuperscript{294} Paragraph 3.3.
\textsuperscript{295} Paragraph 5.1.6.
\textsuperscript{296} Paragraph 5.1.1, 5.1.4, 5.1.6 and 5.1.7.
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