Banking, Finance & Projects

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Prerequisites of an informal charge: Does the mere deposit of an original title deed with a lender create an informal charge?

The sanctity of contracts as a cornerstone of commercial transactions cannot be overstated. Kenyan courts generally uphold contracts freely entered into by parties, save where such contracts contravene statutes or public policy, or are unconscionable, or their enforcement would result in unjust enrichment.

The long-established principle of freedom of contract has been reaffirmed by the Kenyan courts through their refusal to rewrite the terms of contracts between parties. In this regard, judicial precedents have consistently overruled the unilateral alteration of contracts by parties.

Often, contractual relationships between banks and borrowers have been put to the test when the relationship turns sour, usually in cases where a borrower is in default of its obligations under a loan agreement and the ensuing security documents, which often take the form of charges over land, come into play.

In 2012, with the enactment of the Land Act, 2012, the concept of an informal charge was formally introduced. Section 79 of the Land Act provides for the creation of informal charges through (i) the preparation of the prescribed form of charge (Informal Charge LRA 54) or (ii) issuance by a chargor to the lender of a written and witnessed undertaking of the intention to create a charge over the land to secure repayment of money or value, together with interest. In both cases, the chargor would deposit the original title to the land with the lender as security.

Given that the letter of offer between the lender and a chargor would outline the security to be created, lenders would perfect such listed security by creating either formal or informal charges. In certain instances, a chargor may deposit an original title to land informally through a 'gentleman's agreement' with a lender. There may be no formal recording of the deposit of such original title, but between the parties there may be an understanding that the title would constitute security for the loan. Indeed, this was the scenario in the case of *Commercial International Bank (CIB) Kenya Ltd v Azofco General Merchants Limited* [2025] KEHC 640 (KLR).

The facts

Briefly, a dispute arose when Azofco General Merchants Limited (company) defaulted in repayment of a USD 1,4 million loan that had been advanced by the Commercial International Bank (CIB) Kenya Ltd (bank) to it in 2021. The bank, having failed to realise property that had been formally charged in its favour by way of a statutory power of sale, filed an application in the High Court for an order allowing the bank to sell an alternative property owned by the company since, according to the bank, the company had deposited the original title in respect of the alternative property with the bank as security for repayment of the loan. The company opposed the application on the grounds that it had no intention of charging the alternative property with the bank and, in any event, the letter of offer did not list the alternative property as one of the properties to be charged in favour of the bank. Further, the company alleged that by the court allowing the application, it would be effectively rewriting the contract between the parties, which the bank was attempting to unilaterally vary.

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Findings

In dismissing the bank's application, the court held that the prerequisites for the creation of an informal charge had not been met since the bank had not established the circumstances under which the title for the alternative property was deposited with the bank, nor was there a written intention by the company to create an informal charge in favour of the bank. Further, the exercise of statutory power of sale could only arise where the charge over such property had crystalized, which the bank had unsuccessfully attempted to enforce. Since the alternative property was not listed in the letter of offer as constituting security, the court held that making a finding that the alternative property had been charged in favour of the bank through an informal charge would be tantamount to rewriting the contract between the parties.

This decision is a reminder to lenders to exercise caution when accepting deposits of title from borrowers as security for loans in the form of informal charges. There should be an unequivocal written undertaking by the owner of the property to deposit the original title to property as security for a loan. In addition, the letter of offer should succinctly list the title to property as one of the securities to be charged in favour of the lender, whether formally or informally.

We note, however, that section 79 of the Land Act distinguishes between an **informal charge**, which is achieved by the delivery by the borrower of a written and witnessed undertaking of intention to create a charge to secure repayment of money, and **a *lien* by deposit of documents**, which is achieved by the deposit of the original title.

It would appear from case law that the courts have taken the view that intention from the borrower to create an informal charge is a prerequisite for the creation of an informal charge, whether by deposit of a written undertaking or the deposit of the original title with a lender.

Conclusively, the decision reinforces the importance of adhering to contractual terms in lending agreements. It serves as a cautionary tale for lenders, highlighting the need for express and written intention from borrowers to create security over properties. The court's decision underscores that contractual freedom is not limitless and that lenders should ensure that their interests are safeguarded through formal agreements with borrowers that can be provided in court in the event of a dispute.

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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