A CRITICAL ANALYSIS OF THE REGULATION OF PERSONAL PROPERTY SECURITIES IN KENYA

SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTER OF LAWS (LL.M) OF THE UNIVERSITY OF NAIROBI

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NAIROBI NOVEMBER, 2012
DECLARATION

I, JOEL KYATHA MBALUKA, do hereby declare this thesis is my original work and that it has not been submitted elsewhere or is not due for submission for a degree in any other university.

Signed

Date

JOEL KYATHA MBALUKA

22-11-2012

This thesis has been submitted for examination with my approval as the University of Nairobi supervisor.

Signed

Date

MR. TIM O.A. MWESELI

26. 11. 12
DEDICATION

This thesis is dedicated to my entire family of my wives Eunice Katumbi Kyatha and Nancy Njambi Kyatha with my kids Dennis Mbaluka Kyatha, Irene Kanini Kyatha, Derrick Kitela Kyatha, Peter Kitela Kyatha, Simon Mbaluka Kyatha and Gertrude Mwaiki Kyatha for standing by me during the most trying moments of this course.
ACKNOWLEDGEMENT

I wish to thank God for his mercies and love upon me.

I wish to thank my supervisor Mr. Tim O.A. Mweseli for his guidance and useful criticism during the research and writing of this thesis.

I would also like to thank my family and my work colleagues for moral and material support while undertaking my LLM studies.

Thank you also to my classmates, past and present, and everybody else who has helped me in my quest for further knowledge thus far.
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- Advocates Act, Chapter 16, Laws of Kenya.
- Agriculture Act, Chapter 318, Laws of Kenya.
- Banking Act, Chapter 488, Laws of Kenya.
- Limitation of Actions Act, Chapter 22, Laws of Kenya.
- Notaries Public Act, Chapter 17, Laws of Kenya.
- Registration of Documents Act, Chapter 285, Laws of Kenya.
- Stamp Duty Act, Chapter 480, Laws of Kenya.
- Traffic Act, Chapter 403, Laws of Kenya.
- Chattels Transfer Act, Chapter 28, Laws of Kenya.
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<th>Description</th>
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<tr>
<td>ADR</td>
<td>Alternative Disputes Resolution</td>
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<tr>
<td>A&amp;NZ Mar LJ</td>
<td>Australia and New Zealand Marine Law Journal</td>
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<td>IP</td>
<td>Intellectual Property</td>
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<td>NZ</td>
<td>New Zealand</td>
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<tr>
<td>PIN</td>
<td>Personal Identification Number</td>
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<tr>
<td>PMSI</td>
<td>Purchase Money Security Interest</td>
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<td>PPSA</td>
<td>Personal Property Securities Act</td>
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<td>PPSR</td>
<td>Personal Property Security Register</td>
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<td>PPS</td>
<td>Personal Property Security</td>
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<tr>
<td>ROT</td>
<td>Rules of the International Law Commission of Canada</td>
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<tr>
<td>ULCC</td>
<td>United Nations Commission on International Trade Law</td>
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<td>UNCITRAL</td>
<td>International Institute for the Unification of Private Law</td>
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CHAPTER ONE

INTRODUCTION

1.1 Background

In order to secure a loan or credit from financial institutions, lenders will likely require the borrower to provide some form of security for borrowing requests. Mortgages are the most common form of commercial securities in Kenya.\(^1\) They give in rem security rights which mean that they grant an exclusive right to the creditor in order to have its credit satisfied against the value of the assets with preference over any other creditor. In most cases, mortgages are created on real estate assets. Such mortgages do not imply the transfer of the possession of the assets before the potential enforcement of the security.\(^2\) Other types of mortgage structures allowed under the Kenyan law include conditional mortgages, floating mortgages and reverse mortgages.

As regards formal requirements, mortgages on real estate must be granted in a public deed and registered with the Land Registry. The granting of mortgages involves notary fees and registry fees, as well as a stamp duty amounting to one per cent of the secured amount, which may result in a significant cost.\(^3\)

On the other hand, commercial securities may be created on movable assets that may be precisely identified, such as mercantile establishments, motor vehicles, planes, machinery, or industrial property, livestock and crops harvests among others. This mode of mortgage is referred to as chattel mortgage. Generally, chattel mortgages are the most common form of mortgages formed on movable property. Chattel mortgage is where security for a credit arrangement is secured using interest in moveable property other than real property in writing, to guarantee the payment of a debt or the execution of some action.\(^4\)

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1 Commercial securities is the wide concept embracing both personal property securities and real property securities.


4 Ibid.
The main difference between conventional mortgages and chattel mortgage is that unlike the former mortgages which only rarely transfer any interest until there is a default, chattel mortgages are more likely to transfer ownership until the debt is paid off. In effect, the chattel mortgage automatically becomes void when the debt is paid or the action is executed. Therefore, it is important that the chattels purportedly mortgaged be detailed and sufficient such that it can be easily known and distinguished by third parties. In other words, a person looking at the chattel mortgage document should be able to determine by proper inquiries whether or not a chattel in question was encumbered.5

This is not necessary for conventional mortgages as it is easy and possible to confirm if a property is encumbered by doing a search against its registration documents. However, that is not possible given that most chattels are not, in most jurisdictions, registered and where they are registered, there is no provision for indicating the encumbrances entered against them. In effect, this infringes the security of chattel mortgages because it means they are prone to the risk of abuse by re-mortgaging or sale of mortgaged property. Indeed, as a consequence chattel mortgages have been superseded by other types of securities.6

The requirement of registration of chattel mortgages at a central registry does also not help because it leaves the possibility of the mortgagee fraudulently selling the property without making a reference to the mortgagor. This is because the rights of the lender who gives a chattel mortgage are valid only against others who know or should know of the lender’s security interest in the property. Since the borrower possesses the property, others cannot realize that a chattel mortgage exists without notice.7

The administration charges for administering chattel mortgages are therefore higher as are risk management costs compared to conventional mortgages. This makes chattel mortgages unpopular as an alternative form of commercial security for bank loans both for borrowers who are discouraged by the high costs and the lenders who may be afraid to take the risk. As a result, borrowers without formal securities such as land are stripped of an opportunity to borrow from mainstream commercial banks. In the alternative, most borrowers who lack security are forced to
opt for micro-credit which is more expensive even where they have a chattel which would have provided acceptable security if chattels mortgages were properly managed.⁸

Chattel mortgages fall under a large class of securities known as personal properties securities. Essentially, the law divides property into two kinds: real property which is mainly land and personal property which entails everything else. Personal property is then classified into two types: tangible personal property and intangible personal property. Tangible personal property means things which have a physical existence such as motor vehicles, boats, machinery, office equipment, currency, stock-in-trade, artworks and crops. On the other hand, intangible personal property comprises non-physical items which are basically rights or claims against other persons or other things. These include debts, shares, licences, trademarks and patents, receivables and retention of title (ROT) terms in goods supply contracts. Therefore, all collateral backed by personal property is called personal property security and chattel mortgage is one form of such security.

1.2 Problem of Study

Basically, the creation of a security in a tangible personal property creates an intangible personal property interest by the lender in the given property. Given that the person creating the security may continue to use the personal property even though they have mortgaged it to someone else, other people dealing with the person may be misled. This problem makes personal property securities an unpopular mode of securitization of loans especially in Kenya. In effect, it locks out the bulk of borrowers who do not have access to real property, the preferred mode of security.

There is need to deal with this problem in order to open the avenue for majority of Kenyans who cannot at present access credit to be able to borrow using personal property as security. In this regard, the study will explore the legal deficiencies behind limitation of personal property securities as a security as well as explore the need for a new legal and regulatory framework for personal property securities in Kenya. The study will also explore the need for personal property security register (PPSR) consolidating most of the current form of registration of chattel mortgages and registries for other forms of personal property security interests.

1.3 Objectives of the Study

1.3.1 Main objective of the Study
To critically analyze the efficiency of the existing regulatory framework on personal securities in Kenya.

1.3.2 Specific Objectives
The study has the following objectives:
1. To discuss the existing regulatory framework on personal property securities and in particular on chattel mortgages in Kenya;
2. To review the best practices on personal property securities regulations around the world which are relevant to Kenya;
3. To analyze the efficiency of the existing regulatory framework on personal property securities in Kenya; and
4. To make proposals towards effective personal property securities regulatory regime in Kenya.

1.4 Research Questions
The study seeks to answer the following questions:
1. What is the regulatory regime for personal property securities and in particular on chattel mortgages in Kenya?
2. How does the regulatory regime for personal property securities and in particular on chattel mortgages in Kenya compare with best practices from around the world?
3. Is the regulatory regime for personal property securities and in particular on chattel mortgages in Kenya effective?

1.5 Hypotheses
The study will test the following two hypotheses:
1. There is need for a more effective regulatory framework for personal property securities in Kenya.
2. The effective regulation of personal property securities in Kenya will help make credit accessible to more Kenyans.

1.6 Justification of the Study
The government has an ambitious plan of action, namely Vision 2030, aimed at realization in the year 2030. It seeks to achieve substantial mileage socially, politically and economically. The fact
that the Vision recognizes the economic aspect of development underscores the need to work towards poverty reduction and economic empowerment. In order to achieve poverty reduction and economic empowerment of the poor, access to credit by businesses and individuals is key.

In recognition of the fact that money can never be enough, the need to borrow therefore is a never ending one. However, in Kenya most citizens are deprived of opportunity due to lack of access to credit resulting from stringent securities laws and requirements. And thus, the current requirement for securities in lending needs to be re looked at. This study discusses the future of commercial banking as far as liberalizing loan securities is concerned in order to open access to credit to small scale customers, in particular against the background of the now flourishing micro financing. It will seek to explore some of the constraints that commercial banks are facing in taking chattel mortgages and other forms of personal property security schemes and proposals towards making these forms of securities more secure and acceptable.

In addition, the study is a pioneering research in the area of personal property security regulation in the country. This area has not been addressed by research in the recent past with focus mainly being on real property securities. The study will, therefore, be useful as a basis for further research. It will also serve the academia in that it will highlight the emerging issues in personal properties regulation around the world. Lastly, the study will make key proposals which will seek to address the policy issues arising in regulation of personal properties securities in Kenya and therefore is useful in advancing legal reforms.

1.7 Literature Review

John Joseph Ogola’s book, “Company Law” states the relevant rules applicable to the personal property securities in Kenya in a precise manner. In this regard, it discusses key sections of the Companies Act relevant to personal property securities including provisions on debentures, charges and company’s lien on share certificates. There is also an appendix which contains cases which either establish or expound the said rules. Some of the judgments (especially those of the House of Lords) are reproduced at length to ensure full appreciation of the judicial reasoning process by which the legal rules were made.
However, the book is deficient in that it is basically descriptive and does not at all discuss or analyze the law on personal properties. Indeed, the book is published for the purposes of helping in revision of company law by diploma and degree students and does not thoroughly elucidate topical issues as tackled in the current study. The book is clearly specified as intended primarily to provide the knowledge required by students of company law only. Given that the book is focused on the broad subject of company law, it is general in nature and only discusses issues relevant to efficacy of personal property securities in passing.

Ahiq Hussain in the book “General Principles of Commercial Law in Kenya” discusses the general principles of commercial law in Kenya.\(^{11}\) The discussion in the book centres on a wide array of topics including company registration, corporate finance, shares and debentures, insolvency, winding up of companies, lifting of the veil and relationship between the main company and subsidiary companies. In addition to the discussion of company law, the book also deals with commercial principles relevant to hire purchase and factoring.\(^{12}\) Nevertheless, as the topic of the book alludes, the discussion is general in nature and does not entail analysis of the key issues tackled in this study. Further, there is no critique of commercial law carried out as the discussion is generally focused at explaining general principles of commercial law. The book, thus, differs with the present study in that it is merely a textbook of company law and commercial practice while the present study focuses on critically analyzing the law on personal property securities in Kenya.

The author of “Personal Property Securities Law in Australia” describes the Personal Property Securities reforms in Australia as the most significant changes to affect Australian businesses in many years.\(^{13}\) This is because the reforms will consolidate over 70 pieces of State and Commonwealth legislation and business practice into one coherent and easy to implement legislation. The purpose of the book is to discuss the reforms and guide legal practitioners in implementing the reforms. Further, the author addresses the conceptual challenges and risk arising for businesses in the introduction of an Australia-wide legislative scheme for registering and protecting all personal property securities.\(^{14}\)


\(^{12}\) Ibid.

\(^{13}\) O’Donovan, James, *Personal Property Securities Law in Australia* (Lawbook Co., Canberra: 2009).

\(^{14}\) Ibid.
The book discusses in detail the new developments introduced by the new personal properties securities (PPS) regime. In this regard, the scope of the Act is discussed as well as transition provisions. The book includes discussion on provisions of the law dealing with the Personal Property Securities Register (PPSR), attachment, perfection, extinguishment, priorities between security interests, issues touching on agricultural interests and enforcement of personal properties securities.\(^{15}\)

It emerges that the PPS regulatory regime in Australia is well-thought out and will not only promote the use of personal properties securities in Australia but will also significantly boost access to credit in the sub-continent. The discussion also highlights the balance of regulation of personal properties securities between federal government and state government which is very relevant to the Kenyan scenario given the devolved government structure. The discussion in the book is mainly descriptive and does not pay much attention to analysis and evaluation as is the case in the present study. Thus, while the book will provide useful reference material for the present study especially in the examination of best practices in personal properties securities regulation from around the world, it is different from this study which is focused on analyzing the state and efficacy of the law on personal properties securities in Kenya.

In the article entitled “International PPS Reform”, the Personal Property Securities Branch at the Australia’s Attorney General’s Office highlights the efforts taken at the international level in reforming and standardizing personal property securities regulatory regime around the world.\(^{16}\) The reform of personal property securities laws has of late been given significant attention internationally. For instance, the United Nations Commission on International Trade Law (UNCITRAL) is developing a legislative guide for a legal regime for security rights in goods. The guide draws mainly on the models used in the United States, Canada and New Zealand. The Hague Conference on Private International Law (the Hague Conference) and the International

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\(^{15}\) Ibid.

Institute for the Unification of Private Law (UNIDROIT) have also undertaken work in relation to securities interests.\textsuperscript{17}

The paper demonstrates that all Canadian common law provinces have Personal Property Security Acts ("PPSAs"). Ontario was the first to bring in a PPSA, enacting one in 1967 although it took nine years before bringing it into force. Further, a Canadian uniform act was published in 1969, followed by Manitoba legislation in 1973, Saskatchewan enacted legislation in 1979-80 with the other provinces following in the 1990s. These PPSAs have been subject to review and significant change by the Provincial Governments as the law has developed in this area. Further, the Uniform Law Conference of Canada ("ULCC") has kept all the provincial PPSAs under review and has been responsible for several reform initiatives, as well as having various other proposals under consideration. The Law Commission of Canada currently has a reference to examine security interests arising under federal laws and there has been substantive interaction between federal law and the provincial PPSAs generating a number of recommendations which impact on the PPSAs.\textsuperscript{18}

As for New Zealand, the paper argues that the country is currently experiencing the benefits of personal properties securities reforms. The Personal Properties Securities Act 1999 (NZ) came into effect in 2002 and established a single procedure for the registration of security interests in personal property, as well as a centralized electronic register. In the short period the law has been in force, New Zealand has reported that it has yielded increased certainty and confidence to the parties in commercial transactions where personal property is used as a security interest.\textsuperscript{19}

This study offers an examination of the decision and implementation in New Zealand of a personal property security regime based in North American Article 9 Model, with specific focus on the approach in force in Saskatchewan at that time. Subsequent to the New Zealand Personal Property Securities Act 1999 coming into force in 2002, a number of cases have considered the conflicting nature of creditor interests in personal property. The research question underlying this

\textsuperscript{17} Ibid.
\textsuperscript{18} Ibid.
\textsuperscript{19} Ibid.
study is "Has the new personal property security in New Zealand achieved what it set out to do?"20

In essence, the above paper is useful in achieving the objectives of the present study in that it highlights the key provisions in the leading jurisdictions on personal properties securities regulations. It also discusses the dynamics at the international level in achieving uniform and standard regulatory framework for personal properties securities. The papers differs with the present study in that it focuses on highlighting the relevant provisions of the laws without analyzing their efficacy as done in the present study. Further, unlike the paper which focuses on the international reforms on personal properties securities regulation, this study focuses on the Kenyan regulatory regime for personal properties securities only.

Robert Patch et al in their paper written before the implementation of the Personal Property Securities Reforms in Australia describe the eminent reforms as significant in that they aim to introduce a single national law and online national register for secured transactions based on a functional approach.21 Essentially, the paper critiques the proposed reforms under the PPS reform. Clearly, the reforms are drastic in nature and go to show a substantial commitment to reform from the Government. Importantly, the paper analyses the procedure adopted in implementing the PPS reforms in Australia and in so doing offers vital lessons for countries seeking to implement similar reforms in the near future.22

In this regard, the paper discusses the way the PPS reforms were implemented in Australia. It shows that the personal property securities regime reforms in Australia was all inclusive and involved the engagement of the government and stakeholders in dialogue and negotiations. This way, the reforms benefited from a range of views across industry, consumer representatives, academia and government. For instance, the financial sector was brought on board as a key supporter of the reforms to guarantee that the reforms will have the necessary impact of enhancing access to credit for majority of the population in Australia. There was also considerable debate about the detail of the proposed law and register design as well as reconciliation of sectional interests. Overall, the consultation yielded PPS reforms which are

20 Ibid.
22 Ibid.

20 | Page
assured to improve certainty and consistency, while reducing complexity and cost for financiers, buyers and suppliers.\textsuperscript{23}

In justifying the reforms, Robert Patch \textit{et al} argues that a significant proportion of individual and business wealth is held in personal property, with an increasing proportion found in intangible assets such as intellectual property (IP) rights. According to them, this is the reason why Australia embarked on the reforms to Australian finance law, to ensure that individuals and businesses can harness the full value of their property. In their view, with the growing importance and value of IP rights, it is desirable that the law promote this asset class as a means of leveraging finance. As such, there is need for PPS law that takes a functional approach to security interests by treating tangible and intangible personal property in the same way as any other forms property such as real property.\textsuperscript{24} The arguments in this paper are relevant to the present study in that they highlight the best approach for undertaking regulatory reforms to entrench modern personal property securities regime as well as the basics of a regulatory framework for the same.

Cuming argues that legislative jurisdiction over secured financing transactions is divided between the federal Parliament and the provincial legislatures.\textsuperscript{25} Thus, bank financing may fall under provincial or federal regulation depending upon the type of transaction involved. All other secured financing is subject to provincial law except to the very limited extent that bankruptcy law is involved. The state of the law is that six out of the ten provinces as well as the two territories have enacted Personal Property Security Acts based roughly on Article 9 of the Uniform Commercial Code of the United States. The remaining common law jurisdictions are in the process of enacting such law. In addition, the Civil Code of Quebec has recently been revised to provide a system of general application for taking security interests in moveable property.\textsuperscript{26}

According to Cuming, the law replaced by the Personal Property Security Acts was very accommodating to business financing although it had its deficiencies. For instance, the

\begin{itemize}
\item \textsuperscript{23} ibid.
\item \textsuperscript{24} ibid.
\item \textsuperscript{26} ibid.
\end{itemize}
availability of floating charges and equitable mortgages in common law provinces allowed most aspects of secured inventory financing to be carried out with comparative ease and a reasonable level of legal certainty. Moreover, central registries were established in the 1950s in many provinces. As a result, most provinces had legal frameworks and registry systems within which the traditional secured financing devices could function. Nevertheless, there was a deficiency in that prior secured financing law in the common law provinces, there was no systematic or conceptually consistent approach to regulation of personal properties securities in Canada. The concepts of the former law were drawn from the common law, equity and statutes. Superimposed on these concepts were elaborate, disparate and overlapping registry requirements. Priority structures were an anomalous mixture of legal doctrine and statutory rules.27 This is very close to the current state of the law on personal properties securities in Kenya.

Cuming argues that Article 9 of the Uniform Commercial Code was attractive to Canadian law reformers because it swept away established legal doctrine and replaced it with a single conceptual basis for all personal property secured transactions. Once freed from the constraints of doctrine, the drafters could devise rules to regulate inter-partes rights and priority disputes in a way that embodies public policies and responds to the needs of those affected by the law. In addition, the new law created computer-based registry systems as a key aspect of the modernization of Canadian secured financing law. Circumstances in Canada permitted the rapid development and refinement of these systems to the point that they are currently the most advanced of their kind in the world.28 This article is relevant to the current study in that it gives details of the personal property securities reforms in Canada which is used as a case study for comparative analysis in this study.

Dennis Rose’s paper considers the constitutional issues involved in implementing, in all the States and Territories in Australia, the proposals contained in the then draft Bill for the Personal Property Security Act.29 According to him, there were three options open for an Australian

27 Ibid.
28 Ibid.
personal property security legislative system. These options included enacting a single Commonwealth Act following reference of powers by the States or a simple State based co-operative scheme involving no Commonwealth legislation in a State other than possibly registry provisions. Alternatively, Rose argued there was the option of a more elaborate co-operative scheme under which the Commonwealth and the States each enacted personal property securities legislation, with State legislation filling in the unavoidable “gaps” consequent upon the Commonwealth’s limited powers.30

Rose’s View is that, of the three options, the best is either a single Commonwealth Act following reference by the States, or a “simple” State based co-operative scheme involving no Commonwealth legislation in a State other than registry provisions. According to him, a single Commonwealth Act following reference by the States would be the desirable course, having regard to the objects sought to be pursued by the reform of the law relating to personal property securities. He also argues that this option is most fitting if one considers the place of personal property security law properly within the legal system.31

According to Rose, where personal property securities law fits in the legal system is a matter to be determined by both function and government policy. Thus, he argues that while there is no clear government policy in Australia on personal property securities law, policy pursued in related financial and commercial areas may be seen as supporting the view that the appropriate formula would be Commonwealth legislation following a referral of powers. When the matter is considered from a functional perspective, Rose argues that it seems that the law relating to personal property securities is one area of law is so connected with corporate and financial regulation that it ought to have been drawn into the same regulatory network.32

The arguments in Rose’s paper are relevant in the Kenyan scenario because they address the issue of how to reconcile the role of the upcoming county government and the State government in Kenya in regulation of personal properties securities. The case made by Rose above seems to

30 ibid.
31 ibid.
32 ibid.
support the regulation of personal properties securities by the central government with input and consultation of the county governments.

Finally, there is “Guide to Securities Registration in Kenya” which is mainly a guide which provides a brief description of the procedure for the registration of common instruments creating Securities in Kenya. The guide only covers commonly prepared securities of two types, namely securities that require registration at the Companies Registry and securities that require registration at the Lands Registry.

For each of the above securities, a brief overview is given of the law governing them followed by the practical steps to be followed starting from the drawing up of the Instrument comprising the security to the issuance of a certificate or other evidence of completion of the registration process. In this regard, the paper discusses the requirements and procedure for registration of debentures, chattel mortgages, legal charges and legal mortgages.

The paper is relevant for this study in that it shows that the law on registration of securities in Kenya is fragmented and spread across many legislations. Further, the various types of securities in Kenya are registered in different registries and the process is different from one security to another. For instance, the debenture and chattels mortgages are registered under Companies Act and Chattels Transfer Act respectively. While these two principal forms of personal properties securities are registered at the Companies Registry, the legal charge and legal mortgage respectively are regulated under the various land registration laws and registered at the Lands registry.

The implication of the foregoing is that the process of and procedure for registration of securities, and especially personal property securities, in Kenya is unduly complex and inconsistent. The paper, therefore, at basic minimum, highlights the need to streamline the law on securities in Kenya. However, the paper differs with the current study which is analytical in nature and goes beyond description to analyze the root cause and implications of the deficiency in the law.

34 Ibid.
35 Ibid.
36 Chapter 486, Laws of Kenya.
37 Chapter 28, Laws of Kenya.
The most applicable jurisprudential theory for this study is economic analysis of law and legal pluralism.

On the one hand, legal pluralism is a theory of law which emphasizes the multiplicity of forms of law present within any social field. According to Griffiths, legal pluralism holds that law and legal institutions are not all subsumable within one ‘system’ but have their sources in the self-regulatory activities which may support, complement, ignore or frustrate one another, so that the ‘law’ which is actually effective on the ‘ground floor’ of society is the result of enormously complex and usually in practice unpredictable patterns of competition, interaction, negotiation, isolationism and the like.38

One of the leading jurists in this area is Masaji Chiba who models the legal system into a tripartite model with ‘official law,’ ‘unofficial laws’ and ‘legal postulates’. According to him, none of these elements ever exists in isolation as they continuously interact in dynamic fashion. In other words, in Chiba’s view, law is always plural.39 In addition to the state-sponsored legal rules, Chiba argues that any given issue is also regulated by ‘unofficial law’ which embodies the customs regulating the given area regulated by the official law. The third element of Chiba’s law is ‘legal postulates’, or value systems of various types. He views these less as bodies of rules, but rather as norms or values, which are neither created by the state nor by a social group. He argues that these “legal postulates” simply exist in their own right as elements of a specific cultural context, intimately connected to official law and unofficial law.40

In essence, legal pluralism argues that any given aspect in the society is regulated by more than just the mere text of the law. Thus, in determining whether or not a law is efficient, it is important to analyze the other factors that impact on the efficacy of the law in meeting its objective.41 This approach is applied in the current study to support the approach that in determining the efficacy of the law on personal property securities, it is important to go beyond

40 Ibid.
41 Ibid.
the legal rules and also consider other factors in play such as policy and institutional frameworks for the same and the regulatory framework regulating related areas. In view of this, the analysis of the efficiency of the law in the current study will take a holistic view of the regulatory framework for personal property securities in Kenya.

Economic analysis of law applies the tools of microeconomic theory to the analysis of legal rules and institutions. Economic concepts are used to explain the effects of laws, to assess which legal rules are economically efficient.42

There are two distinct strands of thought within economic analysis of law, namely policy analysis and political economy. Policy analysis generally focuses on analysis of the effects of legal rules and institutions on outcomes.43 In this regard, an outcome usually consists of the "objective" effects of the rule or institution on the behavior of "private" individuals. By contrast, political economy generally investigates the operation of political institutions such as courts, legislatures, the executive and administrative agencies focusing on the behavior of the public officials within those institutions. This study is based on the policy analysis strand of economic analysis.44

Policy analysis adopts a welfarist stance towards evaluation of legal rules. Thus, in evaluating the efficiency of legal rules one asks the question whether that legal rule induces behavior that satisfies some welfarist criterion, usually either Pareto efficiency or social welfare maximization. In essence, economic analysis of law argues that law is efficient which helps maximize social wealth.45 Wealth maximization is achieved when goods and other resources are in the hands of those who value them the most; someone values an item more only if he is willing and able to pay more in money (or its equivalent) to have it.

43 Ibid.
On the other hand, Pareto efficiency or Pareto optimality is a situation which is impossible to change without making at least one person believe he is worse off than before the change. A change is Pareto superior to another when at least one person believes he is better off by it while no one believes he is worse off. Whether persons believe that they better off or worse off or the same under a proposed change, and how much, is measured by their willingness to pay for the change, and how much, or to agree to it only if they are paid for it, and how much.\(^{46}\)

The most common criticism of the economic analysis of law is that its analysis merely reflects the capitalistic and free market ideology. In Kenya’s quest to promote trade, she has shed off all her protectionist regimes and assumed a free market regime grounded on the capitalistic ideology. Therefore, economic analysis of law fits into our system perfectly well. The second criticism is that social wealth maximization may not be a worthwhile goal so that legal enactments should try to maximize social wealth. Clearly, this criticism goes against conventional wisdom that holds wealth as value, if not the only or the most important value. At least for the purposes of this study, wealth is of value as people seek to access credit in order to maximize wealth.

The basic idea of this study is that a reliable personal properties securities regulatory framework stands to play a critical role in enhancing access to credit and, by extension, will promote economic development in Kenya. This idea is predicated on the Transaction Costs theory, also known as Coase theorem after the Economist who propounded it.\(^{47}\) Besides advocating for free market economy, the Coase theorem identified the following as transaction costs: Cost of identifying the parties to transact with, the cost of transacting and lastly, the cost of enforcement or implementation. The last are costs incurred on performing the contract, or on adjudication, litigation or Alternative Disputes Resolution (ADR) methods in case of infringements or breach of the contracts entered. Coase further believed that the place of the state was in keeping the transaction costs down and where the transactions fall to zero, the state should focus on creating

property rights and enforcing contracts. Clearly, the reduction of transaction costs is an ideal worth pursuing as it will lower the cost of credit and ensure that majority of the population can afford it.

1.9 Research Methodology
The methodology to be used in this study basically entails a mixture of desktop and field study methods in the collection and analysis of the data necessary for the research. Primary sources such as statutes and policy documents are consulted. Further, secondary sources such as treatises, journals, working papers and newspaper articles are also explored and applied where necessary. The study also analyses statements in reports and policy documents. Further, the Internet is also used as a source of information in this research especially on the best approaches in regulation of personal property securities as adopted in other jurisdictions. The libraries available and resourceful for the research are University of Nairobi School of Law Parklands Campus library, Jomo Kenyatta Memorial Library in Main Campus, University of Nairobi and the High Court libraries in Nairobi Law Courts and Milimani Commercial Courts.

The study will rely on minimal primary research entailing unstructured interviews with key stakeholders namely leading practitioners in conveyancing in Kenya in establishing the challenges faced in formalizing personal property securities in the country. In any case, the subject matter of the study appeals more to secondary research as the regulatory instruments to be analyzed are readily available in secondary data form. The minimal reliance on primary data is also advised by the fact that there is only limited time available to undertake the research.

1.10 Chapter Breakdown
The thesis is divided into the following five chapters:

Chapter one: Introduction to the study.
The first part of the chapter will be dedicated to laying a background of the study as well as reviewing the literature in the area of the study.

Chapter Two: Legal, Policy and Institutional Framework for Personal Property Securities in Kenya

\[48\] Ibid.
In the first place, this chapter will introduce the main forms of personal property securities used in Kenya. The second part of the chapter will discuss the legal, policy and institutional framework in place for regulation of personal property securities in Kenya. In this respect, the relevant provisions of the various Acts of parliament dealing with personal property securities including Chattel Transfer Act (Cap. 28) will be discussed. This chapter will answer a critical research question, namely, whether the existing pieces of legislation are adequate and sufficient in protecting the interests of the investor.

Chapter Three: International Best Practices on Regulation of Personal Property Securities

The discussion in this chapter will focus on best practices in regulation of personal property securities in key jurisdictions namely Australia, New Zealand and Canada. The aim is to distill the salient and relevant provisions of law in those jurisdictions in highlighting the basic minimums for effective regulation of personal property securities in enhancing access to credit for majority of the population.

Chapter Four: Comparative Analysis of Regulatory Framework for Personal Property Securities in Kenya and International Best Practices

The Chapter will be a comparative study and analysis of legal, policy and institutional framework for personal property securities in Kenya with best practices in regulation of personal property securities in other jurisdictions as discussed in Chapter Three above. In essence, the analysis will focus on establishing how Kenyan regulatory framework for personal property measures in comparison and whether or not it meets threshold of efficiency.

Chapter Five: Conclusion and Recommendations

This will be the final chapter of this thesis. The Chapter will present the conclusion and recommendations based on the findings of the study to successfully develop an effective regulatory framework for personal property securities in Kenya.
2.1 Introduction

In the first place, this chapter introduces the main forms of personal property securities used in Kenya. In this regard it discusses the historical development of personal property securities law and regulation in Kenya and around the world. The second part of the chapter discusses the regulatory framework in place for regulation of personal properties securities in Kenya. In this respect, the relevant provisions of the various Acts of parliament dealing with personal property securities are discussed. The chapter then seeks to answer a critical research question, namely, whether the existing pieces of legislation are adequate and sufficient in protecting the interests of the investor.

2.2 Historical Development and Evolution of Personal Property Securities Law

The historical development and evolution of personal property securities in Kenya as well as most of Commonwealth is closely intertwined with the history of English Property Law. English property law refers to the law of acquisition, sharing and protection of wealth in England and Wales. Property law can refer to many things, and covers many areas including the law of real property, the law of personal property and commercial law and insolvency.49

Generally, property law is divided into real and personal represents depicting the divisions between immovable and movable property. The division of property into movable and immovable property was recognised in Roman law and generally adopted since. Thus, on personal property Blacktone wrote "Things personal are goods, money, and all other movables which may attend the owner's person wherever he thinks proper to go". However, this identification of things personal with movables, though logical in theory, does not perfectly express the English law, owing to the somewhat anomalous position of chattels real.50

In some jurisdictions, historically all property was owned by the monarch and it devolved through feudal land tenure or other feudal systems of loyalty and fealty. Although

50 ibid.
the Napoleonic code was among the first government acts of modern times to introduce the notion of absolute ownership into statute, protection of personal property rights was present in medieval Islamic law and jurisprudence, and in more feudalist forms in the common law courts of medieval and early modern England.

In early times, the interpretation of private property rights in England was based on English common law. The property law in England 200 years ago was dominated by the concept of primogeniture, a hold-over rule from feudal law that restricted transfers of ownership. Under the concept of primogeniture, the entire real estate of an English landlord passed to only one heir: his first-born son, or to the closest consanguine male (father, brother, uncle, cousin, and so on). It was not uncommon for an eldest daughter to see her father’s lands inherited by a late-born, five-year-old brother; or if her father never sired any sons, the land might go to her uncle. If the uncle predeceased her father, the estate might end up in the hands of a male cousin.51

Primogeniture evolved in feudal times as a way for the King’s lands to pass within families of nobility, but since the King was under no obligation to share his interests, the lords had no rights to divide the estates entrusted to them. The concept survived evolution from feudal law, because it prevented fragmentation of productive lands and also maintained a relatively easy method of gathering taxes. However, the concept did not survive in the colonies, because the Settlers to the new world were mostly families of expatriates. The colonists embraced the rights to transfer ownership to whomever the current owner wished.52

In England, real property is historically supposed to be superior in dignity to personal property, which was originally of little importance from a legal point of view. This view is the result of feudal ideas. The preference of real property over personal property, however, had no place in the Roman system, in which immovables and movables were dealt with as far as possible in the same manner, and descended according to the same rules. Personal estate is divided in English law into chattels real and chattels personal; the latter are again divided into choses in possession and choses in action.53

52 Ibid.
53 Supra, note 1.
Interest in personal property may be either absolute or qualified. The latter case is illustrated by animals *ferae naturae*, in which property is only coextensive with detention. Personal property may be acquired by occupancy, by invention, as patent and copyright, or by transfer, either by the act of the law (as in bankruptcy, judgment and intestacy), or by the act of the party (as in gift, contract and will).  

There are several cases in which, by statute or otherwise, property is taken out of the class of real or personal to which it seems naturally to belong. For instance, by the operation of the equitable doctrine of conversion money directed to be employed in the purchase of land, or land directed to be turned into money, is in general regarded as that species of property into which it is directed to be converted.

### 2.2.1 Evolution of Law and Regulations on Personal Property in England

The two key laws that pioneered the regulation of personal property law in England. These are the 1670 Statute of Distribution (22 & 23 Charles II c. 10 as amended 1 James II c. 17) and the 1677 Statute of Frauds (29 Charles II c. 3). The 1670 statute dictated that personal property (not real property) was distributed to children where no widow survived: whole property was divided equally among the children with a lone child received all. The property was distributed to children and widow where both survived the deceased as follows: two-thirds to the children or their heirs and one-third to the widow. If no children survived, personal property was to be distributed one-half to widow and one-half to the father of the deceased if alive or, failing him, to the mother or the brothers and sisters. When no widow and children survived, property went to the father if alive or, failing him, to the mother or the brothers and sisters. The Statute of Frauds provided that personal property could no longer be disposed by oral testament and that executors/administrators must distribute such property as stipulated by will. Personal property not disposed by will was treated as intestate.

In turn, these two laws laid the stage for the requirement of documentation of personal property rights in England. However, major development in personal property and corporate securities were experienced in the late nineteenth century starting with the enactment of Joint Stock...
Companies Act 1844. This Act enabled ordinary people through a simple registration procedure to incorporate. However, the most important development in English corporate law came through the Limited Liability Act 1855, which allowed investors to limit their liability in the event of business failure to the amount they invested in the company. These two features, a simple registration procedure and limited liability, were subsequently codified in the world's first modern company law, the Joint Stock Companies Act 1856.56

Further, the emergence of the floating charge as a form of security in 1862 played a significant role in the evolution of personal property securities. In the decision of Holroyd v Marshall it was held that equity would recognize a charge over after-acquired property as being effective to create a security interest over that property automatically upon its acquisition. This decision led to "a further manifestation of the English genius for harnessing the most abstract conceptions to the service of commerce."57 Documents came to be drafted that purported to grant security over all of the debtor's present and future property, but by contract expressly permitted the debtor to dispose of those assets, free from the charge, until such times as the debtor's business ceased. This charge came to be known as the "floating charge". The first case in which a floating security device was tested and upheld came a mere eight years after Holroyd v Marshall in Re Panama, New Zealand and Australian Royal Mint Company.58 The Court of Appeal held that the effect of the document was that the secured creditor could not interfere with the running of the business and its dealings with its own assets until the winding up of the company, but the occurrence of that event entitled the secured creditor to realize its security over the assets and to assert its charge in priority to the general body of creditors.59 Any residual concern about the efficacy of floating charges was rested by the House of Lords in Salomon v A Salomon & Co Ltd.60 Thus, by the turn of the 1900s, corporate securities were accepted in England, and the stage had been prepared inheritance of the legacy in the colonies.

Kenya was declared a British Protectorate in 1895. Before then, the country had no structured legal system to speak of. The territory had been administered via the Imperial British East Africa

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57 (1862) 10 HL Cas 191.
58 (1870) 5 Ch App 318.
59 Ibid.
60 (1897) AC 22.
Company, but in 1896, the territory became known as the East African Protectorate. It was renamed Kenya Colony and Protectorate in 1920 and it remained so until 1963, when Kenya became an independent state. As a result of British administration for over six decades, the Kenyan legal system borrows heavily from the English legal system.\textsuperscript{61}

Most of personal property securities laws were inherited from the Great Britain during the Colonial Period. The only exception is the Hire Purchase Act which was enacted after independence. For instance, the Chattels Transfer Act which contains provisions relating to chattel securities and transfer of chattels for purposes of creating securities,\textsuperscript{62} was enacted in Kenya in 1930 and heavily borrows from the United Kingdom Act of 1920 which had been passed to facilitate borrowing for agricultural farmers.

The Companies Act of Kenya today is based on the now repealed 1948 Companies Act of England. The Kenyan Act commenced in 1962 and has undergone several changes, though the core of the Act is still moulded along the lines of the old English Act. This Act is outmoded and ill-equipped to handle the vicissitudes of 21st century financial instruments. In cognizance of that fact, there have been efforts to reform the law and currently a draft Companies Bill 2010 is at draft stage seeking to reform and modernise the corporate law in Kenya. However, there have been no efforts to undertake comprehensive reform the personal property security law in Kenya except for piecemeal amendments and a recent study commissioned by the Central Bank of Kenya to review the status of the law which is yet to be acted upon.\textsuperscript{63}

2.2.2 Personal Property Securities in Kenya

There is no specific or unified law on personal property securities in Kenya. Indeed, this is an area regulated by outdated law which was inherited from the British colonial regime that governed Kenya. The main law in this respect is found in the Chattels Transfer Act\textsuperscript{64} and the Companies Act.\textsuperscript{65} The Chattels Transfer Act deals with all issues touching on transfer of goods


\textsuperscript{62} Preliminary Section of Chattel Transfer Act, Cap. 28 (Laws of Kenya) Revised on 2010.


\textsuperscript{64} Chapter 28, Laws of Kenya.

\textsuperscript{65} Chapter 486, Laws of Kenya.
specifically for creating security over chattels (goods). On the other hand, Companies Act deals with issues touching on creating debentures and creating and registration of charges against companies as well as mortgaging of shares and company’s lien.

In addition to these main forms of personal property securities, there are other forms of instruments and financial arrangements which are not strictly speaking securities such as factoring, hire purchase and warehouse receipts which either operate informally or are regulated by different legal framework other than Chattels Transfer Act and the Companies Act. The discussion in this chapter shall thus focus on the one hand on the legal frameworks for personal property securities under Chattels Transfer Act and Companies Act and then discuss the regulatory framework for the alternative and emerging forms of personal securities.

2.3 Legal Framework under Chattels Transfer Act

The Chattels Transfer Act contains provisions relating to chattel securities and transfer of chattels for purposes of creating security.\textsuperscript{66} It was enacted in Kenya in 1930 and heavily borrows from the United Kingdom Act of 1920 which had been passed to facilitate borrowing for agricultural farmers. Indeed, this is clear from the definitions given in the Act of chattel, stock and crops.

The Act defines a chattel as “any movable property that can be completely transferred by delivery, and includes machinery, stock and the natural increase of stock as hereinafter mentioned, crop and wool.” However, the Act does not deal with title deeds, choses in action or negotiable instruments, shares and interests in the stock, funds or securities of any government or local authority, shares and interests in the capital or property of any company or other corporate body or debentures and interest coupons issued by any government, or local authority, or company, or other corporate body. This is because these are excluded from the definition of chattel under the Act.\textsuperscript{67}

\textsuperscript{66} Preliminary Section of Chattel Transfer Act, Cap. 28 (Laws of Kenya) Revised on 2010.

\textsuperscript{67} Section 2, Chattels Transfer Act.
Section 2 of the Act provides that stock refers to livestock and includes any sheep, cattle, horses, pig, poultry and any other domestic animals. On the other hand, crops include “coffee berries, sugarcane, wheat, tea leaves, sisal leaves, cotton hemp, hop, maize, wattle, barley, oat and grass and all root crops and cereals and all other crops grown above or below the ground.”

Under the Chattels Transfer Act, all the transactions are required to be effected through an instrument. The Act defines an instrument as meaning “any instrument given to secure the payment of money or the performance of some obligation.” In this regard, instruments include mortgages, bill of sale, lien or any other document that can transfer or purports to transfer the property in or the right to the possession of chattels whether permanently or temporarily, whether absolutely or conditionally and whether by way of sale, security, pledge or gift. In essence, the foregoing means that transfer under the Chattels Transfer Act must be in writing.

However, for the purposes of the Act, an instrument “does not include securities over, or leases of, fixtures except trade machinery, assignments for the benefit of the creditors, transfers of or agreements to transfer instruments by way of security, transfers or assignments of any ship or vessel or any share thereof and transfers of chattels in the ordinary course of business of any trade or calling.” Further, the definition of instrument excludes “documents relating to debentures and interest coupons issued by any government or local authority, bills of sale of chattels in any foreign parts, or at sea and bills of lading, warehouse-keepers’ certificates, warrants or orders for the delivery of chattels, entries in auctioneers’ books or any other document used in the ordinary course of business as proof of the possession or control of chattels are also not instruments as defined under the Act.”

Further, excluded from definition of instrument under the Act are debentures and interest coupons issued by any company or other corporate body and secured upon the capital stock or chattels of that company or other corporate body, mortgages or charges granted or created by a company incorporated or registered under the Companies Act or by a co-operative society.
registered under the Co-operative Societies Act and hire-purchase agreements. The justification for these exclusions is that all these are regulated under other laws. Also, given the history of the Act as meant to facilitate borrowing by farmers, the definition of chattel was limited to those available to farmers and not regulated by other legislation.

2.3.1 Types of Securities under Chattels Transfer Act

The most common securities created over chattels under the Chattel Transfer Act include mortgages, bill of sales, pledge, lien and letters of hypothecation. A mortgage under the Chattels Transfer Act is effected by the creation or transfer of legal or equitable interest in property whether movable or immovable. The most important consideration in creating a mortgage whatever the form of property is the understanding that when the debt is paid, the property will be retransferred to the owner through reconveyance of the mortgage.

Although bills of sale are forms of securities covered by the Act, they are hardly used in practice. In the United Kingdom, bill of sales are of two kinds, namely, absolute bill of sale and conditional bill of sale. Absolute bills of sale, which do not represent any form of security whatsoever, are simply documents evidencing assignments, transfers and other assurances of personal chattels, which are substantially no more than mere contracts of sale of goods covered by the common law of contract and the sale of goods law. The conditional bill of sale refers to any assignment or transfer of personal chattels to a person by way of security for the payment of money.

The conditional bill of sale creates a security in favour of the grantee of the bill whereby the grantee is given personal right of seizure giving right to a security interest of a possessory nature. An example of bill of sale is the so-called logbook loan whereby the loanee gives the logbook of his vehicle on the understanding that in case he is unable to settle the loan, it will be taken that he has sold the car to the lender.

In the case of a pledge, the goods or the title documents for the goods are delivered by the pledgor to the pledgee to be held as security upon the understanding that the goods will be

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73 Ibid.
74 Ibid
restored to the pledgor upon the payment of the debt or discharge of obligation. Thus, a pledge is
that is as security for the payment of a debt or a promise, and
something delivered subject to forfeiture on failure to pay or fulfill the promise.

A lien is where the creditor retains the possession of the goods. The goods held under lien must
have previously been delivered to the creditor for some other purposes but he retains them as
security. An example is where a bank retains money in a customer’s account following default in
that customer’s loan. Another example is where an advocate retains a client’s file until the full
payment of legal fees owed to him is made.

Lastly, letters of hypothecation is where goods are availed as security for a debt without
transferring either the property or the possession to the lender. The debtor under this arrangement
retains ownership but the creditor gets in rem which entitles him to deal with the goods in the
manner stated in the letter of hypothecation in the event the debt is not repaid. It is important to
note that only sole-proprietorships and or partnerships can hypothecate goods and therefore this
form of security is not available to companies.

2.3.2 Preparation of Security Instruments under Chattels Transfer Act
The Act under section 4 specifies the form which the instruments are to take. In this regard, the
instruments are to be in Form 4 of the First Schedule or with such variations, modifications and
additions to the same as per section 22. In essence, this section requires that any such variation,
modification and addition should not alter the basic effect of creating a security as contemplated
under the Act.

The instrument is required to contain or have endorsed therein a schedule of the chattels which
are to be included as security. This is necessary because any chattel not included in the schedule
is considered to be excluded and not covered by the instrument. In addition, the property which
is included as security is required to be sufficiently and specifically identified.75 For example, if
it is a car, it is incumbent to give its registration number, chassis title, registered owner, make
and colour, year of manufacture among others. In addition, the Act requires the instrument be

75 Ibid., Section 5.
accompanied by a supporting affidavit in the form as outlined in Form 1 of the First Schedule. The law requires that the execution of the instrument be attested by at least one witness.\textsuperscript{76}

The Second and Third Schedule make provisions for certain implied terms which must be incorporated in the instrument. In particular, the second schedule deals with terms relating to title. The guarantor is required to state that they have good title. The third schedule enumerates other covenants relating to power, for example a covenant to pay the debt. The incorporation of these terms in the instrument may be express where the parties opt to list them or implied where they are omitted in the instrument but read into it in case of enforcement.\textsuperscript{77}

2.3.3 Registration of Instruments under Chattels Transfer Act

Section 4 of the Chattels Transfer Act requires that all instruments made under the Act be registered with the office of the Registrar General. The registration is required to occur within 21 days of execution. The effect of registration is that it serves as a notice of interest. As per the Act, upon registration “All persons shall be deemed to have notice of an instrument and of the contents thereof when that instrument has been registered as provided by this Act.”\textsuperscript{78} If such registration is not done in time, one may seek leave of the court to register out of time or to extend the time for registration.

Further, such registration is to be renewed every five years as required by section 10(1) of the Act. Such renewal is to be done by way of an affidavit in the stipulated statutory form. Where one fails to renew registration with good reasons he may get the court to extend the time for the renewal. As a matter of fact, if not renewed, the registration of an instrument ceases to be of any effect. Indeed, the Act provides that “if not so renewed, the registration shall cease to be of any effect at the expiration of 5 years during which a renewal has not been made as required under this section.”\textsuperscript{79}

\textsuperscript{76} Ibid.
\textsuperscript{77} 2\textsuperscript{nd} and 3\textsuperscript{rd} Schedule, Chattels Transfer Act.
\textsuperscript{78} Ibid., section 4.
\textsuperscript{79} Ibid., section 10(2).
Upon lodging the instrument for registration, the Registrar is required to enter the particulars of
the instrument in the register book in the same manner as in an original registration. In case of
renewal, the Registrar is required to enter the date of renewal of renewal in the column provided
in the Register Book.

The effect of non-registration is simply that such instrument is not deemed at all to act as notice
to others of the lender’s interest. If an instrument is not registered, it is deemed to be fraudulent
and void as against the Official Receiver or trustee in bankruptcy of the estate of the person
whose chattels or any of them are comprised in the instrument and assignees or trustees acting
under any assignment for the benefit of the creditors of that person. Similarly, such instrument is
void as against a person seizing the chattel or any part thereof comprised in the instrument in the
exercise or execution of a lawful process of any court authorizing the seizure of the chattels of
the person by whom or concerning whose chattels the instrument was made.  

2.3.4 Satisfaction and Discharge under Chattels Transfer Act
The Act provides that instruments be discharged by the filling of a memorandum of
satisfaction. The statutory form of this document is provided for under Form 5 in the First
Schedule although any other document to the same effect may be used for the purpose. Such
memorandum has to be signed by the grantee or his attorney and attested by at least one witness
who is required to indicate his residence and occupation in addition to his signature. The
attestation of the instrument is also required to be verified by an affidavit of the witness.

2.4 Legal Framework under the Companies Act

Essentially, companies borrow money from a range of sources, including their directors and
shareholders, personal contacts, banks, venture capital companies and institutional investors. If
the company is a public limited liability company, it may raise money from the public through
the Stock Exchange by making a public offer of its shares. In most cases, companies borrow
from their directors and shareholders, either formally, perhaps granting them a debenture, or

80 Ibid., section 13.
81 Ibid., section 34.
informally, with just book-keeping records, such as a director's loan account. Lending money or assets to the company can be an alternative to putting it in as share capital.

If a private company borrows from its bank, the bank may require the directors to give personal guarantees of the debt. The bank may also, depending on the amount, want security over the company's assets. Security over the company's assets is usually in the form of a debenture, secured with fixed and floating charges over all the company's assets. In most cases of borrowing a debenture is issued.

2.4.1 Debentures

Basically, a debenture is a means of company borrowing where the company agrees to repay the debt. In such case, the company may undertake to secure the repayment thereof over the company's assets to secure the repayment of this debt. Alternatively the company can raise finance from creditors such as banks or suppliers of goods and services. These creditors may require a form of security to be taken over the company's assets such as a fixed or floating charge.82

A debenture is the traditional name given to a loan agreement where the borrower is a company. Typically, a debenture will set out the terms of the loan: the amount borrowed, repayment terms, interest, charges securing the loan, provisions for protecting and insuring the property etc., and terms for enforcement if the company defaults.

Section 2 of the Companies Act defines a debenture as “including debenture stock, bonds and any other securities of the company, whether constituting a charge on the assets of the company or not.” In this regard, a debenture is that document given by the company as evidence of a debt to the holder usually arising out of a loan and most commonly secured by a charge.

According to Palmer, the word ‘debenture’ signifies “any instrument under seal evidencing a deed, the essence of it being the admission for indebtedness”. In other words, a debenture is a document creating or acknowledging an indebtedness of the company which may or may not be secured. In brief, a debenture involves repayment of all moneys is secured by a charge in favour of the trustee over the whole or any part of the tangible property of the borrower or of any of the guarantors. Secondly, the tangible property that constitutes the security for the charge is sufficient to meet the liability for the repayment of all such money and all other liabilities that have been incurred and rank in priority to or equally with that liability.

Debentures are usually issued by a resolution of the Board of Directors under powers conferred by the company’s articles of association. Where the company has adopted Table A as its articles of association, Article 79 thereof provide that, the directors may exercise all the powers of the company to borrow money and to issue debentures, debenture stock and other securities.

2.4.2 Debentures under the Companies Act

The Companies Act defines “debenture” as including debenture stock, bonds and any other securities of a company, whether or not constituting a charge on the assets of the company.

Under the Act, it is also possible to have debentures which are irredeemable or redeemable only on the happening of a contingency, however remote; or on the expiration of a period, however long. Further, the Act provides for the option of specific enforcement of debenture contracts.

The new law requires registration of the allotment of debentures to be effected as soon as practicable and in any event within two months after the date of the allotment. The company is bound to keep the register of debenture holders and avail it for inspection at the registered office of the company; or at the office where the work of making up such register is done if that is an

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84 Ibid.

85 Clause 303, Companies Bill, 2011.

86 Ibid., Clause 304.

87 Ibid., Clause 305.

88 Ibid., Clause 306.
office other than the registered office. Where a register of debenture holders is kept outside
Kenya, a copy thereof shall be kept in Kenya.\textsuperscript{89}

Clause 309 of the Act provides for the rights of debenture holders. Any holder of debentures of a
company is entitled, on request and on payment of such fee as may be prescribed, to be provided
with a copy of any trust deed for securing the debentures. Further, where a copy of a trust deed
for securing the debentures is not provided under subsection, the court may direct that the copy
required be sent to the person requiring it.\textsuperscript{90}

A trust deed is a document that sets out the rules for the operation of the debentures. It gives
debenture holders a secured position as against secured creditors. Essentially, the trust deed must
provide that the following are held in trust by the trustee for the benefit of the debenture holders,
namely, the right to enforce the borrower's duty to repay, any charge or security for repayment,
the right to enforce any other duties that the borrower and any guarantor have under the terms of
the debentures, the provisions of the trust deed.\textsuperscript{91}

The Bill also provides for the duties and liability of trustees of debentures. These are broad in
nature as the Bill provides that any provision contained in the trust deed for securing an issue of
debentures or any contract with the holders of debentures is a binding on the Trustees. The
trustee is required to provide protection to debenture holders against the risk of abuse by the
borrower. Further, any provisions of the debenture or contract are void in so far as it would have
the effect of exempting a trustee of the deed from, or indemnifying him against, liability for
breach of trust where he fails to show the degree of care and diligence required of him as trustee,
having regard to the provisions of the trust deed conferring on him any powers, authorities or
discretions.\textsuperscript{92}

The Bill gives companies the right to re-issue debentures where the company has redeemed them
previously issued. The only limitation is where there is a provision to the contrary, express or
implied contained in the company’s articles or in any contract made by the company. Further,
renewal is not permissible where the company has, by passing a resolution, manifested its
intention that the debentures shall be cancelled. The company in re-issuing has the option of
either re-issuing the same debentures or by issuing new debentures in their place. In case of re-

\textsuperscript{89} Ibid., Clause 307 and 308.
\textsuperscript{90} Clause 309, Companies Bill, 2011.
\textsuperscript{91} Ibid.
\textsuperscript{92} Clause 310, Companies Bill, 2011.
issue of old redeemed debentures, the person entitled to the debentures have same priorities as if
the debentures had never been redeemed. 93

Further, the company is allowed to deposit its debentures to secure advances from time to time
on current account or otherwise. In such a case, the debentures are not treated as redeemed by
reason only of the account of the company having ceased to be in debit while the debentures
remained so deposited. 94

Lastly, the Bill provides for priority rules applicable where debentures are secured by floating
charge. In such a case, if possession is taken by or on behalf of the holders of the debentures of
any property comprised in or subject to the charge, and the company is not at that time in the
course of being wound up, the company’s preferential debts are to be paid out of assets coming
to the hands of the persons taking possession in priority to any claims for principal or interest in
respect of the debentures. Such payments are to be recouped, as far as may be, out of the assets
of the company available for payment of general creditors. 95

2.4.3 Charges Securing Debentures

There are different types of charges. A company can issue secured and unsecured debentures.
Debentures are usually secured by charges on the company's property. However, it is possible to
have unsecured debentures usually known as 'bare' or 'naked' debentures. If the debentures are
not secured by the assets of the company, the debenture holders position is that of an unsecured
creditor.

Secured debentures are issued by creating a charge on the assets of the company. The term
"charge" means an interest. It may either be a specific (fixed) charge or a floating charge. In
some other instances, it is likely the lender will insist on lending on a combination of a fixed
charge, and a floating charge on all other assets. This is the best security which can be created
over the assets of any particular company. In addition, the lender may also require other security
from the directors and may want their personal guarantees.

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93 ibid., Clause 311.
94 ibid., Clause 312.
95 ibid., Clause 313.
2.4.3.1 Fixed Charge

A fixed charge is created in respect of a definite and ascertained property and this prevents the company from dealing with that property without the consent of debenture holders.96 In the event of winding up of a company, debenture holder secured by a specific charge is in the highest ranking class of creditors. Where there are a number of specific charges on the same property, their priority is determined by the general rules relating to priority of charges.

Generally, a fixed charge is a charge or mortgage secured on particular property, e.g. land and buildings, a ship, piece of machinery, shares, intellectual property such as copyrights, patents, trade marks, etc. Section 96 provides that whenever a company creates a fixed charge over its property, the charge must be registered with the Registrar of Companies within 42 days indicating particulars and instrument creating it. Failure to register means that such charge cannot be enforced against the liquidator of the Company in case of such eventuality.97

2.4.3.2 Floating Charge

A floating charge is an equitable charge which does not fasten on any ascertained or definite property and as such the company can deal with any of its assets in the ordinary course of business.98 Lord Gower has defined a floating charge as “a charge which floats like a cloud over the whole assets from time to time falling within the generic description”.99 The advantage of a floating charge is that the consent of the debenture holders is not necessary for the company to deal with its assets.

The earliest definition of a floating charge was given by Lord Macnaghten in Government Stocks and Other Securities Investment Co Ltd v Manila Rly Co100 where he said:

"A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is the essence of such a charge that it remains dormant until the undertaking ceases to be a going concern, or until the person in whose favour the charge is created intervenes. His right to intervene may of course be suspended by agreement.

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96 Section 96, Companies Act.
97 Ibid.
98 Section 96(2), Companies Act.
100 [1897] AC 81 at 86.
But if there is no agreement for suspension, he may exercise his right whenever he pleases after default."

In *Illingworth v Houldsworth*,101 Lord Macnaghten distinguished between fixed and floating charge as follows:

"A specific/fixed charge is one that fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge on the other hand is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect, until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp."

The characteristics of a floating charge have been ably stated by Romer LJ in *Re Yorkshire Woolcombers Association*.102 Indeed, this description is generally cited as the most authoritative definition of a floating charge. A floating charge is, thus, a charge on a class of assets present and future whose class is one which changes from time to time in the ordinary course of the company's business. Further, it is a key characteristic of a floating charge that it is contemplated that until some event occurs which causes the charge to crystallize, the company may use the assets charged in the ordinary course of its business.103

In the recent case of *National Westminster bank plc v Spectrum Plus Ltd*,104 the House of Lords elected to describe the essential characteristic of a floating charge rather than define it thus:

"the asset subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime the chargor is left free to use the charged asset and to remove it from the security."

As a matter of fact, a floating charge may crystallize or become fixed in case of the following eventualities, namely, when the company ceases to carry on business, when the company defaults and the debenture holders take steps to enforce their security, either by appointing a receiver or applying to court to do so, when the company goes into liquidation and when a receiver is appointed for the company.

102 [1903] 2 Ch 284.
103 ibid.
104 [2005] UKHL 41.
In *Government Stock and Other Securities vs. Manila Railway Co.* the facts were that the debentures created a floating charge. However, after three months, interest became due, but the debenture holders took no steps. The company then made a mortgage of a specific part of its property. Lindley, L.J., pointed out the hardship and injustice that must arise to third parties by the debenture-holders allowing the business to go on after the happening of the specified event and then turning round and treating all the transactions as void under the debenture deed, and held that such a result was so unreasonable and undesirable that in the absence of an express provision to that effect in that case, it ought not to be held to have been in the contemplation of the parties.

On appeal, the House of Lords held that the mortgage has no priority. Lord Macnaughten observed that "it is of essence of floating charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favor the charge is created intervenes. As long as he does not intervene the business will be carried on. Mere default does not cause crystallization and that the debenture holders must intervene by taking steps to enforce their security." When the floating charge crystallizes, it fixes on the assets then owned by the company, catching any assets acquired up to that date, but missing any which have already been disposed of. The debenture-holder is then entitled to appoint an administrative receiver, whose job is to collect the assets charged to pay off the loan. This is what is usually meant when a company goes into receivership.

### 2.4.4 Registration of Debenture in Kenya

The Companies Act provides the legal regime for the registration of debentures and the issuance of a Certificate as evidence of the said registration. The issuing of a debenture by a company is done pursuant to powers conferred to the company by its Memorandum and Articles of Association. In practice in addition to the said powers a resolution by the Board of Directors of the company allowing creation of the debenture will be prepared and executed by the directors of the company.

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106 (1897) A.C. 81.
Once a debenture is registered, it acts as a notice to the public at large that the charge holder has an interest in the charged property of the company. As such, no person can have a defense against the charge holder that he was not aware that a charge was created against the property and any other person will be entitled to the property subject to the interest of the charge holder. Indeed, once a certificate of charge is issued by the Registrar, it is conclusive evidence that the document creating the charge is properly registered.

On the other hand, if the debenture is not registered is void. This does not mean that the creditors cannot recover their dues. It merely means that the benefit of the charged security will not be available to them. In other words, although the security becomes void by non-registration, it does not affect the contract or obligation of the company to repay the money thereby secured.

The first step in the procedure for registering a debenture is to conduct a search on the company file at the Companies Registry to ascertain the existence of the company together with information that is pertinent to the creation of a debenture such as establishing that the provisions of the Memorandum and Articles of Association of the company empower it to create a debenture.

Secondly, it is important to ensure that the debenture instrument is drawn and executed appropriately as per the Act. The Companies Act provides for execution of the debenture by appending of the company seal which is to be witnessed by the signatures of two directors of the company or one director of the company and its company secretary. Execution of the debenture by the financier is not a mandatory requirement.

Thirdly, the stamp duty payable for the debenture is assessed and paid. This step takes place at the Companies Registry and the aim is to determine the stamp duty payable to the Kenya Revenue Authority. At present, the stamp duty payable is 0.1% of the sum secured after the same was reduced in June 2010 from 0.2% of the sum secured to encourage borrowing by companies.

In order to assess a document for stamp duty there is need to have the Personal Identification Numbers (PINs) issued by the Kenya Revenue Authority of the parties to the transaction (in the case of a debenture the PIN of the lender and the borrower). After assessment of payable duty
payment of the tax is made at specified banks which remit details of the payment to the Companies Registry to facilitate the stamping of the debenture instrument. Once the document is assessed, it is required to be lodged with the Registrar of Companies for stamping. The Instrument of Debenture is then presented at the registry where an endorsement is made on its first page signifying the payment of duty.

Thereafter, upon the payment of the standard fee for registration of the debenture, the same is lodged at the Companies Registry for registration. As evidence of registration, the law required the Registrar of Companies to issue a certificate as evidence of the creation of a debenture.

Wherever the terms and conditions or the extent of the operation of any registered charge is modified, the company is required to file the particulars of modification within thirty days thereof with the Registrar of Companies. Similarly, the company is required to make a report to the Registrar upon full payment in discharge of the charge registered under the Companies Act. The satisfaction of charges must be filed with the Registrar within thirty days from the date of such a payment of charge. On receipt of the notice of the company of discharge, the Registrar is required to notice to the charge-holder calling upon him to show cause within time not exceeding fourteen days as why the payment of satisfaction should not be registered.

2.4.5 Priority of Charges on Company Assets

According to the Companies Act, the priority between charges is as follows:

(a) Legal fixed charges rank according to their order of creation.

(b) If an equitable fixed charge, that is, an informal mortgage created by a deposit of title deeds or share certificate to the lender, is created first and a legal charge over the same property is created later, the legal charge takes priority over the equitable charge.

(c) A floating charge will be postponed to a later fixed charge over the same property.

However, it is possible for a floating charge to have priority over the fixed charge if the floating charge contained a clause prohibiting the company from creating fixed charges with priority over it and the holder of a fixed charge actually knew about the prohibition.

(d) If two floating charges are created over the general assets of the company, they will rank in the order of creation.
(e) If a company creates a floating charge over a particular kind of assets, for example book debts, the charge will rank before an existing floating charge over the general assets.

2.5 Mortgage on Shares
A shareholder who intends to borrow money on the security of his shares may do so by way of legal or equitable mortgage on his shares.

2.5.1 Legal mortgage
This entails the transfer of shares to the lender as a security for repayment of an old debt. As long as the mortgagee remains a registered shareholder, he is entitled to all dividends and he is entitled to vote, unless it is agreed between the lender and borrower that dividends will be paid to the latter. A legal mortgagee is for a period when the contract is still in force, a member of the company. In order to effect a legal mortgage of shares, the legal ownership of shares must be transferred to the lender by the registration of a form of transfer with the company concerned.

Dividends paid to the lender during the currency of the loan as the registered holder of the shares are payable by him to the borrower unless the loan agreement provides that they will be applied towards reduction of the loan. The voting rights exercisable in respect of the shares will depend on the provisions of the loan agreement.

2.5.2 Equitable mortgage
An equitable mortgage is effected by a deposit of share certificate by the borrower with the lender as a security for the loans, with or without delivery of a blank transfer. In case the borrower fails to repay the loan the mortgagee may fill the blank transfer form and dispose the shares. There are no legal formalities prescribed for an equitable mortgage which can therefore be created quite informally. Anything done by the lender and the borrower which shows an intention to mortgage the shares will suffice.

The common options for equitable mortgage are as discussed hereunder:
(i) To deposit the share certificate with the lender without executing a transfer:
If the borrower fails to repay the loan as agreed between him and the lender, the lender must apply to court for an order for sale of the shares. Alternatively the lender may apply for an order of foreclosure which would vest the ownership of the shares in him absolutely.

(ii) To deposit the share certificates plus a blank transfer with the lender.

A blank transfer is one which is signed by a named transferor but does not specify the transferee. On default by the borrower, the lender has an implied authority to sell the shares and to enter the name of the purchaser in the transfer as the transferee.

2.5.3 Share Certificates
Section 82(1) provides that within 60 days after the date on which a transfer is lodged with a company, the company must have ready for delivery, a certificate of the shares transferred. Section 82(3) provides that a person aggrieved by the company’s failure to issue a share certificate may serve the company with a notice requiring the company’s compliance with the section. If the company does not do so within fourteen days after the service of the notice he may apply to the court for an order directing the company and the officer responsible to issue the certificate with such time as the court may specify. The costs of application shall be borne by the company or the officer of the company who was responsible for the default.

2.5.4 The Company’s Lien
A lien is the right to retain possession of a thing until a claim is satisfied. In case of a company, lien on a share means that the member would not be permitted to transfer his shares unless he pays his debt to the company. Table A, Article 11 may give the company “a first and paramount” lien on the shares of its members, either in respect of amounts payable on the shares or any amount due from the member of the company. The right of lien is not inherent but must be clearly provided for in the articles. The lien does not however confer a power to sell the property retained. Consequently, if the company wishes to enforce its lien by selling the relevant shares, without a court order, it must insert a suitable clause in the articles.

Where the company has adopted Table A, Article 12 thereof gives the company power to “sell”, in such a manner as the directors think fit, any shares which the company has a lien subject to specified conditions. Since the shares are not physically in possession of the company it appears proper to regard the company’s lien as an “equitable lien” which does not arise until the registered shareholder incurs a debt to the company.

In *Bradford Banking Co. v. Briggs & Co.*, a member deposited his share certificate with the bank as an equitable mortgage of the shares to secure a loan to him by the bank. The bank gave notice to the company of its interest as mortgage. Later, this member became indebted to the company. It was held that as the company had prior notice of the bank’s mortgage, its lien was postponed to the mortgage since the company’s claim under the lien arose after the bank’s notice was received.

### 2.6 Law and Alternative Forms of Personal Property Securities

There are other alternative forms of personal property securities that although operative in Kenya are not considered to be in the mainstream securities segment or they are not properly regulated as is the case elsewhere. These include the innovative and emergent forms of commercial securities such as factoring and invoice discounting, hire purchase, leasing and warehouse receipts. Due to lack or proper legal framework, the programmes are operated informally in the country and have also been infiltrated by unscrupulous shylocks who are only interested in making big profits and have little interest in facilitating access to credit for SMEs.

#### 2.6.1 Factoring and Invoice Discounting

Factoring is the selling of a company’s accounts receivable at a discount to a factor (company specializing in that business), which then assumes the credit risk of the account debtors (purchasers of the original merchandise), generally without recourse, and receives cash directly from the debtors as these debtors pay. Because factors own the accounts receivable they will generally take control of managing the accounts receivable function and will receive the

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28 [1886]35 W. R. 521
payments for the invoice. The factor generally buys a tranche of accounts receivable from predetermined customers and not from individual invoices.\textsuperscript{109} 

Invoice discounting differs from factoring in that invoices are not sold but rather discounted with full recourse to the seller of the original merchandise. In most cases, the buyer of the merchandise is not aware that the seller has discounted the invoices, as the transaction is entirely between the discounter and the seller of merchandise. The selling company continues to collect its own debts, generally into its own accounts, and performs its own credit control functions. The invoice discounter checks regularly to see that the company’s debt collection procedures are effective.\textsuperscript{110} 

In Kenya, invoice discounting and factoring often function differently in practice. A number of institutions will discount invoices, but, rather than the wholesale agreements common in other countries, these are discounts of individual invoices. As with factoring, invoice discounters will generally take control of the accounts receivable function, with the buyer paying directly into the invoice discounters’ accounts. The most important difference between this and the international model is that this is a per-invoice exercise, and, therefore, is time consuming and relatively low volume. For example, the Kenya Gatsby Trust (KGT) Financial Services Department has been running a factoring program since 2002 to bridge the gap between commercial banks and microfinance.\textsuperscript{111} 

The main issue that impedes the development of factoring and invoice is the lack of an adequate legal structure given that no statutory law provides for them. Despite the fact that Kenya is a common law country and as such can use precedents from other common law countries, local courts must first accept that precedent. This could be a very costly process for the first factor test case of the system. There is, thus, need for legislative framework that clarifies the above issues and fosters the development of wholesale invoice discounting or factoring would be preferable.

2.6.2 Hire Purchase


\textsuperscript{110} Ibid.

\textsuperscript{111} Cited as a case study in: Brian Milder, “Closing the gap: Reaching the missing middle and rural poor through value chain finance”, \textit{Enterprise Development and Microfinance}, December, 2008.
Hire purchase is a type of installment credit which is a prime source of credit in Kenya. It works in that the hirer agrees to take the goods on hire at a stated rental price, which is inclusive of the repayment of principal as well as interest, with an option to purchase. Under this transaction, the hirer acquires the property (goods) immediately on signing the hire purchase agreement, but the ownership or title is transferred only when the last installment is paid.\textsuperscript{112}

Hire purchase in Kenya, though relatively common and well known, has had limited economic impact because it has not been channeled to business financing. One reason for its limited impact in Kenya is that the Kenya Hire Purchase Act has provisions that reduce its attractiveness as a mode of business asset financing especially in the case of financiers. Thus, it is important to amend the Purchase Act to encourage the use of hire purchase as a financing mechanism.\textsuperscript{113} Additionally, the tax laws should be amended so that hire purchase agreements can allow hirers to include the assets in their balance sheets and depreciate them for tax purposes.

### 2.6.3 Leasing

Leasing as a financing scheme works in a similar way as hire purchase because it allows a business to use an asset over a fixed period in return for regular payments. Leasing works such that the business chooses an equipment and the finance company buys it on behalf of the business either under operating or finance leasing arrangement.\textsuperscript{114}

An operating lease is a financing arrangement where the ownership of the personal property remains with the financier and never passes to the business customer. The benefit to the business entity is that it gets to use the asset in return for a series of contractual, periodic and tax deductible payments by claiming the capital allowances. The leasing company on its part leases the equipment expecting to sell it second-hand at the end of the lease or to lease it again to someone else. It will, therefore, not need to recover the full cost of the equipment through the lease rentals. This type of leasing is common for equipment with a well-structured second-hand

\textsuperscript{112} See, “Hire Purchase”, The Encyclopadedia of Forms and Precedents (4\textsuperscript{th} Edition), Volume 10.

\textsuperscript{113} Hire Purchase Act, Chapter 507, Laws of Kenya.

market such as cars, stationary equipments and construction equipment. In Kenya, this segment is fast growing targeting large or corporate firms although it is yet to gain popularity in the SME sector. The sector is limited in that there is still no clear and straightforward law for business outsourcing services in Kenya.\textsuperscript{115}

The finance leasing is where the leasing company recovers the full cost of the equipment and financing charges during the period of the lease. It is also called asset financing. However, finance leasing is not widespread in Kenya due to tax legislation as the Kenyan tax authorities "claw back" the deduction of the installments if the asset goes on the books of the business, in effect creating a tax disadvantage for the product.\textsuperscript{116}

2.6.4 Warehouse Receipts

Generally, warehouse receipts are useful as informal security because they provide proof of ownership of commodities that are stored in a warehouse, vault, or depository for safekeeping. Warehouse receipts are issued in negotiable or non-negotiable form. Where they are issued in negotiable form, they are eligible to be used as collateral for loans. Warehouse receipts also guarantee the existence and availability of a commodity of a particular quantity, type and quality in a named storage facility.\textsuperscript{117}

Well-regulated warehouse receipt systems can help make agricultural marketing more efficient and improve access to finance for smaller firms. The availability of secure warehouse receipts may also allow owners of inventory to borrowing against inventory of an export commodity. This would be of benefit in Kenya where coffee stocks are often financed in pounds sterling.\textsuperscript{118}

However, this form of security is still in its infancy in Kenya. The first warehouse receipts loan facility was recently launched in Nakuru by Equity Bank. However, the lack of enabling legislation is still a factor that will undermine the continued development of this industry.\textsuperscript{119}

\textsuperscript{116} Ibid.
\textsuperscript{117} Ibid.
\textsuperscript{118} Ibid.
\textsuperscript{119} Ibid.
2.7 Analysis of the Regulatory Framework for PPS in Kenya

The foregoing discussion reveals that the law in place for chattel security is outdated given that it was enacted in Kenya in 1930 having been inherited from the United Kingdom Act of 1920. The Act is also out of context in that it was meant to facilitate borrowing for agricultural farmers in a different time epoch. It does not address itself to the modern issues and concerns on chattel security. The registration system established under it is manual making it difficult to retrieve the records whenever it is necessary to establish the status of the security. Further, the law does not provide for innovative and emergent personal property securities that are currently operated informally in the country. These include factoring, invoice discounting, warehouse receipts and leasing. This in turn closes many borrowers from credit especially with the reforms in public procurement and purchasing where many small businesses are looking for lending to service the purchase orders.

On the other hand, the framework established under the Companies Act is equally outdated and in dire need of reforms. First and foremost, it establishes a different registration regime for personal property charges given by companies in that they have to be registered at the Companies Registry. It would have been better if all the companies' securities were registered in the same registry for ease of administration. Secondly, there is so much reliance in the current debenture system on the common law and decisions from courts in United Kingdom. The problem with this is that it creates uncertainty in the law in that the lenders cannot be too sure of the law before coming to the process. Further, too much burden is placed on the lender to ascertain whether or not the company is entitled to borrow for the purpose it is seeking and whether the required documentation is in place. In fact, this comes at the pain of the lender being unable to enforce his credit if the documentation is improper and the registration has not been properly undertaken.

As currently conceived, preparation and registration of debentures by companies cannot also be undertaken without the help of a lawyer even where the amount sought to be secured is minimal or the parties to the transaction are small borrowers. In turn, this has made debenture security a rather expensive borrowing activity and thus only the reserve of big companies who can afford the cost of credit.
Further, it has been established that some of the most effective personal property security vehicles such as factoring, hire purchase, leasing and warehouse receipts are still undertaken informally given that there is no formal legal framework providing for their operationalization. The problem with this state of affairs is that it makes these forms of security inaccessible in the mainstream lending institutions such as banks except where there is a special arrangement. Further, lack of a formal legal framework makes them rather expensive to administer and risky further making the cost of credit prohibitive especially for small businesses in the country.

In summary, there is no coherent and modern legal and institutional framework for personal property securities in Kenya. The problems facing the system include a weak and dispersed legal framework given that there are numerous statutes regulating the creation and perfection of collateral. The personal security laws also lack uniformity and result in a convoluted conveyance system and the stamp duty is expensive both in its direct cost and in the method of its collection. Further, there is a weak and dispersed registry system for registration of personal property securities in Kenya. The problem is that there are many registries, which are manual, inefficient, uncoordinated and inconclusive. This situation has been exacerbated by the practice of using the registries as tax collectors. Personal property securities in Kenya are also made untenable by weak and uncertain enforcement procedures. There have been numerous cases where the judicial system has been a major hindrance to lenders' ability to raise security. Lastly, there is limited and restricted scope of security instruments as provided in the law and, therefore, lenders have not been innovative in considering other forms of collateral. As a result, there has been a tendency to rely on traditional all-asset debenture and legal mortgages at the expense of less costly and more innovative financial products.

2.7 Conclusion

This chapter has discussed the current law, policy and institutional framework on personal property securities in Kenya. The next Chapter will entail a discussion of the best practices in regulation of personal property securities in key jurisdictions namely Australia, New Zealand and Canada. The aim is to distill the salient and relevant provisions of law in those jurisdictions in highlighting the basic minimums for effective regulation of personal property securities in enhancing access to credit for majority of the population.

CHAPTER THREE
INTERNATIONAL BEST PRACTICES ON REGULATION OF PERSONAL PROPERTY SECURITIES

3.1 Introduction

The discussion in this chapter will focus on best practices in regulation of personal property securities in key jurisdictions namely Australia, New Zealand and Canada. The aim is to distill the salient and relevant provisions of law in those jurisdictions in highlighting the basic minimum for effective regulation of personal property securities in enhancing access to credit for majority of the population.

The three jurisdictions, namely, Australia, New Zealand and Canada is because these are closer to Kenya given that they are part of the Commonwealth and they share a common colonial history with Kenya. The legal system in these countries is mainly common law just like the case in Kenya. Other relevant jurisdiction which would have served as case studies such as United States and United Kingdom have more complex regulatory frameworks which would be very expensive to replicate in Kenya.

3.1.1 Internationalization of Personal Property Securities Reforms

In the recent years, the reform of personal property securities laws has received significant interest internationally. The United Nations Commission on International Trade Law (UNCITRAL) has developed a legislative guide for a legal regime for security rights in goods. This guide draws mainly on the models used in the United States, Canada and New Zealand in the regulation of the PPS regime in each of these countries. Further, the Hague Conference on Private International Law (the Hague Conference) and the International Institute for the
Unification of Private Law (UNIDROIT) have also undertaken work in relation to securities interests.\(^{121}\)

At the national level, all the Canadian common law provinces have Personal Property Security Acts. Ontario was the first to enact a personal property securities Act (PPSA) in 1967 but it took nine years before bringing it into force. A Canadian uniform act was published in 1969, followed by Manitoba legislation in 1973, Saskatchewan legislation in 1979-80 with the other provinces following in the 1990s. These PPSAs have been subject to review and significant change by the Provincial Governments as the law has developed in this area. The Uniform Law Conference of Canada ("ULCC") has kept all the provincial PPSAs under review and has been responsible for several reform initiatives, as well as having various other proposals under consideration. The Law Commission of Canada currently has a reference to examine security interests arising under federal laws and there has been substantive interaction between federal law and the provincial PPSAs generating a number of recommendations which impact on the PPSAs.\(^{122}\)

In New Zealand, the Personal Properties Securities Act 1999 (NZ) was enacted in 1999 and came into effect in 2002 and established a single procedure for the registration of security interests in personal property, as well as a centralised electronic register. Indeed, these reforms in New Zealand have resulted in increased certainty and confidence to the parties in commercial transactions where personal property is used as a security interest and clarity where competing security interest is an issue.\(^{123}\)

The Australian Personal Property Securities Act (PPSA) was enacted in 2009 and commenced operation in May 2011. The Act replaced over 70 different state registers and unifies the principles pertaining to security over personal property. The Act borrows heavily from the New Zealand Law and the Canadian Personal Properties statutes.\(^{124}\) The process of reforming the personal property law in Australia began in the 1970s but received limited support at the time.

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124 Ibid.
This was by the 1971-72 Report of the Molomby Committee (an ad hoc committee of the Law Council of Australia (LCA)). The Victorian and Queensland Law Reform Commissions produced reports recommending law reform in 1992. The relevant industry and legal sectors showed little support for proposals for reform of the law on personal property in a 1993 interim report including a draft Bill by the Australian Law Reform Commission, and a 1995 discussion paper by the Commonwealth Attorney-General’s Department.125

However, a workshop convened at Bond University, and financed by the then Banking Law Association (BLA) and Australian Finance Conference in 2000 generated substantial support for reform and concluding that a new Bill was needed. Subsequently, the BLA convened a committee to draft the Bill — comprising representatives from the major banks and other financial service providers, consumer interests, relevant government departments, infrastructure agencies, and individual lawyers from legal practices and universities in Australia and New Zealand. This draft Bill, which came to be known as the Bond Bill is what culminated to the current Australian personal property securities Act albeit with significant reforms emanating from stakeholder contributions and negotiations.126

In August 2011, the Government of Papua New Guinea announced it is pursuing reforms to regulation of loans and other obligations that are secured by personal property. The Government has tabled a draft Personal Property Security Bill for comment. Other governments including the government of Pacific Islands such as Tonga have also followed suit and enacted a personal property securities Act.127

3.2 Regulation of Personal Property Securities in Canada

In Canada, six out of the ten provinces as well as the two territories have enacted Personal Property Security Acts. Before the enactment of the law, most provinces had legal frameworks and registry systems within which the traditional secured financing devices could function. The

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126 Ibid.
The principal deficiency of prior secured financing law in the common law provinces was that it embodied no systematic or conceptually consistent approach given that its concepts were variously drawn from the common law, equity and statutes. As a result, priority structures were an anomalous mixture of legal doctrine and statutory rules. The legal reforms, therefore, involved sweeping away established legal doctrine and replacing it with a single conceptual basis for all personal property secured transactions.

In effect, the drafters came up with new rules to regulate inter-partes rights and priority disputes in a way that embodies public policies and responds to the needs of those affected by the law. Given that the reforms of personal properties securities law in Canada was parallel to information technology revolution of the late 1970s and which has continued to the present, the creation of computer-based registry systems was an important aspect of the modernization of Canadian secured financing law. Indeed, circumstances in Canada have also led to rapid development and refinement of these systems to the point that they are currently the most advanced of their kind in the world.

Given that each Canadian provincial Personal Property Security Act is unique and different from the other, it is not easy to make accurate generalizations applicable across the board. However, it suffices to say that six of the existing Acts, namely, those of Alberta, British Columbia, Saskatchewan, Manitoba, New Brunswick and the Northwest Territories contain very similar features which are amenable to generalization. According to Gedye, Cuming and Wood, except for Ontario which was the first Canadian province to enact such legislation, the statutes in the other provinces are similar in all respects and for this reason they are termed 'uniform Canadian Acts'.

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119 Ibid.
The following are key features which are typical of the Canadian personal property securities law regime as deduced from the various Provincial Personal Property Security Acts.

3.2.1 Scope of the law

The Act applies to all transactions that have the effect of providing an *in rem* interest in personal property to secure an obligation. Further, the law applies to security interests in fixtures. As a result, it is possible to take and preserve a security interest in goods that are attached to land. In addition, the personal properties securities law gives explicit recognition to agreements providing for a security interest in all of a debtor's present and after-acquired personal property, or in all of a debtor's present and after-acquired personal property other than specified items or kinds of collateral.\(^{132}\)

3.2.2 Perfection and Enforcement of Securities

Protection against third party claims, also called perfection, is well catered for in the Canadian PPSA law. The Act provides for perfection by possession of tangible collateral. Further, it provides for perfection by registration of security interests in all types of collateral, including money and negotiable securities.\(^{133}\)

As for enforcement, the Act prescribes an elaborate code of rules regulating the procedures to be followed when enforcing a security interest. The courts are also given broad discretionary power to provide relief from compliance, give directions and issue orders affecting the rights of secured parties and debtors. This is balanced in that debtors are also given extensive rights of redemption and reinstatement in order to avoid the effect of acceleration clauses.\(^{134}\)

In case of non-compliance by the secured party, it does not result in an automatic loss of the right to a deficiency. It can, however, result in deemed damages and the shifting of the burden to the secured party to prove that the non-compliance did not result in the full realization of the value

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\(^{132}\) Section 3 (1), Personal Property Securities Act of 1993 (Saskatchewan)

\(^{133}\) See sections 19, 24(1), 25, Ibid.

\(^{134}\) Ibid., section 24.
of the collateral, or that it did not interfere with the debtor's right to redeem the collateral or to reinstate the security agreement.

Further, the Act provides that the parties may include in the security agreement the power to appoint a receiver or a receiver-manager in the event of default. Such a receiver has the power to take control of the business and, in the case of a receiver-manager, he is given the power to run the enterprise, or to liquidate it either as a "going concern" or on a piece-meal basis. Nevertheless, the law provides that all aspects of a receiver's activities be subject to scrutiny by the court. This oversight can be invoked in a summary manner by initiating court proceedings by the debtor or by other persons who have interests in the collateral.135

3.2.3 Registration Process of Personal Property Securities in Canada

In all of the Canadian personal property registries, the systems are computerized and registrations are effected at a single central registry within each province. In addition, most of the registries are accessible, both for registering financing statements and searching for registrations, through remote computer terminals. This means that there is remote access to the registries and thus no need for a physical search or registration. The following are the ground-breaking characteristics of Canadian Personal Property Security Registers.136

One characteristic of the Canadian PPS Registry is the ability to access it from remote locations. In other words, it is possible for to access the registries from a remotely connected computer regardless of its distance from the central registry, or in the office of a financial institution or any other business premises. Therefore, registrations and searches can and are effected by remote computer access from any place in the world where long distance telephone communication is available. The only requirement is that the users of the remote communication facilities must make prior arrangements for the payment of registration and search fees. The system also allows for week-end and after-hours computer access to the registry to enable searches. It is also

135 Ibid.
136 Supra, note 3.
possible to undertake registration and searches by way of telephone or facsimile thereby further increasing registry accessibility.137

3.2.4 Registration of Financing Statements

All acts provide for the registration of "financing statements." A financing statement is not a security agreement but a statutorily prescribed form. In the case of electronic registration, it is basically a prescribed computer screen on which basic information regarding the relationship between a secured party and a debtor is recorded and then entered into the database of the registry. The financial statement contains the name and address of the secured party and the debtor, as well as a description of the collateral. However, it does not contain the terms of the security agreement or the signature of the debtor.138

A financing statement may be registered before a security agreement is executed, and it may relate to any number of separate security agreements between the parties. A financing statement is not signed by the debtor; however, the Act contains an elaborate system which protects against unauthorized registrations or the over-description of collateral.139

One unique feature of the Canadian PPS registration regime is the elimination of the need for statutory limits on the duration of registrations. Because paper records are replaced by the electronic storage of financing statements, there is little need to periodically cleanse the system. Accordingly, a registering party may choose a period of registration anywhere from 1 to 25 years. Or, a registering party may select "infinity registration."140

However, the ability to select a long registration period and to register a financing statement without the debtor's signature and before a security agreement exists, provides opportunities for abuse hence the need for control. For example, a registering party could effect or maintain a registration when there is no justification for doing so. Hence, all of the Canadian Acts contain a system designed to address these potential abuses. It also deals with situations in which the

137 Ibid.
138 Section 43(1), Personal Property Security Act 1993 (New Brunswick).
139 Ibid., Section 44(1).
140 Ibid.
secured party may have over-described the collateral. The secured party is required to give the
debtor a copy of the financing statement or a copy of the verification statement issued by the
registry upon an electronic registration of the financing statement. In that case, the debtor may
demand that the secured party amend or discharge the registration, as is appropriate under the
circumstances, within 15 days from the date the demand is delivered. If the secured party fails to
respond to the demand, upon proof to the registrar that the demand was delivered, the demanding
party may register a financing change statement amending or discharging the registration as the
case may be. If a secured party has a right to have the registration maintained, he or she must
apply to the court for an order maintaining the registration.\textsuperscript{141}

3.2.5 Verification and Discharges

When a registration is effected, the computer automatically prints out a verification statement
containing the information that has been entered into the data base relating to that registration.
This statement is immediately sent to the registering party. A verification statement has two
principal functions. First, it provides a fail-safe measure by permitting a registering party to
verify the accuracy of the information contained in the registry data base relating to his or her
registration. In this way, errors on the part of the registering party can be immediately identified
and corrected. Second, a verification statement encourages the early discharge of unnecessary
registrations. The statement includes, on the second page, a discharge verification form
containing the registered information. Should a secured party wish to discharge a registration, he
or she simply sends the discharge verification form to the registry where it is processed at no
charge.\textsuperscript{142}

The law makes allowance for reinstatement of inadvertent and fraudulent discharges or lapsed
registrations. This has to be done within 30 days of discharge or lapse and the same occurs
without loss of priority status \textit{vis-à-vis} anyone other than the holder of an intervening interest.\textsuperscript{143}

3.2.6 Errors in Registered Information

\textsuperscript{141} Ibid., section 43(1).
\textsuperscript{142} Ibid., section 43.
\textsuperscript{143} Section 50, Personal Property Securities Act of 1993 (Saskatchewan).
The Acts provide that the validity of a registration is not affected by a defect, omission or error unless that defect, omission or error causes the registration to be "seriously misleading." Clearly, strict compliance with registration requirements is not a pre-requisite to a valid registration. The test of validity contained in the Act is necessarily an objective one. Its application involves the determination of whether a reasonable person who obtains a search result using the debtor's correct name, or the correct serial number of the collateral, would be misled by an error on the part of the registering party in recording the debtor's name or the serial number of the collateral on the financing statement.\textsuperscript{144}

### 3.3 Regulation of Personal Property Securities in New Zealand

The Personal Property Securities Act (PPSA) of New Zealand was passed in 1999, and came into force on 1 May 2002. The Personal Property Securities Regulations and Register took effect at the same time. The preamble to the Act describes it thus:

> "An Act to reform the law relating to security interests in personal property and, in particular,—
> (a) to provide for the creation and enforceability of security interests in personal property; and
> (b) to provide for the determination of priority between security interests in the same personal property; and
> (c) to provide for the determination of priority between security interests and other types of interests in the same personal property; and
> (d) to provide for the enforcement of security interests in personal property other than consumer goods; and
> (e) to provide for the establishment of a register of security interests in personal property."\textsuperscript{145}

In brief, the Act deals with perfection of security interests over personal property, the resolution of competing security interests, the enforcement of security interests and the operation of the new personal property securities register. There are several exceptions defining the issues which are not regulated under the Act but the most important is security interests over land.\textsuperscript{146}

\textsuperscript{144} Ibid., section 44.
\textsuperscript{145} Preamble, Personal Property Securities Act, New Zealand.
\textsuperscript{146} Section 23, Ibid.
The PPSA repealed the *Chattels Transfer Act 1924* (NZ)\(^{147}\) which provided for a system of registering securities similar to that in Kenya. Under the Chattels Transfer Act security interests in personal goods such as crops, machinery, livestock and the like were required to be registered in the office of the High Court nearest to the location of the goods. The registration was effected by lodging a certified copy of the instrument. The system was therefore cumbersome and inefficient and the documents were invariably out of date. The Act also repealed the *Companies (Registration of Charges) Act*\(^{148}\) whose provisions were similar to those of the Kenyan law on debenture and charges against the company and *Motor Vehicle Securities Act*\(^{149}\) which was applicable where the security interest to be safeguarded related to a motor vehicle.\(^{150}\)

Before the enactment of the Act, each of the thirty separate High Court registries throughout New Zealand had to be searched to establish whether or not a property was free of encumbrances. As a result, the system was expensive and there could be delays between the granting of security and the appearance of the paper document in the registry. In brief, these complications were the driving force behind the introduction of the PPSA in New Zealand. Thus, one of the aims of the PPSA was to do away with the myriad of formalistic distinctions that existed under prior law and to treat in like manner all transactions that in economic substance utilized personal property as collateral for the performance of an obligation.\(^{151}\)

The PPSA has introduced fundamental changes to the prior legislation or the common law. The PPSA is modeled on Canadian legislation, which has operated successfully for over 30 years.\(^{152}\) Among the key changes implemented to the law by PPSA relating to security interests over personal property include:

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147 Chattels Transfer Act 1924
150 Section 13 of the Personal Property Securities Amendment Act 2001 (2001 No 23).
152 Ibid.
3.3.1 Definition of Security Interest

The key concept under the Act is 'security interest' which is central to the scheme of the legislation. The Act defines "security interest"\(^1\) as an interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation without regard to the form of the transaction and the identity of the person who has title to collateral. Under the Act, security interest includes an interest created or provided for by a transfer of an account receivable or chattel paper, a lease for a term of more than one year and a commercial consignment (whether or not the transfer, lease or consignment secures payment or performance of an obligation).

Further, the Act defines security interest as including a fixed charge, floating charge, chattel mortgage, conditional sale agreement (including an agreement to sell subject to retention of title), hire purchase agreement, pledge, security trust deed, trust receipt, consignment, lease, an assignment, or a flawed asset arrangement, that secures payment or performance of an obligation\(^2\). The definition of security interest catches not only traditional security arrangements such as mortgages and charges, but also other transactions which under prior law were often treated differently from traditional security devices. It is the case that the above definition of a security interest is deliberately wide-ranging and way beyond conventional concepts of property rights which are capable of transfer\(^3\).

The Act provides that all rights, duties, or obligations arising under a security agreement or Act be exercised or discharged in good faith and in accordance with reasonable standards of commercial practice. Further, the rights available to the debtor need not be the rights of ownership. A bare interest in possession as, for example, pursuant to a lease is sufficient to found the security interest. A security interest thus created exists irrespective of the vesting of title\(^4\).

3.3.2 Attachment of Security Interest

\(^1\) Section 17(1), Personal Property Securities Act, New Zealand.
\(^2\) Section 17(3), Personal Property Securities Act, New Zealand.
\(^3\) Supra, note 24.
In order to provide optimal protection for the holder of the interest, a security interest requires both attachment and registration or possession by the secured party. Under the New Zealand PPS Law, attachment is provided for under Part 4 of the Act. Three conditions are necessary for attachment to occur, namely, value must be given by the secured party, the debtor must have rights in the collateral and the security agreement has to be enforceable against third parties.\textsuperscript{157}

The Act provides the circumstances under which the security interest will be enforceable as being where the collateral is in the possession of the secured party or the debtor has signed an agreement that contains an adequate description of the collateral or a statement that a security interest is taken in all of the debtor’s present and after acquired property.\textsuperscript{158}

3.5.3 Personal Property Registration in New Zealand

The Personal Property Securities Register became operational on 1 May 2002. It replaced four separate registries: the motor vehicle securities register, the chattels register at the High Court, and the registers of company charges and industrial and provident society charges at the Companies Office. Security interests over almost all types of personal property, other than land and ships, can now be registered in one place. The main advantages of the PPSR is that not only does it provide for a unified registration system for all personal property securities in New Zealand, it is an Internet-based register and hence is accessible and searchable 24 hours a day, seven days a week and registrations can be completed almost instantaneously.\textsuperscript{159}

The new law resembles in some respects the priority regime found in the \textit{Land Transfer Act 1952} (NZ).\textsuperscript{160} However, unlike the Torrens system contained in the Land Transfer Act, the PPSA does not create a title-based system. Only security interests are recorded in the Personal Property Securities Register. The Register does not identify the owner of any particular item of personal property and does not provide indefeasibility of title.\textsuperscript{161}

\textsuperscript{157} Section 40, Personal Property Securities Act, New Zealand.
\textsuperscript{158} \textit{Ibid.}, Section 36.
\textsuperscript{160} Land Transfer Act 1952 (1952, No. 52).
The new registration system simply provides a warning that a debtor has granted a security in a particular item or type of collateral. Only brief particulars are registered by the secured creditor, and are revealed by a search of the register. If a searching party legitimately requires more information, the Act provides a mechanism by which this can be obtained from the secured party.\textsuperscript{162}

Some of the most important features of the personal property securities registration system include the fact that it is internet-based and easily accessible at any time of the night or day. Secondly, registration can be carried out by creditors at the time a decision is made to grant accommodation and before funds are advanced. Thirdly, with some minor exceptions, the system is universal in its application. If the security is not available for searching on the register, it does not exist and may be disregarded. Fourthly, the registration is implemented using only relatively simple documents. The notice of security interest is relatively simple and the law allows debtors to require amendment or removal by the creditor and this process can be overseen by the Court.\textsuperscript{163}

3.3.4 Perfection of Security Interest in New Zealand

The last building block in the process is the perfection of the attached security interest. A security interest is perfected when the interest has attached and a financing statement has been registered or the secured party has possession of the collateral (other than by seizure or repossession).\textsuperscript{164}

Thus, under the New Zealand law, a security interest is not perfected until attachment and either registration of the financing statement or possession. It is only when this state of attachment is achieved the security interest is perfected.\textsuperscript{165}

\textsuperscript{162} Ibid.
\textsuperscript{163} Ibid., p. 24.
\textsuperscript{164} Section 41, Personal Property Securities Act, New Zealand.
\textsuperscript{165} Ibid.
3.3.5 Priority of Security Interest in New Zealand

PPSA provides for a common set of rules for establishing priority of security interests in personal property. In this regard, the PPSA makes very clear the proposition that a perfected security interest has priority over an unperfected security interest in the same collateral where no other means of determining priority is established under the legislation.\(^{166}\)

In the case of a conflict between perfected priority interests, this is resolved by reference to time of registration rather than time of perfection. Priority between unperfected priority interests is determined by the order of attachment of the security interest.\(^{167}\)

3.3.6 Purchase Money Security Interests (PMSIs)

A purchase money security interest can achieve a super priority which enables it to slip in ahead of an already perfected security interest in the same collateral. A secured creditor who has provided credit through which the debtor acquires the collateral in which the secured creditor has an interest, achieves super priority, provided the security interest is registered within 10 working days of the debtor acquiring possession of the collateral.\(^{168}\)

3.3.7 Transitional Clauses

The personal properties securities system was introduced seamlessly mainly because of clear transitional provisions of the PPSA. In this regard, the law required preexisting securities under other registers to be transferred by creditors over to the new register within a relatively short lead in time, namely, within 60 days.\(^{169}\) In addition, the PPSA very specifically provides that, even where title to collateral is in the secured party, rather than the debtor, the application of the Act is not affected. This section emphasizes that the rights that a debtor holds in respect of leased goods or goods acquired under a conditional sale agreement are rights for the purpose of this section.\(^{170}\)

\(^{166}\) Section 66, Personal Property Securities Act, New Zealand.
\(^{167}\) Ibid.
\(^{168}\) Section 72, Personal Property Securities Act, New Zealand.
\(^{169}\) Ibid., Section 199.
\(^{170}\) Ibid., section 36.
3.4 Regulation of Personal Property Securities in Australia

The Australian Personal Property Securities Act (PPSA) was enacted in 2009 and commenced operation in May 2011. It entailed a significant legislative development in Australia in that before the Act came into force, the various Australian states had different legal frameworks regulating personal property securities. The Federal Act replaced over 70 different state registers for various forms of chattel security and the like. In essence, the Act unifies the principles pertaining to security over personal property and also sets up an internet based mechanism for the registration and search of the applicable security interests.

The Act is modeled on similar legislation in place in New Zealand since 1999. It also borrows concepts from Canadian Personal Properties statutes. The Act is conceptually similar to the New Zealand Act and the two differ only in the sense that the Australian law is more detailed and complex. Thus, broadly, the definitions of security interests are the same and substance matters over form. In order to fall under the Act, the interests secured must secure payment or performance of an obligation. Secondly, the protected interests under the two regimes are essentially the same. With respect to PMSI, the law is the same except for the fact that Australians carve out security interests in collateral that the debtor intends to use for personal, domestic or household purposes unlike the case in New Zealand. In addition, in both regimes the creditor does not obtain possession of the collateral. Rather, there is a requirement for a written security agreement for it to be enforceable against third parties. Nevertheless, the Australian Act is a little less strict in that confirmation of the written terms can come from an act or omission, for example, the placing of further orders and need not itself be in writing. Additionally, the concept of attachment is also similar in both jurisdictions. With respect to perfection, both regimes require that it must be by possession or by registration on the PPSR. However, in Australia, perfection by “control” is also possible in relation to some financial assets.

3.4.1 Definition of Key Concepts under the Act


The key concepts in the Act are collateral, security interest and security agreement. The Act defines personal property as consisting of virtually all forms of property other than land and some statutory licences. In this sense, it includes goods and equipment of all kinds, inventory, intellectual property, currency, contractual rights, investment instruments such as shares, units and debt securities, livestock, crops and artwork. The foregoing list is not exhaustive. It when any such personal property becomes the subject of a security interest that it known as collateral.173

It is important to note that the nature of security interests has not been changed except, in some cases, for the names and labels. For example the categories of security such as the mortgage or charge are still in use. The concept of the floating charge is replaced by a security interest over "circulating assets." However, a circulating asset is wider in concept than a floating charge as it includes, for example, a conditional sales contract, for example a retention of title arrangement.174

A security interest is defined as an interest in personal property created under a transaction which secures a payment or the performance and obligation. Examples of security interests under the Act include fixed and/or floating charge, a chattel mortgage, a hire purchase agreement, the goods lease, a conditional sales contract, a pledge, and transfers of accounts or book debts.175

In addition, the Act expands the definition of security interest to include certain transactions which do not secure any property. These include commercial consignment, the assignment of an account or book debt, or the transfer of chattel paper and goods leases. The PPS Act does not, however, apply to liens, fixtures, set-offs, security over water licences, or transfers of debts where the transfers are for collection or as part of the sale of a business.176

Lastly, it is important for any security interest be in writing to be recognized under the Act. The document in which the security is reduced into writing is what is called security agreement. The Act provides that the security agreement may secure past, present and future money advanced.

173 Section 10, Personal Property Securities Act, Australia, Act No. 130 of 2009.
174 Ibid., section 11.
175 Ibid., section 12.
176 Ibid.
under it. The security agreement under the Act can also be made to apply to all of the existing property of a debtor, to property of a particular class and even to after-acquired property.\textsuperscript{177}

### 3.4.2 PMSIs

The Act creates a new sub-category of personal property called a Purchase Money Security Interest, or "PMSI". A PMSI comprises (i) a bailment or lease, (ii) a security interest to secure a purchase price and (iii) a commercial consignment or RoT arrangement. The PPS Act gives PMSIs priority over all other forms of security interests. This is basically in reflection of the existing law whereby a goods lease of identified chattels in the possession of a lessee will always confer the superior property rights on the named lessor, even in the presence of a floating charge over the lessee, or upon the insolvency of the lessee.\textsuperscript{178}

However, under the PPS regime, it is essential for the security holder to perfect its position by registering its PMSI in order to be certain of defeating third parties such as a liquidator. A perfected PMSI will always take priority over a prior registered security interest affecting all the assets including after-acquired assets of the grantor.\textsuperscript{179}

### 3.4.3 Attachment of Property under the Act

Under the Act, in order for a security interest to be valid against the grantor, it must attach to a given personal property. Attachment occurs through transfer of rights in personal property by one party to another as collateral to the secured party who gives value. It may also occur where the grantor does an act creating the security interests such as declaring a trust for the benefit of the secured party. It is also possible to create a security interest in future property by providing that attachment occurs on the relevant property at a future date when it is acquired.\textsuperscript{180}

\textsuperscript{177} Section 10, Personal Property Securities Act, Australia, Act No. 130 of 2009.
\textsuperscript{178} Ibid., section 14.
\textsuperscript{179} Ibid., section 62.
\textsuperscript{180} Ibid., section 41.
The essence of attachment as envisaged under the Act is that once it takes place, the security interest is enforceable against third parties. Further, it implies that either the secured party has possession or control of the collateral or a security agreement covers it.¹⁸¹

3.4.4 Perfection of Security Interest under the Act

In simple terms, perfection means that a security interest is enforceable against all others. Under the Act, perfection entails the party who is to possess or control the collateral to obtain registration for its security interest. Once that occurs, the secured party's rights are unchallengeable. Under the Act, perfection is achieved by registration of the security interest on the PPS register. This is achieved by means of the filing of a "financing statement". If a security interest is unperfected or the collateral is not otherwise in the possession or control of the security holder, it will lose (i) priority to perfected security interests (ii) title to most purchasers of the collateral and (iii) the whole of the security provider's interests on liquidation, bankruptcy or voluntary administration of the grantor.¹⁸²

3.4.5 Priorities of Securities under the Act

The principal priority rule under the Australian personal property law is that a perfected security interest defeats an unperfected security interest. In other words, a perfected security interest ranks in order or priority in time and the earlier of registration time the better. On the other hand, a perfected PMSI generally defeats a perfected but non-PMSI security interest. Lastly, a security interested perfected by control defeats a security interest perfected in some other way.¹⁸³ As a consequence, the effect of the well-known legal maxim nemo dat quod non habet, that is you cannot give what you don't have and certain other principles of law has been diminished by the Act.

The effect of the priority rules is that perfected security interests survive transfer by the grantor to another party. This is because the PPS Act allows them to be traced into other assets and proceeds. Contractual restrictions on assignments or accounts (debts) are overridden by the new

¹⁸¹ Section 41, Personal Property Securities Act, Australia, Act No. 130 of 2009.
¹⁸² Ibid., sections 21 and 22.
¹⁸³ Ibid., section 55.
laws. There are priority rules for particular situations, such as between competing PMSIs in particular collateral, and in the cases of co-mingling of assets, or where assets become attached to other property ("accession").

3.4.6 Registration of Personal Property Security in Australia

The PPS register in Australia as established under the Act is for enabling secured parties to given notice of actual or prospective security interests. The data that are recorded includes information about the secured parties, the grantors and the collateral. It is possible to register in advance of the provision of finance and also to effect registration where the assets are entirely offshore.

The register is national in scope and thus all the personal property securities entered in all the States in Australia are registered in the same database. Further, it is internet based and therefore online and accessible for search 24 hours a day 7 days a week. Further, its operations are real time and therefore registration of a security interest can be confirmed in minutes. In order to effect registration, security providers are required to file a "financing statement" which enables the Registrar to produce a "verification certificate" to substantiate successful registration of the security interest.

Once registered, the registration remains valid for 7 years in the case of property held by an individual and 25 years in the case of all other property. In case of defective registration, for instance through a misdescription of the collateral, the law affords the secured party up to five (5) business days after registration to cure the defect. Failure to do so renders such defective registration ineffective. Further, the law requires corporate grantors to register their security interest within 20 business days of its creation. If this requirement is not met, the security stands invalid in case a liquidator is appointed within the succeeding 6 months.

Finally, the law provides for elaborate transitional clauses to ensure seamless transfer from the old and state-based personal property securities registration system to the PPS system. In this

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184 Section 62, Personal Property Securities Act, Australia, Act No. 130 of 2009.
185 Ibid., section 147.
186 Ibid.
187 Ibid., section 160.
188 Ibid., section 164.
regard, most existing registered security interests such company charges are to be migrated onto the PPS register over a two year transition period. Where the security interests were not registered at the coming into force of the PPSA for example in the case of goods leases or ROT arrangements, the law provides that these be registered on the PPS register within the two year transition period if they are to preserve their rights.189

3.4.7 Extinguishment and Enforcement of Security Interests

Under the Australian PPS Act, there is no concept of extinguishment. In case of transfer of the secured property, the law provides that the transferee of collateral will take property in that collateral free of any security interests in certain circumstances.190 An example is where the goods were meant to be described by serial number but were not such as a motor vehicle. This is also the case where the personal property in question is all consumer property, or it is currencies. The property will also be deemed free of security interest where it is an investment instruments or if it’s a temporarily perfected security interests in proceeds and goods.

As regards enforcement of security interests, the PPS Act provides all rights, duties and obligations under the Act be exercised honestly and in a commercially reasonable manner, obtaining market value or the best price available. Where this is not the case, the law provides for remedies which supplement the security agreement and rights at general law, and co-exist with the consumer credit code. In addition, there are rules regarding notice periods, and seizure of particular types of collateral. The effect is that the eventual enforcement mechanism under the Act is such that the security provider is safeguarded in case he wishes to enforce the security and the grantor is guaranteed of fair dealing to avoid cases of abuse of security.191

3.5 Conclusion

The chapter has discussed the main provisions of the law on personal properties in Canada, New Zealand and Australia. One thing that came out from the discussion is that the laws in these three jurisdictions are related and they have embraced what has become the model of personal property securities law. Further, it emerged that the Canadian Law has been replicated in New

189 Section 306, Personal Property Securities Act, Australia, Act No. 130 of 2009.
190 Ibid., section 49.
191 Ibid., Sections 19 and 20.
Zealand which in turn influenced greatly the enactment and content of the law in Australia although the latter included some key improvements.

The discussion has also revealed some key similarities in the focus of these laws especially in the five key areas of personal property securities, namely, creation, registration, perfection, enforcement and priorities of securities. Indeed, some salient and common features emerge from a discussion of the framework from the three jurisdictions. First, there is a unified legal framework for personal securities which repeals the former law which was fragmented and disconnected. The registration system is also computerized and therefore capable of remote access for search and registration. Additionally, the law in all these jurisdictions is precise in aspects relating to creation, perfection, enforcement and priority.

The next Chapter will be a comparative study and analysis of legal, policy and institutional framework for personal property securities in Kenya with best practices in regulation of personal property securities in other jurisdictions as discussed in this chapter. In essence, the analysis will focus on establishing how Kenyan regulatory framework for personal property measures in comparison and whether or not it meets threshold of efficiency.
CHAPTER FOUR
COMPARATIVE ANALYSIS OF REGULATORY FRAMEWORK FOR PERSONAL PROPERTY SECURITIES IN KENYA AND INTERNATIONAL BEST PRACTICES

4.1 Introduction

The Chapter entails a comparative analysis of legal, policy and institutional framework for personal property securities in Kenya with best practices in regulation of personal property securities in other jurisdictions as discussed in Chapter Three. In essence, the analysis focuses on establishing how Kenyan regulatory framework for personal property measures in comparison and whether or not it meets the threshold of efficiency.

The Chapter critically analyses of the legal framework for personal security property in Kenya. In this regard, it highlights the main weaknesses and deficiencies in the law, policy and institutions in comparison with the framework in leading commonwealth jurisdictions, namely, Canada, New Zealand and Australia. The focus is on the five key aspects of personal property securities, how they feature in the best jurisdictions and the provision of the limitations of the Kenyan law thereon. These aspects are creation, registration, perfection, priority and enforcement of personal property securities in Kenya. The aim is to show that Kenya’s personal property securities regime falls short of the ideals for the collateral process. This chapter discusses the various constraints to the collateral process currently affecting Kenya.

4.2 General Criticism of the Kenyan Regulatory Framework for Personal Property Security

The law on personal property securities in Kenya at present is basically English 19th century law with very little local variations. The law is basically meaningless in Kenya in the 21st century, particularly for harnessing the value of many assets, private or commercial, for capital and commercial purposes. This owes to the historical orientation of the law in that both the Chattels Transfer Act and Companies Act (relevant provisions on debentures) were enacted at a time when use of freehold land as security dominated the political and economic system.192

However, a lot has changed as with time tangible movables became capable of performing similar functions in spite of their ability to move between jurisdictions. This was in response to the challenge and development in the credit economy and the quest for maximization of all available assets to secure credit. Indeed, even security over tangible movables has proved inadequate with time. This is because in today’s world much wealth is increasingly found in intangible assets such as accounts receivable and intellectual property rights. These types of properties can certainly not be ignored for the purpose of securing credit any more. Further, in today’s economy, cash money is soon becoming of little importance given that it is possible to transfer debits and credits nationally or internationally, electronically. The world today is not only based on a credit economy, but most transactions are now in digital form. The law cannot ignore these changes and must respond to them to make business possible.193

The main handicap of the current law and regulation of personal property securities in Kenya is generally that it is unsatisfactory in the modern credit and digital economy. This owes to the fact that at present the law on personal property securities in Kenya is spread over numerous legislations and also operates alongside complex common law and equitable principles. The result is that Kenya now has a personal property security system that operates in different ways at different levels. In other words, Kenya has personal property securities law and arrangements that vary according to the nature of the collateral, the nature of the security interest, and the legal personality of the grantor. For example, a different law operates where the grantor is a corporation from the one in cases where he is an individual. These artificial distinctions are widely regarded as immaterial to the substance of secured transactions. 194

In addition, the registration system for personal property securities is manual and multiple depending on the nature of the security and the nature of the grantor. There is proliferation of registers that has created duplication as well as gaps. For example, registration may be mandatory under one scheme and voluntary under another and, for other interests or there may be no specific register at all. The law also does not provide for emergent forms of personal

193 Ibid.

property rights such as IP rights, factoring, warehouse receipts and invoice discounting among others. These problems are spread across the spectrum of Kenyan personal property security law. They are discussed herein below.

4.3 Weak and Disorganized Legal framework for Personal Property Securities

Generally, the laws governing the creation, perfection, registration and enforcement of personal security interests should facilitate a timely and cost-effective collateralisation process. However, this is not the case in Kenya and the law presents numerous challenges to the creation, perfection and enforcement of personal property securities in the country. The key finding of this study is that personal property securities regime in Kenya compared to the leading jurisdictions is deficient and wanting in efficiency. In the first place, the law on personal securities in Kenya is still regulated by a legal framework which is variously drawn from the common law, equity and statutes. This anomalous mixture of legal doctrine and statutory rules makes enforceability of personal securities in Kenya difficult and risky venture.

The Kenyan personal property security system is derived from English law and shares English law's mistrust of the non-possessory security. Thus, much security over personal property is achieved by transactions such as hire-purchase which are not security transactions in form. Kenya does not yet have a comprehensive statutory regime of personal property security such as the personal property security legislation in the Canadian provinces, New Zealand and Australia which regulate transactions which giving security regardless of form.

In Kenya, in addition to the main legislation for personal property securities, namely, Chattel Transfer Act and Companies Act, there are more than other 10 Acts of Parliament which regulate diverse aspects of personal property securities at one given time or another. These include Law of Contract Act, Stamp Duty Act, Registration of Documents Act, Agriculture Act, Traffic Act, Banking Act, Arbitration Act, Limitation of Actions Act, Advocates

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195 Ibid.
196 Ibid.
197 Chapter 23, Laws of Kenya.
198 Chapter 480, Laws of Kenya.
200 Chapter 318, Laws of Kenya.
201 Chapter 403, Laws of Kenya.
Act, Notaries Public Act and Evidence Act. The problem with this multiplicity of laws is that it creates uncertainty in the law as to what requirements need to be met in perfecting the security and also complicates the process of enforcing the security in case of a default.

This was also the situation in the comparative jurisdictions discussed before the enactment of the single personal property securities law. For instance, Australia had more than 70 legislations regulating different aspects of personal property securities. In New Zealand, the need for the Personal Property Securities Act (PPSA) arose due to the fact that the existing law on personal property securities was heavily fragmented and inconsistent. The applicable law under the repealed regime in New Zealand, as is the case in Kenya, depended on who the debtor was, that is whether it is an individual borrower or corporate debtor, what the property was and what type of security interest was taken. With the enactment of the PPSA, these distinctions became irrelevant as the Act did away with the myriad of formalistic distinctions between personal property securities that existed under the prior law and treats all transactions that in economic substance utilize personal property as collateral for the performance of an obligation the same way.

In essence, Kenya does not have a dedicated legislation dealing with issues touching on personal property securities. The operative law, namely, the Chattel Transfer Act and Companies Act, do not address decisively issues relating to creation, perfection and enforcement of collateral owned or held by individuals. For instance, the law also does not reflect changes that have been ushered by the modern technology such as online registration and search and oversees an archaic and complicated registration system which requires the help of a professional to carry out.

The Chattels Transfer Act has also been criticised on the basis that it fails in the perfection, that is, registration and prioritization of securities created under it. This is because the law requires the registration of the security interest rather than the asset that is encumbered. In practice, this means that priority rights are not clear and enforcement is often difficult as the assets may never be found. In turn, it leaves borrowers the leeway to frustrate the enforcement process by hiding

\[204\] Chapter 22, Laws of Kenya.
\[205\] Chapter 16, Laws of Kenya.
\[206\] Chapter 17, Laws of Kenya.
\[207\] Chapter 80, Laws of Kenya.
\[208\] Personal Property Securities Amendment Act 2001 (2001 No 23).
\[209\] Ibid.

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or cannibalising the assets to the lender’s detriment. As a result, chattel mortgages are still considered risky due to the likelihood of registration of multiple and simultaneous chattels mortgages by pledging the same assets with a number of institutions. In any case, it is impossible for any prospective buyer to search the chattels mortgage registry by borrower or by asset.\footnote{Betty Maina, “Access to Finance In Kenya: Conditionalities and Cost of Borrowing for SMEs”, available at: http://www.esabmonetwork.org/fileadmin/esabmo_uploads/Kenya_-_Access_to_Finance_-_PPP.pdf (accessed on 20/09/2011).} The registration process is also cumbersome given that it has to be refreshed every five years.\footnote{Section 10, Chattels Transfer Act, Chapter 28, Laws of Kenya.}

In the new personal properties regimes in Canada, Australia and New Zealand, the risk of the debtor not having a clean title has been surmounted by providing for enforceability of security interests even where the rights available to the debtor are not be the rights of ownership. For instance, in Canada a bare interest in possession as, for example, pursuant to a lease is sufficient to found the security interest.\footnote{M. Gedye ‘What’s Yours is Mine: Attachment of Security Interests to Third Party Assets’ (2004) 10 New Zealand Business Law Quarterly 203.} In addition, the new law establishes a registration regime which enables the secured parties to given notice of actual or prospective security interests. Further, for example in Australia, the Personal Property Securities register is national in scope and thus all the personal property securities entered in all the States in Australia are registered in the same database and are searchable via internet.\footnote{Section 147, Personal Property Securities Act, Australia, Act No. 130 of 2009.}

Thus, in comparison, the regulatory frameworks for personal property securities in New Zealand, Canada and Australia enjoys the advantage that they are contained in unified law and the registration, search and priority system has been streamlined and made fool-proof.\footnote{M Gedye, ‘Reflections on some Practical Issues Which Have Arisen under New Zealand’s Personal Properties Securities Act and Some Lessons for Australia’ (2004) 15 Journal of Banking and Finance Law and Practice 20.} The Canadian PPS registration regime, for instance, eliminates the need for statutory limits on the duration of registrations. The system requires the registration of a financial statement which contains the name and address of the secured party and the debtor, as well as a detailed description of the collateral. It is also possible to remotely access the records for search in order...
to establish the status of the property in terms of encumbrances at short notice. This is also the case in the other jurisdictions which also have very clear provisions on priority of securities.

4.4 Limited Scope of Personal Property Securities in Kenya

The Chattels Transfer Act and the Companies Act provide for a limited number of personal property securities that may offered and registered in Kenya. For instance, the definition of instrument under the Chattel Transfers Act excludes “securities over, or leases of, fixtures except trade machinery, assignments for the benefit of the creditors, transfers of or agreements to transfer instruments by way of security, transfers or assignments of any ship or vessel or any share thereof and transfers of chattels in the ordinary course of business of any trade or calling. Documents relating to debentures and interest coupons issued by any government or local authority, bills of sale of chattels in any foreign parts, or at sea and bills of lading, warehouse-keepers’ certificates, warrants or orders for the delivery of chattels, entries in auctioneers’ books or any other document used in the ordinary course of business as proof of the possession or control of chattels are also not instruments as defined under the Act.” This locks many would be borrowers from accessing credit on strength of personal property securities which fall under the excluded instruments.

The Canadian, New Zealand and Australian Personal Property securities laws define security interest broadly such that it covers virtually all interest in personal property. The Australian Act defines personal property as consisting of all forms of property other than land and includes goods and equipment of all kinds, inventory, intellectual property, currency, contractual rights, investment instruments such as shares, units and debt securities, livestock, crops and artwork. The same is capable of being collateralised into a security interest. The definition of security interest under the Australian Act extends to transactions which do not secure any property such

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216 Section 2, Chattels Transfer Act.

217 Section 10, Personal Property Securities Act, Australia, Act No. 130 of 2009.
as commercial consignment, the assignment of an account or book debt, or the transfer of chattel paper and goods leases.²¹⁸

Similarly, the definition of security interest under the New Zealand law is deliberately wide-ranging and way beyond conventional concepts of property rights which are capable of transfer. It includes, inter alia, "hire purchase agreement, pledge, security trust deed, trust receipt, consignment, lease, an assignment, or a flawed asset arrangement, that secures payment or performance of an obligation."²¹⁹ The Canadian law simply declares that it applies "to all transactions that have the effect of providing an in rem interest in personal property" to secure an obligation.²²⁰ The Kenyan legal framework is therefore limited to the extent that it limits its application to some forms of security interests as against others as it bars some classes of borrowers from accessing credit using their personal property as collateral in those forms.

4.5 Weak Enforcement Mechanism of Personal Property Securities

In enforcing the personal property securities, as apparent from discussion of best practices above, it is important to have clear priority rules as to how the rights of different claims on the secured property rank. In addition, it is important to have in place enforcement mechanisms that allow for easy but transparent realization of the security by the secured creditor. This is directly related to the risk of default so that if the realization process is efficient, cost of credit will be cheaper given that costs of managing attendant risks will also be lower.²²¹ The inefficiency in realization and enforcement of securities on the one hand owes to weak provisions of the law on enforcement while on the other it is related to the state of the judicial process obtaining in the country. The Chattels Transfer Act and the Companies Act are deficient in that they do not stipulate clear modes of enforcing the personal property securities provided under them. Thus, priorities between competing securities are regulated largely by common law principles derived from English common law. The mechanisms are available to security holders to enforce their securities are different deferent depending on whether the grantor is an individual or a corporate body. There are diverse option and no clear stipulations when each is applicable as

²¹⁸ Ibid.
²¹⁹ Section 17(3), Personal Property Securities Act (New Zealand).
²²⁰ Section 3 (1), Personal Property Securities Act of 1993 (Saskatchewan).
against the other. For instance, the creditor may exercise the power to take possession of the property, power to appoint a receiver, power to foreclose, power to sell the secured property and power to wind up the corporate borrower. As a result of the uncertainty of the enforcement laws, the creditors have resorted to having the lending instruments unduly detailed and complex on enforcement terms even where the secured sum is minimal to escape the legal limitations.222

The right of the secured creditor to ‘self-enforce’ the security without the need for an order of a court or the consent of a regulatory authority is also not clear under the current legal framework. While a legal charge’s power of sale can be exercised without resort to court provided the conditions under the mortgage for its exercise have arisen, in most cases the need for a court order arises upon the charger’s refusal to give up possession of the property voluntarily. Similarly, although appointment of a receiver under a debenture creating a fixed and floating charge is a self-help remedy which can be resorted to without reference to the courts or any regulatory authority, the onus is on the lender to ensure that the debenture was validly given and that the power to appoint a receiver has validly arisen, failing which the lender and the purported receiver will be liable in damages to the borrower. This has given leeway to borrower and as a result in many cases borrowers in Kenya rise to challenge the exercise of the right to appoint a receiver.223

The PPS law in Canada, Australia and New Zealand articulates a clear framework for enforcement of personal property securities in their respective jurisdictions. For instance, the Canadian law prescribes an elaborate code of rules regulating the procedures to be followed when enforcing a security interest giving courts broad discretionary power to provide relief from compliance, give directions and issue orders affecting the rights of secured parties and debtors. Debtors are also given extensive rights of redemption and reinstatement in order to avoid the effect of acceleration clauses.224 The New Zealand Act allows for self-enforcement where the security interest is in the possession of the secured party.225 The Australian law requires that enforcement of security interests be exercised honestly and in a commercially reasonable

222 Supra, note 3.
223 Ibid.
224 Sections 25, Personal Property Securities Act of 1993 (Saskatchewan).
225 Section 36, Personal Property Securities Act (New Zealand).
manner, obtaining market value or the best price available. Further, the Act makes provisions for notice periods, and seizure of particular types of collateral.\textsuperscript{226} The effect is that the law in these three jurisdictions ensure that enforcement mechanism of personal property securities balances interests of the secured creditor in case he wishes to enforce the security against those of the grantor seeking to guard against abuse of security.

4.6 Weak Judicial Mechanism for Enforcing Personal Property Securities

As already noted, in most cases, the realization process will be contested by the borrower. If the realization is uncontested, the process is much easier because all the lender is required to do is to issue notice of the intended realization. The duration of the notice depends on the nature of the property and varies from two weeks to 3 months depending on the nature of the property and the agreement of the parties. On the other hand, if the matter becomes contentious, the recovery process is likely to be hampered and delayed by the costly and procedural judicial process. For instance, borrowers have the discretion to obtain an injunction to stall the repossession of their secured assets. The threshold for this is rather low and once the injunction is in place, it may take months and even years to set it aside.\textsuperscript{227}

The Judiciary has established the Commercial Division to handle securities matters and commercial disputes. In addition, the Civil Procedure Code\textsuperscript{228} was recently overhauled as part of the on-going judicial reforms efforts which are meant to enhance the efficiency of the court system in Kenya. However, the commercial courts have had limited impact in expediting security realisation process as the courts sit only in Nairobi and there is still a shortage of judges and judicial officers. The court system in Kenya is still characterised by backlog of cases which means that some cases take a minimum of three years or even more to be resolved. This is, further, complicated by the general perception of most lenders that the courts will not resolve in their favour or that by the time the dispute is resolved it may be too late for any meaningful recovery to take place and the assets may have been sold, lost or damaged.\textsuperscript{229}

\textsuperscript{226} Sections 19 and 20, Personal Property Securities Act, Australia, Act No. 130 of 2009.
\textsuperscript{227} Supra, note 3, p. 18.
\textsuperscript{228} Civil Procedure Code, 2010.
\textsuperscript{229} Ibid.
Further, even where it is provided for under the security agreement, alternative dispute resolution is not necessarily an efficient replacement for the court system in Kenya. Although in some other jurisdictions and in some cases arbitration is used to ease the process of enforcement of securities, the mechanism has limited use in Kenya. This is because the recovery process largely requires the use of the enforcement power of the state which is only obtainable through application in a court of law. Thus, even where the dispute is dealt under an arbitral process, the parties are forced to have recourse to the courts for recognition and enforcement of the award. Due to this limitation, most lenders prefer to have their right to realise not made subject to an arbitral process.  

4.7 Weak and Dispersed Registry System

There is no doubt registration is a key aspect of the security process given that it is what lenders use to notify the general public other lenders and future purchasers of the encumbered assets of the existence of an encumbrance. This helps in determining the priority of interest in the secured property in case of a conflict arising from multiple securities or subsequent purchase of the secured property.

The registration system for personal property securities in Kenya is weak and unsatisfactory for three main reasons. In the first place, the registration requirements under the current regulatory framework for personal property securities are piecemeal in their application. Secondly, most of these requirements overlap in ways that result in duplication of efforts on the part of registrants and searchers. Thirdly, most of the registration requirements are in many respects outdated. The registration system for securities is also characterised by many registries depending on the type of property and whether or not the borrower is an individual or a limited liability company.

The registration requirements are piecemeal in that at present the question of whether and what registration of a personal property security is required depends on a number of factors including the status of the debtor, the subject matter of the security interest and the form of security arrangement. For example, the Companies Act requires registration of charges including

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231 Supra, note 30.
mortgages over certain kinds of property but only where the debtor is a company. There is no corresponding requirement for registration in the case of a business debtor who is not incorporated. Given the fact that registration serves to secure the creditor, there is nothing in principle which justifies the requirement for registration only in the case of a particular class of a debtor.232

In other cases, whether registration is required under the current law depends on the form of security arrangement. Thus, a charge or a mortgage given by a company is registrable. However, other transactions, even though they serve the same purpose as security are not subject to the legislation and are not required to be registered. For example, title retention arrangements including conditional sales, hire purchase and finance lease do not require to be registered if used for security purposes by a corporation in Kenya. Similarly, although registration is required of a charge on a book debt, factoring arrangements are not currently registrable under the Chattels Transfer Act.233

Further, the existing requirements are characterised by overlaps which in many cases result in the need for multiple registration or multiple searches. Basically, two types of overlaps are exhibited under the current registration framework for personal property securities. In some cases, the same security is subject to more than one registration regime. In others, similar and corresponding legislations establish separate registers for similar security interests.234

The problem with overlap of registration is that they result in duplication of efforts and resources trying to meet registration requirements or searching to establish a clean title. It also foments conflict between the various registration regimes on which takes precedence. This may potentially yield litigation to establish the rights of the parties involved leading to increased costs and difficulties in enforcing personal property securities. This can be resolved by having a single national securities registry or having the alternative registries computer-linked to ensure registration in one register reflects in all the other registries and there is ease of search.

In addition, in Kenya there are numerous registries for personal properties, another factor which has rendered the registration process inefficient. For example, there is multiplicity of registries,

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232 Supra, note 3.
233 Section 2, Chattels Transfer Act.
234 Supra, note 3.
including: the Companies Registry, the Ship Registry, the Aviation Registry, the Co-operative Societies Registry, the Registry of Societies, the Chattels Registry, the Registry of Business Names, the Motor Vehicle Registry, the Trade Marks Registry, and the Registry of Shares. Generally, Kenya’s registries are disparate and do not facilitate searches by asset or by debtor or lender. There is also no uniformity, synergy and symmetry of information among these registries or sharing information.\textsuperscript{235}

Additionally, the registries for personal property securities in Kenya are manual. As such, the registration process is completed by filling of physical files which are kept in specific locations. Similarly, changes to the files are made manually as new documents are added to the files. The system does not have an audit trail and it is marked by misplacement and loss of files and documents. It is also not possible for users to remotely access the registry or to file documents without physically attending the relevant registry at the correct location. Even where there has been attempt at automation, for instance at the Companies Registry, the automation process remains a mirror image of the physical system, including preparation of all documents manually and then scanning these into the system. While this is undoubtedly superior to having only a physical file, it does not simplify or re-engineer the procedures as needed. Changes to the procedures are complicated by the need of the registry to comply with public sector hiring, procurement guidelines and limited statutory reforms which constrain the scope for action.\textsuperscript{236}

Further, under the current system, it is not possible to obtain prompt and up-to-date information on the asset or the debtor through undertaking a personal or official search of the registry. On the one hand, there are numerous logistical challenges caused by the use of the manual system. In addition, there are numerous cases of missing records and files, mutilated documents, incomplete or incorrect information, incidents of fraud and document tampering, and weak monitoring of compliance rules and corruption of the registration officers all of which limit the integrity of the registration system.\textsuperscript{237}

In addition, the format of search in most cases results in incomplete information which is not of much use in risk management in the credit process. An example is official search in the

\textsuperscript{235} Supra, note 3.
\textsuperscript{236} Ibid.
Companies Registry. The resultant report usually lacks details such as the security interests created, if any, by the company. If one needs such information, he or she is required to undertake personal search which also involves taking the risk of assuming that the records are up to date. The result is that there is uncertainty that all registered encumbrances have been identified during a search.238

4.8 Weak and Compromised Priority rights

The main aim for registration of security is to ensure that it has priority over other securities on the same property in the event of default and eventual realisation. The problem in Kenya is that it is difficult to ascertain the status of registration of security as each registry is independent and the statutes establishing them are separate and distinct. Further, the rules and requirements at the registries also complicate the collateral procedure, as each registry has different registration and priority rules.239

In law, the priority of security interests depends on the date of registration or filing rather than the date when the instrument was entered.240 Thus, in case of failure to register or file, the right of the secured party may be overtaken because it implies that such a party has not given notice to the world of his security interest and his action has facilitated fraudulent activities. The problem is that the current legal framework for personal security registration provides for different deadlines for registration for different registries.241 For instance, the Companies Registry requires a security instrument to be registered within 42 days of its creation. On the other hand, the Chattels Registry requires registration of a chattel’s instrument within 21 days of execution. Further, the registration of a chattels mortgage expires after every five years, which is not the case for securities registered under the Companies Act. These variances in registration requirements become important when, for example, a company creates a charge or a mortgage over a property. In such a case, the law requires that the charge or mortgage created by the company to be registered both at the Land Registry and the Companies Registry to ensure priority rights. Thus, if the lender undertakes registration in one of the registries but delays in

238 Ibid.
239 Supra, note 3.
240 Section 4-5, Chattels Transfer Act.
effecting registration in the other registry, conflicts and uncertainty arise as to the priority rights of the interest created.²⁴²

These inconsistencies in rules of registration in various registries also complicate and confuse the application of priority rules between the various registries. For instance, a request for an official search from the Land Registry creates a window of 14 days during which an instrument can be registered in priority to any other instrument. However, there is no such rule at the Companies Registry. Further, a charge or mortgage by a company, even if registered at the Land Registry, would be void against a liquidator if not registered at the Companies Registry within the statutory period of 42 days. However, a lender who has delayed registering an instrument at the Companies Registry within the required 42 days can apply to the High Court for an extension of the period for registration if the delay is caused by reasons set out in the Companies Act. Further, the law requires that company annual reports be up to date prior to registration of the security. This further weakens lenders security rights by pegging their priority rights to a procedure to which they are not parties and over which they have no control.²⁴³

The foregoing is unlike the case under the legal framework in Australia and New Zealand where the land establishes clear priority rules which are supported by a unified PPS registry system. In the case of Australia, the priority rules are such that a perfected security interests survives transfer by the grantor to another party given that the Act allows them to be traced into other assets and proceeds.²⁴⁴ In New Zealand, the law provides that priority conflicts with respect to perfected security interests are resolved by reference to time of registration rather than time of perfection. If priority issues arise between unperfected security interests, the law provides for determination following the order of attachment of the security interest.²⁴⁵

The problem with the current personal property securities priority rules in Kenya is that transactions are regulated according to their forms rather than substance. Thus, parties are made to conform to rules that are not based on any policy or commercial convenience. Further, the

²⁴² Supra, note 50.
²⁴³ Supra, note 3.
²⁴⁴ Section 55, Personal Property Securities Act, Australia, Act No. 130 of 2009.
²⁴⁵ Section 66, Personal Property Securities Act, New Zealand.
rules are conflicting in some respects especially where registration is required under two different regimes.

4.9 Restrictions on Freedom to Contract

The law of securities in Kenya is limited in that it lays too much reliance on professionals to facilitate transactions. This is mainly the case because the law requires registration of far too much detail making it difficult for lay people to prepare the documents without professional input. Secondly, due to weaknesses in the enforcement, registration and priority rules as already highlighted, many creditors insist on using professionals as a risk management measure. In most case, the security instruments are far too complicated and each lending institution has its own version and the borrower is required to hire a lawyer to prepare and perfect the instrument from a pre-selected panel of lawyers.

In other instances, the law renders some security transactions invalid if professional assistance is not sought in preparing the documents. This is the case even where it is the choice of the parties and where such professional assistance is not needed to protect either party to the transaction. For instance, the law limits the right to as to who can prepare documents relating to securities.246

In this regard, section 34(1) of the Advocates Act of Kenya provides that no unqualified person shall, either directly or indirectly, take instructions, draw up or prepare any document or instrument relating to, inter alia, the conveyancing of property.247

In other words, where a security for any property is prepared by an unqualified person or a non-lawyer, the same is considered invalid. This is also the case where a person is a qualified advocate but does not have a valid practicing certificate at the time of preparing the document. As a result, the cost of preparing securities documents is generally high because most lending institutions insist on borrowers hiring their legal representatives from a list of prequalified law firms who charge standard fees even for simple documents which could be prepared by non-lawyers or be set out in standard forms by the respective institutions.248

247 Section 34(1), Advocates Act.
248 Ibid.
description of the collateral and need not contain the terms of the security agreement or the
signature of the debtor.\textsuperscript{251}

4.10 No Clear Provisions for Conflict of laws

The current law does not address the eventuality of conflict of laws where a security is related to
two or more jurisdictions. Generally, conflict of laws issues may arise when the parties to the
security transaction and the relevant personal property are not all located in Kenya. These rules
are especially important in this age of information technology where most financial transactions
are carried out electronically and from remote location. Conflict of laws are also critical given
that Kenyans in the diaspora are increasingly becoming an important category of borrowers in
Kenya especially those seeking to undertake projects back home and who still have personal
property lying idle here.\textsuperscript{252}

The New Zealand legislation, for instance, establishes conflict of law rules that apply when an
aspect of the transaction is not within their jurisdiction. In New Zealand, for non-possessory
security interests in a personal property, the law (including the conflict of laws rules) of the
jurisdiction where the debtor is located when the security interest attaches governs the validity,
perfection, and effect of perfection or non-perfection of a security interest in personal property
security. The law of New Zealand will govern a possessory security interest if the personal
property is situated in New Zealand or the security agreement specifies the law of New Zealand
as the relevant law.\textsuperscript{253}

In the Kenyan case, the securities law makes no provisions on conflict of laws. Thus, recourse is
had to the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary
(also called The Hague Convention).\textsuperscript{254} This is the international model law which establishes a
framework for determining conflict of laws questions that may arise in the course of transactions
involving securities entitlements. It is, therefore, important to reform the personal property
securities legislation to ensure there are conflict of laws rules based on registration supplemented

\textsuperscript{251} Section 43, Personal Property Security Act 1993 (New Brunswick), Section 41, PPS Act (New Zealand), and
Section 10, PPS Act (Australia).
\textsuperscript{252} Supra, note 3.
\textsuperscript{253} Sections 26 and 30(c), Personal Property Securities Act, New Zealand.
by conflict of law rule adopted by the Hague Convention in similar lines as the New Zealand law. 255

4.11 Restricted scope of Innovation in Personal Properties Security

The law on personal securities in Kenya currently limits the scope of lenders in innovating lending and security solution that are suitable for different classes of borrowers. This is due to the limited scope of the securities law and lack of clarity on the status of non-traditional forms of securities such as factoring, hire purchase, warehouse receipts and invoice discounting. As a result, lenders have generally been reluctant to take these forms of credit although they are widely used in other jurisdiction. Instead, there has been a drift towards relying on traditional form of security, namely, all-asset debenture and legal mortgages, which are expensive and only available to a limited group of borrowers. 256

In effect, this serves to lock out use of less costly and more innovative financial products which would significantly help in lowering cost of credit and therefore help make credit affordable and available to majority of the population and, in particular, to the SME sector. Indeed, this limitation in available collateral mechanisms has resulted in flawed collateral process which has, in turn, affected the demand for finance as an increasing number of borrowers have difficulties meeting the collateral requirements. The process also negatively affects lenders as they have to compete vigorously for the small crop of borrowers who meet the stringent criteria for collateral. Lenders also have to contend with the costly realisation process. All these problems add risk to the business of lending and borrowing. 257

In addition, the personal properties law in the three jurisdictions, namely, Canada, New Zealand and Australia creates a new sub-category of personal property called a Purchase Money Security Interest, or "PMSI" which enjoys superior priority status compared to the ordinary securities. PMSIs comprise (i) a bailment or lease, (ii) a security interest to secure a purchase price and (iii) a commercial consignment and enjoy priority over all other forms of security

257 Ibid.
interests. Further, the new law in these jurisdictions make clear provisions on attachment and perfection of securities. These aspects are not clearly catered for under the personal property securities law in Kenya.

In addition, the legal status of alternative personal property security products, such as hire purchase, leasing, factoring and warehouse receipts which have proved to be very successful in other parts of the world, is not clear in Kenya. The law either imposes legal difficulties or creates tough tax consequences against their use as is the case with hire purchase or addresses them partially or not at all. For instance, the current Hire Purchase Act places legal pitfalls which act to discourage use of hire purchase as a security and in particular the tax implications of acquiring assets under it.

The development of leasing as a personal property security product is also inhibited by fact that there is no specific legislation on the same which puts lessors at a disadvantage as the courts may use hire purchase provisions to determine how leasing should operate. The same case applies to invoice discounting whose group especially at the wholesale scale has been inhibited by absence of adequate legal structure in Kenya. Lastly, lack of an appropriate legal environment is also the main constraint to the growth, creation and acceptance of warehouse receipts in Kenya. These alternative security products are thriving in Canada, Australia and New Zealand because of viable the legal system which recognizes them as secure collateral.

4.12 The Current Regime does not cater for Securitization of IP Rights
An example of the restricted scope of security instrument is the fact that Kenyan law does not cater for securitization of intellectual property rights as a form of personal property. This is despite the fact that in today’s economy, tangible property is becoming less important than an intangible property which is very often a company’s most important, if not the only, valuable asset. Thus, now it is common for a debtor to want to offer intellectual property rights, namely, copyright, trade market, plant breeders’ rights, patents as collateral. The World Intellectual

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258 Sections 21 and 22, PPS Act (Australia).
259 Supra, note 3.
Property Organisation (‘WIPO’) in 2000 described IP securitisation as the ‘new trend.’ This has seen IP securitisation becoming more generally accepted by the financial markets.\textsuperscript{260}

Indeed, the UNCITRAL Legislative Guide on Secured Transactions (the ‘Guide’)\textsuperscript{261} emphasises the importance of IP rights in secured transactions, including the rights of a licensee under an IP licence agreement, to promote low-cost secured credit. The Guide recommends a legal regime which provides for a system where the debtor remains in possession of the secured rights in order to allow him to continue the business combined with an efficient publicity system.\textsuperscript{262}

The securitization of IP rights would allow a company in distress to look to its IP portfolio to create additional value and obtain cash at short notice. Further, such credit facilities secured by IP rights would allow secured creditors to access the IP portfolios of their debtors as another source of payment in case a default occurs. As in these circumstances, the risk of non-payment for the secured creditor is decreased; the availability of credit for a company in distress increases and the cost borrowing is reduced.\textsuperscript{263}

However, compared to the traditional personal property securities, in particular, securitisation of receivables, the securitisation of IP rights is much more complex. A company considering securitisation of its IP rights must first assess whether its IP portfolio is suitable for securitisation and creates sufficient revenue. In particular, the following issues must be considered: the ownership of the IP rights, the enforceability of the IP rights, possible litigation and invalidity claims, the lifetime and the market of the IP rights, whether future IP rights, including improvements, should be included, the terms of the licence agreements and in particular the termination clauses, in case of insolvency and the flexibility to licence back the IP rights.

\textsuperscript{260} Prabudda Ganguli, “Securitization of IP Rights”, Presentation at the WIPO-Italy International Symposium on IPR and Competitiveness of SMEs in Textile and Clothing Caserta, Italy, November 30-December 1, 2005.


In Kenya, the use of IP rights as security is limited in that there is no law officially recognising them as personal property capable of attracting security interests. The IP laws in the country do not provide a clear right of securitization of IP rights. Similarly, the companies’ law and Chattels Transfer Act do not anticipate use of intangible property as security. As a result, the law limits access to credit for companies that have valuable IP rights to secure credit. At present, the law only applies to securitisation of receivables, including royalty interests under an IP licence agreement.

4.13 Dominance of All Asset Debenture

As a result of the numerous limitations of the personal property securities regime in Kenya, lenders in Kenya impose strict security requirements to ensure best protection against the risk of default by borrowers. Most lenders insist that companies enter into all asset debentures. The all asset fixed and floating debenture affords the lender much influence in relation to the debtor company and other creditors, over enforcement and reorganisation of the debtor company in event of default. Under such a debenture, the borrower commits to discharge all obligations and liabilities, whether actual, accruing or contingent, present and future, or owing or incurred to the holder of the security. Under the all asset debenture, the borrower places a security interest over any and all assets that the company may hold at present or in the future, including real estate, fixed assets, fixtures, cash, and anything else whether in the balance sheet or not such as goodwill, trademarks and patents among others.

The problem is that while this approach favours lenders, it disadvantages borrowers leaving them less protected. The all asset debenture also imposes undue cost to the economy in terms of less credit, reduced financial sector competition, and the winding down of productive enterprises. The enforcement of such a debenture in the case of default is the appointment of a “receiver and manager” who will oversee the winding down of the company in order to repay the lender, with complete loss of power by managers and directors.

\[\text{Supra, note 3.}\]
\[\text{Supra, note 19.}\]
\[\text{Ibid.}\]
Once an all asset debenture is given to a particular institution, the only way that a new institution can lend money to the company is with the authorisation of the original debenture holder. This ties the ability of the company to borrow in future after it has issued an all asset debenture to the institution’s willingness to share the encumbrance. However, while smaller financial institutions may be willing to share such a debenture with other lenders, this is not the case with larger lending institutions and this may end up limiting the ability of the company to borrow in future. Alternatively, it may result in incremental borrowing where in order to borrow afresh, the company management has to convince the new lender buy offer the secured credit from the older lender.

4.14 Restrictive Banking Prudential Regulations

Generally, the regulatory environment for banks and credit in Kenya is satisfactory in that it does not impose undue burdens on the system. For instance, the Banking Act does not expressly oblige institutions to lend against collateral except in the case of employees and other officers and associates. However, in most cases lending by banking institutions is impacted by the need to meet prudential guidelines which focus on risk classifications of assets. These are mainly geared towards risk-weighting of assets for capital adequacy purposes.267

Thus, even where the lender is not obliged to lend against security, in adherence to the prudential guidelines, it will seek to have security provided which is perfected in all respects. For instance, in order to meet prudential requirements lending financial institutions require that security provided to them be duly charged and registered, adequately insured and valued by a registered valuer. Further, and in addition to that, the lender requires that the security be perfected in all other areas specified in the letter of offer of the facility. In turn, this has the effect of increasing the cost of credit to the borrower in order to meet these perfection requirements. The costs of administering the credit also go up because some of these processes are renewable even where the borrower seeks to top up the credit facility.268

4.15 Does Kenya Have the Capacity to Undertake the PPS Reforms

267 Supra, note 3.
268 Ibid.
The reforms implemented in the case study countries require considerable resources to realise. Further, such reforms require concerted stakeholder mobilization to ensure the resulting laws are acceptable to the business community. Additionally, the process of implementation of the legal reforms after enacting them is rather costly given the need to digitise security records and to establish remote access locations in every county.

However, that is not to say Kenya cannot afford implementing the reforms. In any case, a developing economy such as New Zealand has successfully reformed its PPS system and is now reaping the benefits thereof. Indeed, Kenya can implement the PPS reforms as part of the ongoing E-governance initiative which enjoys very good donor support. Further, the PPS reforms could be implemented as part of GJLOS programme and thus tap into the resources allocated for reform of administration of justice. In any case, the streamlining of the process of enforcing PPSs is an integral part of reforming administration of justice.

Lastly, even though the reforms may be costly in the short-term, the payback from implementing them is worth the cost. Reforming PPS regulatory system will help improve the investment climate in Kenya. Further, such reforms will enhance access to credit especially by SMEs. This will have a ripple effect on the economy and help in promoting economic development in Kenya in the long-term.

4.16 Conclusion

This chapter has critically analysed the legal and policy framework for personal property securities in Kenya in comparison with the reformed framework in leading jurisdictions, namely, Canada, New Zealand and Australia. The key finding is that the Kenya regulatory regime for personal property securities is deficient and in effect limits the utility of this form of security in enhancing access to credit in the country. The key reasons behind the inefficiency of the law are numerous including the historical background given that the law was enacted in the early 1920s when the value of tangible property had not fully been realised and therefore is ill-suited to regulate the credit economy in today’s environment which has graduated to the use of intangible property as security.
Further, the analysis has shown that the personal property securities law is fragmented and contained numerous disparate laws, a fact which creates hurdles and legal uncertainties in the enforcement process. The registration process is inefficient in that it entails numerous and inconsistent registration regime and that is manual and incapable of remote access.

Additionally, the process of enforcing personal property securities in Kenya is limited by the administrative weaknesses of the court system in Kenya as well as outdated legal provisions which make legal proceedings for realization of security potentially contentious and capable of dragging on for years. This is worsened by the fact that the alternative dispute resolution mechanisms, and in particular arbitration, is limited as a mode of resolution of securities dispute, owing to the fact that it is a private mechanism and therefore lacking in the state enforcement power unless formal application is made to the court for recognition and enforcement of the final award.

The law is also deficient in that it provides for a restricted list of securities which are clearly provided for under it. This limits innovation of lenders in coming up with new credit solutions as there is no certainty that the law will provide the requisite protection to safeguard the lender’s interest. As a result, only mainstream borrowers, mainly those who have access to real property security or those who can afford all-asset debentures, mainly enjoy unfettered access to credit. This limited number of borrowers and limited number of creditors has made the credit market in Kenya less competitive and useful in contributing to economic development. The law also does not adequately cater for emerging securities trends such as securitization of IP rights. This limits access to credit and liquidation of idle company assets in form of intangible property such as IP which would go a long way in enhancing access to credit in the country. Further, the law does not clearly and adequately provide for other non-traditional forms of securities which research show to be versatile in helping SMEs access credit such as factoring, invoice discounting, warehouse receipts, hire purchase and leasing.
CHAPTER FIVE
CONCLUSION AND RECOMMENDATIONS

5.1 Introduction
This chapter entails conclusion of the study and recommendations. In the first place, the chapter will distil the key findings made in the various chapters in the study and relate them to the hypotheses and objectives of the study. The second part will be focused on making recommendations on the best policy and legal reform measures to heal the deficiencies afflicting Kenya’s personal property securities law. Further, the chapter will also recommend the best way forward in the light of the findings of the study.

5.2 Conclusions
The study achieved all its research objectives. The main objective of the study was to analyse the efficiency of the existing regulatory framework on personal securities in Kenya. This was achieved in Chapter Four of the Study reaching the finding that the regulatory framework is generally wanting in efficiency and therefore in need of reforms. Further, the study achieved its specific objectives. In this regard, Chapter two entailed a discussion of the existing regulatory framework on personal property securities and in particular on chattel mortgages in Kenya. Secondly, international best practices on personal property securities regulations were in reviewed and, in particular, the personal property securities regimes in Canada, Australia and New Zealand were analysed for comparative purposes. Finally, this chapter will make recommendations for reforms towards efficient personal property securities regulatory regime in Kenya.

The study has twin hypothesis which it set out to prove or disapprove. On the one hand, the study was based on the assumption that there is need for a more effective regulatory framework for personal property securities in Kenya. This hypothesis was answered in the positive in Chapter Four in the finding that the regulatory framework for personal property securities in Kenya is ineffective. The second hypothesis was that effective regulation of personal property securities in Kenya will help make credit accessible to more Kenyans. The discussion in Chapter Three and Four showed how effective regulatory framework for PPS in the case studies had streamlined credit access. Thus, this hypothesis was answered in the positive, namely that effective regulation of personal property securities in Kenya will enhance credit access in Kenya. Hence,
the proposals in this chapter are targeted to achieve an effective regulatory framework for PPS in Kenya and, therefore, enhance credit access in the country.

The following is a summary of the key discussion in each preceding chapters of the study.

Chapter One laid a background of the study by discussing introductory aspects of the study including statement of the problem, research objectives, research questions, hypothesis, research justification, literature review, theoretical framework, research methodology and chapter breakdown. The problem of the study was defined as exploring the legal deficiencies behind limitation of personal property securities and the need for a new legal and regulatory framework for personal property securities in Kenya. It also explored the need for personal property security register (PPSR) consolidating most of the current form of registration of chattel mortgages and registries for other forms of personal property security interests.

Chapter Two discussed the main forms of personal property securities used in Kenya and the legal, policy and institutional framework in place for regulation of the same. The relevant provisions of the various statutes dealing with personal property securities including Chattel Transfer Act were discussed. The key finding of the discussion in the chapter was that Kenya has no specific or unified law on personal property securities. The Chapter concluded that personal property securities in Kenya are regulated by outdated laws inherited from the colonial regime instituted by the British Colonial Government. Further, it became clear that the main law in this respect is found in the Chattels Transfer Act and the Companies Act. The Chattels Transfer Act deals with all issues touching on transfer of goods specifically for creating security over chattels (goods). On the other hand, Companies Act deals with issues touching on creating debentures and creating and registration of charges against companies as well as mortgaging of shares and company’s lien. It established that there is limited and restricted scope of security instruments as provided in the law and, therefore, lenders have not been innovative in considering other forms of collateral. As a result, there has been a tendency to rely on traditional all-asset debenture and legal mortgages at the expense of less costly and more innovative financial products.

In addition to these main forms of personal property securities, there are other forms of instruments and financial arrangements which are not strictly speaking securities such as factoring, hire purchase and warehouse receipts which either operate informally or are regulated by different legal framework other than Transfer Act and the Companies Act. The analysis
focused on the one hand on the legal frameworks for personal property securities under Chattels Transfer Act and Companies Act and then discussed the regulatory framework for the alternative and emerging forms of personal securities.

Chapter three discussed the best practices in regulation of personal property securities in Australia, New Zealand and Canada focusing on the salient and relevant provisions of law in those jurisdictions which enhance access to credit for the majority of the population. It revealed that the laws in these three jurisdictions are related and borrow from the Universal Commercial Code of United States. Further, the Canadian Law has been replicated in New Zealand which in turn influenced greatly the enactment and content of the law in Australia although the latter included some key improvements.

Further, the analysis revealed some key similarities in the focus of these laws especially in the five key areas of personal property securities, namely, creation, registration, perfection, enforcement and priorities of securities. It emerged that the three jurisdictions have a unified legal framework for personal securities which repeals the former law which was fragmented and disconnected. The registration system is also computerized and therefore capable of remote access for search and registration. Additionally, the law in all these jurisdictions is precise in aspects relating to creation, perfection, enforcement and priority. Further, the law in all the jurisdictions provides for clear guidelines on transition from the old regime to the present reformed framework of personal property securities.

Chapter Four entailed a comparative analysis of legal, policy and institutional framework for personal property securities in Kenya with best practices in regulation of personal property securities in Canada, New Zealand and Australia. The key finding from the analysis was that the personal property securities regime in Kenya in comparison with those leading jurisdictions was deficient and in need of urgent reforms. Further, it established that the law on personal property securities in place in Kenya at present is outdated, of little value and meaningless in Kenya in the 21st century for purposes of enhancing access to credit.

Chapter Four established that at present the law on personal property securities in Kenya is spread over numerous legislations and also operates alongside complex common law and equitable principles. This makes it difficult to enforce the law and creates uncertainty which inhibits commercial activity. The foregoing, combined with poor and inefficient court system
and limited utility of alternative dispute resolution mechanisms, demonstrated that the mechanism for enforcing and realising personal property securities in Kenya is unreliable. For instance, the registry system does not outline clear priority rules as to how the rights of different claims on the secured property rank. There is also no enforcement mechanism in place that allows for easy and transparent realization of the security by the secured creditor.

In addition, the registration system for personal property securities is manual and multiple depending on the nature of the security and the nature of the grantor. It emerged that this proliferation of registers had created duplication as well as gaps. It became apparent from the analysis that the law also does not provide for emergent forms of personal property such as factoring, licensing, warehouse receipts and hire purchase. The law of securities in Kenya also limits the freedom of parties to contract in that it makes it a requirement in some instances that professionals facilitate transactions and in some instances, it renders security transactions invalid if professional assistance is not sought in preparing the documents. The current law does not also address the eventuality of conflict of laws where a security is related to two or more jurisdictions. Lastly, it emerged from the analysis that the current securities laws in Kenya do not sufficiently cater for securitization of IP rights. This, in turn, has restricted the use of intangible personal property rights as securities in the country locking many potential borrowers from accessing credit.

5.3 Recommendations
The following recommendations are made for reforms needed to heal the deficiencies of the personal property securities law in Kenya:-

5.3.1 Enact a Personal Property Securities Law
The comparative jurisdictions analysed in the study are beneficiaries of recent legal reforms that were marked by unification of the law into one comprehensive framework. It is recommended that if Kenya is to achieve an effective regulatory framework for personal property securities, the current law should be overhauled. Secondly, the framework for company securities and chattel mortgage should be combined and regulated under one law. Further, the process of reviewing the law should, as far possible, incorporate the views and input of finance and SME industry stakeholders. It should also be broad in perspective to include the regulation of emergent and innovative forms of securities.
In addition to establishing a single personal properties security law, the legal regime there therein for corporate securities should take measures to widen the scope of the instruments available to corporate borrowers. Further, there is need to review the pending companies Bill to ensure it is based on modern legal jurisprudence, taking as reference company laws of various jurisdictions. In this regard, there is need to reform the law to give floating charges equal standing as against fixed charges given that the former presents a more flexible securities option. This is necessary to reform the current arrangement where floating charges are ranked as subordinate to the fixed charges with the preferential fixed charge creditors having priority in the event of liquidation and receivership. Given that Kenya is an agricultural economy and the agro-export sector is burgeoning, this elevation of the floating charge will open up the use of crops and other export products as collateral. This should be undertaken under the framework of reforming the Companies Act which is proposed.

5.3.2 Need for Single Computerised Registry for Personal Property Securities

As noted, there are numerous registries for personal property securities in Kenya. It is recommended that the new law establishes one registry where all personal property interests and encumbrances are to be registered. The registry should also be set up as an autonomous institution free from other government departments such as Companies Registry and Attorney General’s Office. Indeed, it is recommended that Kenya leverages the existence of the Office of Register General and thus create a modern office in the same lines as Personal Property Security Registry in Australia and New Zealand.

In terms of features, it is critical that the registry be computerised and capable of remote access. Further, the registry should be need to be freely accessible or searchable by anyone, preferably over the Internet. The registry should also reflect the status of securities that are searchable by debtor, asset, and lender. Rather than the full security agreements, only the necessary information about the security interest should be filed in the form of filing statement. The registration entry should, thus, include notice of its existence, with identification (names and addresses) of the parties, full description of the collateral asset(s) or floating charges (for identification purposes), value secured (entire asset or specific amount), date and time of filing. In this regard, it is important that the registration system limit physical visits to the register in
order to eliminate the risk of paper or file manipulation and, therefore, enhance security of information and data stored.

5.3.3 Enhancing Scope for Innovative Securities products

The current law for personal securities in Kenya leaves little or no room for innovation in the provision of securities products in Kenya. The scope of the law is limited to the traditional forms of securities and, as a result, there is a domination of all-assets securities in Kenya. It is important, therefore, to reform the law to ensure that it accommodates other alternative securities as discussed above including hire purchase, leasing, factoring and invoice discounting, warehouse receipts and use of IP rights as securities among others. This will, in turn, increase the number of borrowers who can access credit and also open the market for participation of more lenders thereby increasing competition in the credit and finance market in Kenya. The formal regulation of these innovative and alternative credit products will also lower their risk rating and thereby make them available to low-end borrowers.

In particular, legal reforms need to address the tax aspects of the alternative credit products to make them equal and commensurate with those offered in other parts of the world where they have succeeded. Further, there is need to resolve outstanding legal difficulties surrounding the products to ensure the law regulating them is clear and certain to ease enforcement and realisation of the security. In particular, the current Hire Purchase Act should be overhauled and the framework for it provided under the unified properties personal securities as outlined in the New Zealand Hire Purchase Act. With respect to the other forms of alternative securities products, the personal property securities law should adequately cater for in order to allow for the current informal practices to blossom into full pledged forms of credit available and accessible to the entire credit market. In this regard, it is important to ensure the relevant laws are reformed to accommodate securitization of IP rights and to guarantee smooth application of intangible rights as securities in Kenya.

5.3.4 Enhance Wide-Access Credit Information by Lenders

There is need for a legal framework establishing the mode and mechanisms for sharing credit information among lenders in Kenya and East African Community region. This is important so as to make it possible for negative information to be freely shared by lenders without limitations
that attend bank-customer relationships. While there is presently a framework in place to allow for information sharing, it is not wide enough in scope and it is fragmented in that every form of lender including buyers and micro-finances are regulated under a different framework. Further, the current credit information framework does not reflect realities that are prevalent in Kenya such as the informal nature of the economy which has meant that the majority of the adult information are yet to access loan from the mainstream financial institutions. Thus, the credit information system should be expanded to include other lending institutions including Savings and Credit Co-operatives (SACCOs). Further, the focus of credit information sharing should be generally making personal credit history of a borrower a key factor in determining credit worthiness. In this regard, sharing should include both positive and negative information through instructions and manuals. In addition, measures should be taken to promote capacity building to institutions providing and using credit information and educate the public about the efficacy of the new system and how it is in their interest for lenders to share their information both positive and negative.