

default by the 1st defendant, the plaintiff's suit is premature as against the 1st defendant since the loans were for a period of 48 months which period has not elapsed. The steps undertaken by the 2nd defendant were for recovery of an undisputed sum of shs. 457,360,192/= due from the 1st defendant as unpaid taxes. This was in reaction to the 1st defendant's filing of a petition for winding up, without disclosing the said liability. All assets of the 1st defendant were disposed of at a public auction conducted on 12th November, 2021 upon expiry of an interim injunction order on 14th July, 2021. The 1st defendant still owes shs. 1,213,081,786/= in unpaid tax.

c) The issues to be decided;

According to Order 37 rule 4 of *The Civil Procedure Rules*, any mortgagee, whether legal or equitable, may take out as of course an originating summons, returnable before a judge in chambers, for such relief of the nature or kind following as may be by the summons specified, and as the circumstances of the case may require; that is to say, sale, foreclosure, delivery of possession by the mortgagor, redemption, re-conveyance or delivery of possession by the Mortgagee.

Originating Summons (OS) is one of the two modes of commencing a civil suit. A suit is commenced by this mode where the dispute concerns matters of law, and there is unlikely to be any substantial dispute of fact. The affidavits are the pleadings for the case. The affidavit filed in support serves as the plaint, while the affidavit in reply serves as the written statement of defence. This procedure exists in the interests of efficiency and cost. It provides a simple, informal, expeditious and inexpensive method of obtaining a final judgment, where no oral evidence is required, and the proceedings can be determined by way of affidavit evidence. An originating summons is the appropriate procedure where the main point at issue is one of construction of a document or statute or is one of pure law. It is not appropriate where there is likely to be any substantial dispute of facts that the justice of the case would demand the settling of pleadings.

The plaintiff should set out in the originating summons a concise statement of the questions which the plaintiff seeks the court to decide or answer, or, a statement of the relief or remedy claimed (where appropriate). The originating summons should also contain sufficient particulars to identify

the cause of action in respect of which the plaintiff claims the relief or remedy. In the instant case, the issues raised for trial are as follows:

1. Whether the plaintiff is entitled to foreclosure and sale of the mortgaged assets.
2. Whether the plaintiff is entitled to take possession of the charged assets.
3. Whether the defendants should pay the costs of the suit.

d) Submissions of counsel for the plaintiff;

M/s Kiiza and Kwanza Advocates together with M/s Nambale, Nerima and Co. Advocates on behalf of the plaintiff submitted that the existence of the debentures and the register charges is not controverted. The default of the borrower is not controverted. The 2nd defendant relied on *The Tax Procedures Code Act*. The warrant of distress was issued by the Commissioner General. This is permitted by section 32. It does not override the right of a secured creditor. It appears that the borrower is insolvent and there is a need for creditors to line-up. Section 11 (2) of *The Insolvency Act* Creditors may realise any asset subject to a charge. The secured creditors had the right to realise the security and unsecured creditors line up. Even if URA could levy, the distress was illegal. Under section 32 (5) (a) of the Act, sale by public auction must be within ten days of the distress. Para 7 (g) of the affidavit in reply the warrant was issued on 25th May, 2021. The seizure was on 26th May, 2021. Para 7 (l) the date of sale is 20th November, 2021. The advertised date of sale was 15th June, 2021 as per annexure “G” Even the advertised time was beyond the time specified in the Act.

The sale was meant to pre-empt the decision of this court. URA was served on 11th November, 2021 and it became aware that the assets are the subject of registered charges. There was sale the following day without re-advertising. If it is true that the borrower is insolvent then the distress would be illegal under *The insolvency Act*. Section 97 (1) (c) of the Act. Distress is prohibited once there is commencement of liquidation. Section 93 (2) liquidation commences at the time of presentation of the petition for liquidation. The petition was filed on 21st April, 2021. They could not properly levy distress in respect of the assets of the debtor.

Some of the items have already been sold. Annexure “E” of the reply is the auction report and it has a schedule of the plant and machinery auctioned. The last page gives the total proceeds of item

sold as shs. 1,020,000,000/= The secured creditor is entitled to those proceeds. Para 5 of the affidavit is support the plaintiff was owed shs. 4,236. 031,316. The auction report in para 2 they said the highest bidder have not paid. The court issues an order to hand over the unsold items to the plaintiff as a secured creditor. Alternatively, if URA had the right the maximum recoverable is the sum of the distress warrant; shs.457,360,192/=

By the plaintiff seeking foreclosure and sale of a borrowers' property it is not a tax process under the tax legislation. Article 152 (3) provides for Tax Appeals Tribunals to handle tax disputes. Section 1 (1) (k) of *The Tax Appeal Tribunal Act*, a taxation decision means any assessment, determination, decision or notice. Section 1 (1) (l) defines a "taxing Act" to mean an act which imposes a tax. The warrant of distress is a method of recovery under *The Tax Procedures Act*. Section 14 of *The Appeals Tribunal Act* applies to persons aggrieved by a decision under a taxing Act. In the instant case the plaintiff is not objecting to the tax assessments as it is not a tax payer and the taxes being recovered were assessed under the VAT and Income Tax Act. *The Tax Procedures Code Act* is procedural and does not impose a tax.

Tax claims are not under the ambit of insolvency. Section 12 (6) URA is near the bottom. The provision supersede any other. Section 11 (2) secured creditors may realise the security. Section 93 (2) of *The Insolvency Act*, it commences on presentation of a petition. It did not matter that a liquidator is not appointed yet. The advert is dated 22nd September, 2021 and the auction was to take place on 5th October, 2021. The auction report indicated the action was on 12th November, 2021. The sale was intended to pre-empt the suit. That date is not supported by the dates on record. Notices of default is not the business of URA. The affidavit of the bank states that the borrower has defaulted and this has not been refuted by the borrower. URA has attached the borrower petition that it is unable to pay its debt and that is an event of default. Dissipation of the subject matter during the pendency of the suit may not extinguish the claim it only affects the process. URA claim is based on a warrant of distress stating a specific sum of money. They cannot levy distress in excess of the warrant. Secure creditors do not have to line up. The entire production plant was seized. I pray that the applications is allowed. I pray for the costs.

e) Submissions of counsel for the 1st defendant;

The petition seeks appointment of a liquidator. It was initially fixed for 12th July, 2021 and is now fixed for 21st February, 2022. Section 21 of *The Tax Procedures Code Act* provides that the Commissioner has to serve the tax payer with the assessment. The fresh assessment was made after the suit. It is not exclusively an issue of tax collection in as far as there is liquidation. It is about priority of debt. It would defeat the purpose of preserving all assets for the benefit of all creditors. The purpose is to avoid preferential payments.

f) Submissions of counsel for the 2nd defendant;

Paragraph 5 of the reply raises two points of law. Lack of jurisdiction. Section 14 of *The Tax Appeals Tribunal Act* refers to decisions made under any taxing Act, the aggrieved party should go to the appeals tribunal for any redress. Section 3 of *The Tax Procedures Code Act* defines a taxation decision as per the *Rabo Case*. The application is overtaken by events. The plaintiff seeks remedies to foreclose the charged assets. Annexure “E” to the affidavit in reply, the assets the plaintiff seeks to sell have already been sold. All have been sold. In *Environmental Action Network Ltd v. Joseph Eyau, C. A Civil Application No. 98 of 2015* it was held that no appeal lay because the subject matter of the intended appeal had been overtaken by events. Insolvency has begun and thus the plaintiff has no *locus standi*. It should be the liquidator. The 1st defendant filed a debtor’s petition declaring that they are unable to pay debt.

The plaintiff relied on section 32 (5) of *The Tax Procedures Code Act* to suggest that the warrant of distress lapses within ten days. It is intended to redeem the property. It did not rely on the advert of 2nd June, 2021 because on advertisement the 1st defendant obtained an interim order against the sale. This is annexure “B” on the affidavit in reply. It is not until 22nd September, 2021 that the 2nd respondent re-advertised. A copy is provided to the court.

Regarding the sale while there is a suit, there was no injunctive remedy. The plaintiff should have applied for an injunctive remedy before the sale which it never did. Section 97 of *The Insolvency Act* is titled “effect of liquidation.” There must be a liquidator. It presupposes that there is a

liquidator. Section 12 (6) of the Act subjects tax collection to liquidation, but only after the liquidator is appointed. There can never be recovery without default. Under the loan agreement there has to be demand in case of default. The plaintiff has not made one. Even when URA advertised there the plaintiff did not take action. Section 21 and 24 give the Commissioner General to make additional assessments. The last annexure is a notice of assessment and the Commissioner invoked powers under 21 and 23 and the moment it issued a tax is due and owing. Section 30 onwards of *The Tax Procedures Code Act* allows the Commissioner to collect any taxes.

g) The decision:

In all civil litigation, the burden of proof requires the plaintiff to prove to court on a balance of probabilities, the plaintiff's entitlement to the relief being sought. The plaintiff must prove each element of its claim or cause of action, in order to recover.

1st issue; whether the plaintiff is entitled to foreclosure and sale of the mortgaged assets;

Before dealing with the substantive issues, it is imperative to address the jurisdictional issue raised by counsel for the 2nd defendant as a preliminary point. This is because courts are powerless to act without jurisdiction over the subject matter, and any order or judgment issued by a court without such jurisdiction will be void and unenforceable. Unlike jurisdiction over the person, which may be waived, jurisdiction over the subject matter may not, and can be challenged at any time.

a. The jurisdiction of this court over the subject matter of the suit.

The requirement that a court should have subject-matter jurisdiction means that the court can only assume power over a claim which it is authorised to hear under the law. Any issues that come up in court that are outside of that court's subject matter jurisdiction have to be disregarded or dismissed because the court has no legal power to decide over them. By virtue of article 139 (1) of *The Constitution of the Republic of Uganda, 1995* and section 14 (1) of *The Judicature Act*, the High Court has unlimited original jurisdiction to try all suits of civil nature excepting suits of which its cognisance is expressly or impliedly barred by statute. It is contended by the 2nd

defendant that this court is not seized with original jurisdiction over the matter in so far as the 2nd defendant's actions were undertaken in execution of a taxing decision.

5 Subject-matter jurisdiction is the authority of a court to hear and determine cases of the general class to which the proceedings in question belong. Generally defined, the "subject-matter" of a suit is the thing in dispute, the matter in controversy between the parties, or the issue about which a right or obligation has been asserted or denied. The matter in controversy in the instant suit regards the proper ranking in priority between the right of foreclosure asserted by the plaintiff as mortgagee of the 1st defendant's business assets vis-à-vis the right of recovery of unpaid tax by
10 distress and sale of the movable property of a taxpayer claimed by the 2nd defendant, over the same assets. The question is whether or not that is a tax dispute.

Whereas in *Commissioner General of Uganda Revenue Authority v. Meera Investments Limited S.C. Civil Appeal No. 22 of 2007* it was decided that the High Court may exercise original
15 jurisdiction by way of residual powers only in the interpretation of conflicting provisions in tax legislation, in *Uganda Revenue Authority v. Rabbo Enterprises (U) Ltd and another S. C. Civil Appeal No. 12 of 2004* it was held that by virtue of section 27 of *The Tax Appeals Tribunal Act* the High Court has no original jurisdiction, but rather appellate jurisdiction only in tax disputes. The matter now before court, not being one that requires the interpretation of conflicting provisions in
20 tax legislation, the question then is whether or not it is a tax dispute in respect of which this Court does not have original jurisdiction. This requires a determination of whether or not this court is vested with subject matter jurisdiction.

A tax dispute is any contention or legal disagreement arising between the Uganda Revenue
25 authority and a tax payer or any other person, relating to an audit, request for information, investigation, examination, claim, appeal, review, proceeding, assessment or collection action, relating to taxes or any tax return in respect of which a liability to tax or relief from tax may arise. Whereas section 1 (k) of *The Tax Appeals Tribunal Act* defines a "taxation decision" as any assessment, determination, decision or notice, according to section 14 (1) of *The Tax Appeals
30 Tribunals Act*, any person who is aggrieved by a decision made under a taxing Act by the Uganda Revenue Authority may apply to the tribunal for a review of the decision. Section 1 (l) of that Act,

defines a “taxing Act” as any Act which imposes a tax. Therefore the tax disputes over which the Tax Appeals Tribunal has exclusive jurisdiction are those relating to any assessment, determination, decision or notice made under any Act which imposes a tax.

5 In the instant case, there is no dispute between the 1st and 2nd defendants relating to the assessments made and liability to tax determined under the relevant tax legislation. It so happens that the decision to recover unpaid tax by distress and sale of the 1st defendant’s movable property as a defaulting taxpayer was made subsequent to uncontested assessments, determinations, decisions or notices made under specified Acts imposing tax. It was specifically made under section 32 of
10 *The Tax Procedures Code Act, 14 of 2014*. By its long title, that Act provides a Code to regulate the procedures for the administration of specified tax laws in Uganda; to harmonise and consolidate the tax procedures under existing tax laws; and to provide for related matters. Its provisions are entirely procedural in nature, designed to guide processes in the administration of specified tax laws. None of its provisions imposes a tax. It therefore is not a “taxing Act.” It follows
15 that standing on their own without an underlying controversy arising out of action taken or omission under a taxing Act, decisions taken under *The Tax Procedures Code Act, 14 of 2014* are not taxation decisions for purposes of section 14 (1) of *The Tax Appeals Tribunals Act*.

The 2nd defendant’s decision to recover unpaid tax by distress and sale of the 1st defendant’s
20 moveable property was a procedural decision. There is no underlying contention or legal disagreement arising under any Act imposing a tax. Not arising from a taxation decision made under an Act which imposes a tax, the controversy at hand therefore is not within the category of disputes over which the Tax Appeals Tribunal has exclusive original jurisdiction. I therefore find that this court has original subject matter jurisdiction over the issues in controversy and the
25 preliminary objection is accordingly overruled.

b. The plaintiff’s claimed right of foreclosure.

A secured party may apply to court for an order to foreclose the right of a debtor to redeem the
30 collateral. Foreclosure is the legal process that allows lenders to recover the balance owed on a defaulted loan by taking ownership of and selling the mortgaged property as collateral. The equity

of redemption is a right given to the mortgagor over the mortgaged property, which includes the right to redeem the property on full repayment of the secured debt (see section 54 of *The Security Interest in Movable Property Act, 2019*). The mortgagor may redeem the mortgaged property on paying the full amount, including costs found due to the plaintiff. A final order of foreclosure usually puts an end to the equity of redemption and is valid against all defendants. Once obtained, the plaintiff obtains title to the property free and clear of the interests of the defendants and may therefore proceed to take possession or transfer the property to a purchaser.

Through a suit for foreclosure, the mortgagee becomes the owner of the mortgaged property and those interests subsequent to the mortgage in priority will lose their interest in the mortgaged property. Suits for foreclosure appeal to mortgagees where the value of the property at the time is not sufficient to repay the mortgage debt. If a mortgagee seeks to take possession of the mortgaged property, (because the property value exceeds the mortgage debt, or the estate market is depressed, and the value may increase over time) a suit for foreclosure may be more favourable. Court will order a foreclosure where it appears the value of the property is unlikely to satisfy the plaintiff's claim.

The plaintiff is the holder of a chattels mortgage and debenture charge dated 26th March, 2019, which incorporated a fixed charge over the 1st defendant's fixed assets and a floating charge over other assets. According to clause 3.1 (a) – (x) thereof the fixed charge registered on 28th March, 2019 covered the 1st defendant's "estates and other interests in freehold, leasehold and other immoveable property (including buildings , developments, fixtures, and fittings, improvements thereon) whosoever situate now or hereafter of the company...all stocks, share bonds, debentures, loan capital....the goodwill of the company and the uncalled capital of the company....all trade names, brand names registered and unregistered trade or service marks.....all motor vehicles, plant, machinery (whether or not fixed to immoveable property) tools and chattels now or at any time hereafter belonging to the company....all chattels now or at any time hereafter hired, leased or rented by the Company to any other person...the benefit of all licenses, consents and authorisations (statutory or otherwise) held in connection with the business of the Company.....entitlement...to the payment of any money....all present and future book debts.....title and interest in and to all present and future contracts....."

Clause 3.1 (b) of the same debenture deed comprises a first floating charge registered on 28th March, 2019 over all the 1st defendant's "undertaking, revenues, property right and assets (including without limitation, stock in trade) whatsoever and whosoever situated, both present and future as are not for the time being or from time to time, subject to an effective fixed charge in favour of the bank under sub-clause 3.1 (a) or the provisions of any deed or other instruments executed pursuant thereto."

The key feature of a floating charge is that, until it crystallises, the chargor is entitled to deal with the charged assets in the normal course of business without any further consent from the chargee (see *Robson v. Smith* [1895] Ch D 118 and *National Westminster Bank Plc v. Spectrum Plus Ltd* [2005] 2 All ER 1000). The central feature which distinguishes a floating charge from a fixed charge lies in the chargor's ability to control and manage the charged assets freely and without the chargee's consent. The essence of a floating charge is that it is a charge, not on any particular asset, but on a fluctuating body of assets which remain under the control of the chargor (see *Agnew and Kevin James Bearsley v. The Commissioner of Inland Revenue, and Official Assignee for the Estate In Bankruptcy of Bruce William Birtwhistle and Mark Leslie Birtwhistle* [2001] 2 AC 710; [2001] Lloyd's Rep Bank 251, [2001] 3 WLR 454). It "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" (see *Illingworth v. Houldsworth* [1904] AC 355 at 357).

Clause 3.4 (c) and (d) of the debenture deed provides that the floating charge created by sub-clause 3.1 (a) was to automatically and without notice be converted into a fixed charge in respect of the charged assets subject to the floating charge, if and when the company ceases to carry on business or to be a going concern, or upon the occurrence of a potential event of default and / or an event of default. Upon crystallisation of a floating charge, the floating charge attaches to all existing assets that are within the scope of the charge and becomes fixed.

The main consequence of crystallisation is that the chargor's authority to dispose of or to deal with those assets without the consent of the chargee comes to an end. It is accepted that crystallisation will occur automatically upon the winding up (or other business cessation event) or the

appointment of a receiver of the chargor (see *In Re Portbase Clothing Ltd; Mould v. Taylor* [1993] Ch 388). When a floating charge crystallises, it becomes a fixed charge attaching to all the assets of the company which fall within its terms. Thereafter the assets subject to the floating charge form a separate fund in which the debenture holder has a proprietary interest. For the purposes of paying off the secured debt, it is his fund. The company has only an equity of redemption (see *Buchler and another (as joint liquidators of Leyland DAF Limited) v. Talbot and another (as joint administrative receivers of Leyland DAF Limited) and Stichting Ofasec and others*, [2004] 2 WLR 582; [2004] AC 298).

In the instant case, the plaintiff's floating charge crystalized on 21st April, 2021 upon the 1st defendant's filing of a petition for winding up. According to clause 7.1 (c) of the debenture deed dated 26th March, 2019 a default would be deemed to have occurred upon the 1st defendant's passing of a resolution or filing a petition for the winding up of the company. Therefore not only did the filing of the petition for winding up crystallise the floating charge, but it also constituted an act of default on the part of the 1st defendant. It is trite that the mortgagee or charge may exercise his right of recourse against the security whenever he pleases after default (see *Governments Stock and other Securities Investment Company v. Manila Railway Company* [1897] A.C. 81).

When a floating charge crystallises, it becomes a fixed charge attaching to all the assets of the company which fall within its terms. Thereafter the assets subject to the floating charge form a separate fund in which the debenture holder has a proprietary interest. For the purposes of paying off the secured debt, it is his fund. The company has only an equity of redemption; the right to retransfer of the assets when the debt secured by the floating charge has been paid off. It is this equity of redemption which forms part of the fund held on trust for the company's creditors which arises upon a winding up. Section 44 (1) of *The Security Interest in Movable Property Act, 2019* provides that where a debtor defaults on the obligation to pay or where another event of default occurs, the security interest becomes enforceable.

Upon default, the chargee or mortgagee has the option of taking possession of the assets of the charger or mortgagor that form the subject of that security, until the default which was the cause of the entry into possession has been rectified through the possession of the mortgagee, or until

the mortgagee has exercised the power of sale (see section 47 (1) of *The Security Interest in Movable Property, Act 2019*). In a suit for foreclosure, following a final order of foreclosure, the mortgagor and subsequent encumbrancers are absolutely debarred and foreclosed of and from all right, title and equity of redemption of, in and to the mortgaged lands. This means that the mortgagors no longer have equity in the property which could support a claim to any right to request relief. An order of “foreclosure and sale” would thus be preferable for a defendant in situations where the value of the property exceeds the amount owing on the mortgage.

Slightly over one month following the 1st defendant’s filing of a petition for winding up on 21st April, 2021, before the plaintiff had taken any step towards the realisation of the security, the 2nd defendant on 25th May, 2021 issued a warrant of distress authorising the attachment and sale of the 1st defendant’s “goods, chattels, or other distrainable things [of the 1st defendant] wherever the same may be found, and all vessels, vehicles, animals and other articles used within Uganda in commercial transactions...in any premises or any land in the use or possession of the said taxpayer or any person on his behalf for in trust for him,” for recovery of shs. 457,360,192/= in unpaid taxes. It is on that basis that the 1st defendant’s assets, already the subject of the plaintiff’s chattels mortgage and debenture charge, were attached. The 2nd defendants seized the assets on 26th May, 2021 and advertised them for sale that was scheduled to take place on 15th June, 2021.

That attachment prompted the plaintiff on or about 7th June, 2021 to file an application for an interim injunction order restraining the 2nd defendant from auctioning, selling, transferring or alienating the 1st defendant’s assets until the determination of the main application for an interlocutory injunction order. The interim injunction order was granted on 14th June, 2021 lasting until 14th July, 2021. The sale eventually took place on 20th November, 2021.

A company's liquidation starts at the time the liquidator is appointed but the start of the liquidation relates back to the date the application was filed. According to section 93 of *The Insolvency Act, No. 14 of 2011*, where, before the presentation of a petition for the liquidation of a company by the court, a resolution is passed by the company for voluntary liquidation, the liquidation of the company is deemed to commence when the resolution is passed. In all other cases, it is taken to commence at the time of presentation of the petition for liquidation.

The purposes of a liquidation are; (a) to ensure a just distribution of the company's assets among creditors and contributories and (b) to terminate the company's existence by its eventual dissolution. The winding up of a company is a form of collective execution by all its creditors against all its available assets. The resolution or order for winding up divests the company of the beneficial interest in its assets. They become a fund which the company thereafter holds in trust to discharge its liabilities (see *Ayerst (Inspector of Taxes) v. C & K (Construction) Ltd* [1976] AC 167). It is a special kind of trust because neither the creditors nor anyone else have a proprietary beneficial interest in the fund. The creditors have only a right to have the assets administered by the liquidator in accordance with the provisions of *The Insolvency Act, 2011* (see *In re Calgary and Edmonton Land Co Ltd (In liquidation)* [1975] 1 WLR 355 at 359). But the trust applies only to the company's property. It does not affect the proprietary interests of others.

According to section 2 *The Insolvency Act, No. 14 of 2011*, “secured creditor” means a creditor who holds in respect of a debt or obligation a charge over property. Section 11 (2) (a) and (3) of the Act provide that a secured creditor may realise any asset subject to a charge, where he or she is entitled to do so, and after realising an asset subject to a charge may claim as an unsecured creditor for any balance due, after deducting the net amount realised, or account to the liquidator for any surplus remaining from the net amount realised after satisfaction of the whole debt, including any interest payable in respect of that debt up to the time of its satisfaction and after making proper payments to the holder of any other charge over the asset subject to the charge. Therefore, a secured creditor’s rights are discretionary. A secured creditor may realise any asset subject to a charge, where they are entitled to do so, can claim as a secured creditor in the order of preferences, or surrender the charge for the general benefit of all creditors and claim as an unsecured creditor.

The implication of the above provision is that the rights of the secured creditor to deal or realise security over company assets are not affected by the petition for winding. In the event of default, secured creditors can exercise their powers to sell the company’s assets which have been charged to them as security in order to satisfy the debts in accordance with the law. Should there be any shortfall therefrom, secured creditors may file proof of debt and they will consequently be regarded as unsecured creditors. Secured creditors are required to hand over the remaining proceeds from

the sale of the company's asset to the liquidator to be credited into the estate of the company. Creditors generally seek security for the purpose of protecting their interests if the debtor fails to repay. If security is to achieve this objective, upon the commencement of insolvency proceedings, the secured creditor should not in any way be delayed or prevented from immediately foreclosing upon its collateral.

A secured creditor "stands outside the winding up" and can realise and enforce its security by sale *de hors* the winding up proceedings or without intervention of the court (see *Wrenbury in Food Controller v. Cork*, [1923] AC 647; *Kenya National Capital Corporation Ltd v. Albert Mario Cordeiro & another* [2014] eKLR (Civil Appeal 274 of 2003); (27 February 2014); *Siraje Ndugga v. Kabito Karamagi and another (Receivers of Spencon Services Limited in Receivership) H. C. Misc. Cause No. 219 of 2020* and *African Textile Mill Ltd (in liquidation) v. Co-operative Bank Ltd (in liquidation), H. C. Civil Suit No. 20 of 2005*). "Sometimes the mortgagee sells, with or without the concurrence of the liquidator, in exercise of a power of sale vested in him by the mortgage. It is not necessary to obtain liberty to exercise the power of sale, although orders giving such liberty have sometimes been made" (see *Palmer's Company Precedents*, Vol. II, p.415). Therefore creditors with a mortgage or fixed charge over assets secured in this way are outside the scope of the insolvency. A sale outside the winding up or without the intervention of the Court would be valid and cannot be challenged as invalid nor can it be challenged as void.

Questions of priority arise only between interests which compete with each other for payment out of the same fund. According to section 12 (6) (a) of *The Insolvency Act, No. 14 of 2011*, in the distribution of non-charged assets of the company, tax obligations rank second last after claims of other preferential creditors including; remuneration and expenses properly incurred by the liquidator, the reasonable costs of any person who petitioned court for a liquidation, all wages or basic salary of employees, amounts due in respect of any compensation or liability for compensation under *The Worker's Compensation Act*, and a lien over any document of the insolvent company in respect of a debt for services rendered. It is after paying preferential debts in accordance with the above order of priority, that the liquidator applies the assets in satisfaction of all other claims (see section 13 (1) of the Act). The general rule is that unsecured creditors are entitled to share *pari passu* in the company's fund (see section 13 (2) of the Act).

The rights of unsecured creditors over the company's assets are virtually "frozen" upon the commencement of the liquidation to avoid a further deterioration of the company's financial position and proliferation of its liabilities. If a company is in liquidation, its former assets are comprised in two quite separate funds. Those which were subject to the floating charge ("the debenture-holder's fund") belong beneficially to the debenture-holder. The company has only an equity of redemption. Those which were not subject to the floating charge ("the company's fund") are held in trust for unsecured creditors. In the usual case in which the whole of the company's assets and undertaking are subject to the floating charge, the company's fund will consist only of the equity of redemption in the debenture-holder's fund.

The assets available for payment of general creditors in a winding up are the primary source of payment of the preferential debts. Such assets do not include charged assets, which are not available for payment of the general body of creditors until the claims of the charge holder have been satisfied. They are what remains of the company's free assets after the expenses of the winding up have been paid or provided for. The greater such expenses are the less that is left for the general creditors and consequently the less that is available for the preferential creditors. It is only when the assets are insufficient to meet them, that preferential debts have priority over the claims of secured creditors in respect of assets which are subject to a security interest (see section 12 (2) (a) of the Act). So far as there are insufficient assets after the expenses of the winding up have been paid or provided for to enable the preferential debts to be paid in full, this section makes them payable out of the assets subject to a floating charge (see *Buchler and another (as joint liquidators of Leyland DAF Limited) v. Talbot and another (as joint administrative receivers of Leyland DAF Limited) and Stichting Ofasec and others*, [2004] 2 WLR 582; [2004] AC 298). The exception does not apply to the facts of this case since the winding up petition crystallised the floating charge and it has not been shown that there are insufficient assets, after the expenses of the winding up have been paid or provided for, to enable the preferential debts to be paid in full.

After a petition for winding up has been presented, no creditor is allowed to take out or continue attachment or execution proceedings against the company. After a company goes into liquidation, unsecured creditors cannot commence or continue legal action against the company, unless the court permits it. A creditor must complete execution before the winding up application has been

presented. Otherwise, a creditor cannot retain the assets. Any disposition or sale of the company's assets, transfer of shares or alteration in the status of company's contributories made after the commencement of the winding up by the Court without the Court's sanction or approval is void. Section 97 (1) (c) specifically prohibits the levying of distress against the company or its property, upon the commencement of liquidation. Therefore once the petition was filed on 21st April, 2021, the defendant, although a preferential creditor, the 2nd defendant could take out or continue attachment, distress or execution proceedings against the company or its property. It follows that the 2nd defendant's warrant of distress issued on 26th May, 2021 in a bid to recover unpaid taxes of shs. 457,360,192/= was illegal and void. The sale that eventually took place 20th November, 2021 too was illegal.

Upon the 1st defendant's default, the plaintiff was entitled to foreclosure and sale of the mortgaged assets, but for the 2nd defendant's unlawful actions. As a borrower, the 1st defendant could have stopped the process of foreclosure by redeeming its property before a foreclosure sale (see section 54 of *The Security in Movable Property Act, 2019*). To redeem the property, the 1st defendant had to pay the full balance due before the foreclosure sale. Alternatively, the 1st defendant was required to prove that the plaintiff as foreclosing mortgagee did not comply with the foreclosure laws or the terms of the mortgage. The 1st defendant not having sought to assert its right of redemption, and not having challenged the process, I find that the plaintiff is entitled to foreclose.

2nd issue; whether the plaintiff is entitled to take possession of the charged assets.

A charge or mortgagee has the option to enforce their mortgage security through a foreclosure or judicial sale but for the most part, the exercise of a contractual or statutory power of sale is the more favourable remedy for mortgagees. If the deed does not contain a power of sale clause, statutory power of sale provisions are set out in section 48 of *The Security Interest in Movable Property Act, 2019*. According to that section, where a debtor is in default, sell any or all of the collateral in its condition. For that purpose, unless otherwise agreed, a secured party has the right to take possession of the collateral without a court order, provided this can be effected without a breach of the peace (see as well section 47 (2) (c) of *The Security in Movable Property Act, 2019*).

If a mortgagee seeks to enforce their security as quickly and cost effectively as possible, a sale by private treaty is the appropriate remedy. In the instant case, the chattels mortgage and debenture charge did not reserve that power. However, according to section 48 (2) of *The Security in Movable Property Act, 2019*, where a mortgagee becomes entitled to exercise the power of sale, that sale must be by public auction.

If before the charged property has been realised under that fixed charge events occur which cause the floating charge to crystallise, then the proceeds of realisation must be paid to the holder of the floating charge; the holder of the fixed charge can have no claim upon those proceeds until the claims under the floating charge have been paid out (see *In Re Portbase Clothing Ltd; Mould v. Taylor* [1993] Ch 388). Secured creditors with a security interest in tangible movable assets are entitled to the proceeds of sale of the collateral.

The power of sale allows the mortgagee to convey the mortgaged property to a purchaser, free and clear of the interest of the mortgagor and any other subsequent interests in the property. The defendants' right, title and equity of redemption to and in the mortgaged property having been foreclosed, it is ordered and adjudged that the defendants forthwith deliver to the plaintiff or as the plaintiff directs, possession of the mortgaged property or of such part of it as is in the possession of the defendants.

As regards those assets already disposed of by the 2nd defendant in execution of the warrant of distress, the right of the secured creditor to avoid preferences and fraudulent transfers is fundamental to corporate insolvency policy. Whereas provisions prohibiting fraudulent transfer are designed to enhance the total amount of distribution, preference avoidance serves to ensure the equality of distribution. As a general rule, outside of corporate insolvency, a debtor has every right to pay one creditor in preference to another. In most instances, disfavoured creditors have no claim against the favoured creditor, provided that the transfer was made to satisfy a genuine obligation owed by the debtor. Only in corporate insolvency proceedings are preferences subject to attack; transfers made by an insolvent debtor with intent to prefer one creditor over another (see *Accord Iraqi Min. of Defence v. Arcepey Shipping Co., S.A.* [1980] 1 All E.R. 480 and *Polly Peck Intern., P.L.C. v. Nadir (No. 2)* [1992] 4 All E.R. 769). In some instances a desperate or devious defendant

or debtor will attempt to fraudulently conceal his, her or its assets by transferring them to a friend, relative, a related company or other cooperating third party, to try to look impecunious or judgement-proof, and avoid paying what is owed.

- 5 Of similar importance is the fundamental policy of corporate insolvency to ensure that similarly situated creditors are given equal treatment. A preferential transfer focuses on whether a creditor has received a payment that results in that creditor getting better treatment than other creditors in light of the insolvency. Therefore preference recoveries help to deter or to remedy the perpetration of dismemberment of the debtor, even if no fraud or chicanery would be or was involved in the
- 10 dismemberment, by countering voidable transactions involving unfairness between creditors, as well as between the debtor and the creditors. Just as creditors who have used their power or influence to extract a payment from a struggling debtor should repay that money to benefit all, those that have done so in violation of the secured creditors ought to refund the proceeds.
- 15 I find in this case that not only was the action of the 2nd defendant in issuing the warrant of distress on 26th May, 2021 after the 1st defendant had filed for winding up on 21st April, 2021 a contravention of section 97 (1) (c) of *The Insolvency Act, No. 14 of 2011*, but also the sale that took place on 20th November, 2021 provided a benefit to the 2nd defendant as creditor, out of turn and possibly in excess of what the 2nd defendant as creditor would have received in liquidation if
- 20 that sale had not been made. From both perspectives, recovery by the 2nd defendant as an unsecured creditor depletes the insolvent debtor's estate to the disadvantage of other creditors and the proceeds of that sale ought to be recovered from the 2nd defendant.

On the other hand, a secured creditor is entitled to receive the value of its collateral up to the

25 amount of its debt. Thus, payment to a fully secured creditor does not deplete the insolvent debtor's estate to the disadvantage of other creditors. It is the plaintiff's case that at the time of default, the 1st defendant owed it US \$ 556,715.27 and shs. 4,767,887,731/= It is for that reason that the shs. 1,020,000,000/= received by the 2nd defendant as proceeds of the void sale ought to be applied towards satisfaction of the plaintiff's debt, and it is ordered.


30

3rd issue; whether the defendants should pay the costs of the suit.

The general rule under section 27 (2) of *The Civil Procedure Act* is that costs follow the event unless the court, for good reason, otherwise directs. This means that the winning party is to obtain
5 an order for costs to be paid by the other party, unless the court for good cause otherwise directs. I have not found any special reasons that justify a departure from the rule. Therefore in conclusion, judgment is entered for the plaintiff against the defendants jointly and severally, as follows;

- a) An order directing the defendants to forthwith deliver to the plaintiff or as the plaintiff
10 directs, possession of the mortgaged property or of such part of it as is in the possession of the defendants.
- b) Recovery of the shs. 1,020,000,000/= received by the 2nd defendant as proceeds of the void sale, to be applied towards satisfaction of the plaintiff's debt.
- c) The defendants jointly and severally meet the costs of the suit.

15 Delivered electronically this 21st day of March, 2022

.....Stephen Mubiru.....
Stephen Mubiru
Judge,
21st March, 2022.