Legal Alert | April 06, 2023

Application of the *In Duplum* Rule in Kenya

The High Court held the *in duplum* rule in Section 44 of the Banking Act does not apply to non-deposit taking microfinance institutions.[i] The rule limits interest accrual to equal the principal amount outstanding when a loan becomes non-performing. We analyse below the difference between this decision and the one that held *in duplum* applies to loans given by the Higher Education Loans Board (HELB).

The Momentum Case

A lender had given a facility to a borrower, who defaulted forcing the lender to recover the debt by disposing security provided by the borrower. Unfortunately, the sale proceeds were not sufficient to clear the outstanding debt. The lender therefore sued in the Small Claims Court for the shortfall.

The borrower successfully argued before the Small Claims Court the lender as a microfinance institution was subject to the *in duplum* rule in the Banking Act. The Small Claims Court agreed and held the lender could not recover the shortfall in light of the exorbitant and unconscionable interest rates charged.

On appeal, the High Court overturned these findings. The Court found the relevant provision of the Banking Act did not apply to the lender as it was not a deposit taking institution. Interest rates were governed by the contract between parties, and the Court would only interfere if the contract was unconscionable, unfair or oppressive. The borrower had not proved either of these so there was no basis for the Court to intervene. The Court therefore allowed the lender's appeal and entered judgment for the shortfall in its favour.

The HELB Case[ii]

HELB beneficiaries challenged continued accrual of interest and penalties on non-performing loans which eventually exceeded the principal amount borrowed.

The Court held the *in duplum* rule applied to all lenders as it did to banks. It took this view, as the rule was introduced due to public interest policy in protecting borrowers from exorbitant interest accumulation on loans.

Commentary

In the Momentum Case, the Court focused on who Section 44 of the Banking Act was meant to apply to. It determined the section only applied to banks, mortgage finance companies, and finance institutions gazetted by the Cabinet Secretary in charge of finance.

In contrast, the HELB Case focused on whether imposition of interest and penalties exceeding the principal loan, contravened constitutional protections against discrimination and violated constitutionally guaranteed socioeconomic rights. It should be noted the Court found section 15 (2) of the HELB Act unconstitutional to the extent it led to interest and fines exceeding the principal amount advanced.

Accordingly, while the Momentum Case reinforced that Section 44A of the Banking Act only applies to banks and financial institutions, the HELB Case has provided a constitutional basis for challenging interest accrual exceeding the outstanding principal.

Conclusion

It is clear Courts are divided on who the *in duplum* rule applies to. Lenders who are not regulated by the Banking Act should therefore tread carefully. With the 2022 Digital Credit Providers Regulations applying the rule to digital lenders, it would appear the winds are blowing towards *in duplum* applying to all forms of lending.

[i] Momentum Credit Limited v Kabuiya Civil Appeal E035 of 2022 [2022] KEHC 13705 [KLR])
[ii] Mugure & 2 others v Higher Education Loans Board (Petition E002 of 2021) [2022] KEHC 11951 (KLR)