PRIVITY OF CONTRACT AND ASSIGNMENT OF ARBITRATION AGREEMENTS IN KENYA

(Kampala International University v Housing Finance Company Limited [2021] KEHC 105 (KLR))

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Abstract

The assignability of contractual rights has more often than not been discussed in terms of the privity of contract. It is widely accepted that contractual rights can freely be assigned. However, there are exceptions to this rule, which are non-assignability clauses in the contracts and personal nature of contractual rights. Consequently, there are discussions on whether the arbitration agreement in the contract is also freely transferrable through assignment of contractual rights. In *intuitu personae* contracts (where the relationship and confidence of parties resulted in the arbitration agreement), it is argued that the arbitration agreement is not transferrable, but different jurisdictions conclude differently. This paper exposes Kenya's stand on assignability of arbitration agreements as rendered by the High Court of Kenya in *Kampala International University v Housing Finance Company Limited* (Miscellaneous Cause E564 of 2019) [2021] KEHC 105 (KLR) (Commercial and Tax) (16 September 2021) (Ruling).

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Introduction

In Kenya, Section 35 of the Arbitration Act gives an aggrieved party in arbitration proceedings the right to challenge the same in a court of law.[1] Such a challenge should be made before the High Court of Kenya. One of the issues susceptible to challenge is the jurisdiction of the arbitral tribunal. The challenge to jurisdiction of the arbitral tribunal can be made before constitution of the tribunal, during proceedings or after the tribunal has concluded its proceedings and has published an award.[2]

The High Court of Kenya in *Kampala International University v Housing Finance Company Limited,*[3] was called upon to determine the jurisdiction of the arbitral tribunal after the final award was made by the arbitral tribunal. One of the issues for determination was whether a third party, who one of the main parties assigned rights to, was capable of enforcing the arbitral award. The court concluded that the third party, a subsidiary of one of the respondents in the suit, was capable of enforcing the award.

Despite the decision of the court being on the right of a third party to enforcement of the award of an arbitral tribunal, the decision has a bearing on subsequent contracts that have or would be assigned to third parties, and such contracts contain arbitration agreements. This paper appreciates the decision of the court, but hypothesises that in future commercial contracts executed in Kenya, a party is likely to assign or transfer its rights to a third party, including the arbitration agreement, without the consent of the other.

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[1] Arbitration Act, Cap 49 Laws of Kenya.

[2] Arbitration Act, Section 6, 7, 14 and 35; *Nyutu Agrovet Limited v Airtel Networks Kenya Limited; Chartered Institute of Arbitrators-Kenya Branch (Interested Party)*, Petition No 12 of 2016, Supreme Court Judgement (2019) eKLR.

[3] *Kampala International University v Housing Finance Company Limited*, Miscellaneous Cause E564 of 2019, Ruling of the High Court at Nairobi of 16 September 2021, KLR.

Background

Facts of the case

In 2010, Kampala International University (KIU) undertook the process of construction of a university campus in Kitengela, Kajiado County and sought through Housing Finance Corporation of Kenya (HFCK) USD 15,000,000 to partly finance the construction. Due to the size of debt instrument, HFCK agreed to syndicate the facility with another financial institution that it worked with previously to fund the balance of USD 5 million. The loan facility was subject to first charge over KIU's immoveable properties, its escrow account for receipt of income from the University and various guarantees, and all agreed securities were executed in favour of HFCK.

HFCK did not syndicate the loan as agreed and did not disburse monies in a timely manner as agreed. Further, HFCK did not disburse the last tranche. On account of the failure of HFCK to disburse the monies, KIU's development came to a halt, contractors deserted the site and KIU's losses accumulated. The applicant instructed its advocates to file suit in court for damages. However, in discussions/correspondence by parties' advocates, they agreed to arbitration. The arbitration proceedings resulted to the Final Arbitral Award made and published by the arbitrator, Hon. Mr. Collins Namachanja, on 27th September 2019.

The applicant, KIU, filed an application in the High Court of Kenya, Commercial and Tax Division that sought for the Final Arbitral Award made and published by the arbitrator be set aside or stayed. The Applicant sought to convince the Court that it would suffer irreparable damage if the arbitral award was enforced as the Arbitral Tribunal lacked jurisdiction. Among the grounds the applicant relied on were:

i. That the arbitrator was partial as he had failed to disclose circumstances likely to give rise to justifiable doubts as to his impartiality or independence.

ii. That the arbitral award deals with a dispute not contemplated by the terms of reference to the arbitrator.

iii. That the arbitral award contained decisions on matters beyond the scope of the reference of arbitration and in the premise the award was in favour of the respondent.

iv. That the respondent unlawfully passed itself off as HFCK, another company incorporated under the laws of Kenya, while it had no privity of contract between the parties.

v. That the Final Arbitral Award adversely affected independent third parties without their knowledge and consent.

However, from the above, the review's focus lies on ground (iv) and (v) above on privity and independent third parties.

Relevant facts to privity and independent third parties

The Court formulated an issue for determination on this argument; whether the dispute/claim by HFCK can legally be pursued by (Housing Finance Corporation) HFC, a new company that was not in existence at the time of signing the contract in dispute. The applicant contended that HFC had no cause of action against it as it was a stranger to the Agreement between HFCK and KIU. KIU based the argument on the fact that HFC lacked privity of contract. On the other hand, the respondent (HFCK) argued that in the contract between itself and KIU, there was a part that it described itself to "…*include successors in title and assigns in the contracts/agreement between HFCK & KIU*…" It is important to note is that HFCK had restructured itself and formulated many other subsidiary companies including HFC after it entered into the contract with the Applicant.

The Court looked into the evidence provided by both parties and pointed out to the Letter of Offer for Construction Loan Facility dated 8 January 2014 and 4 November 2014. The letters provided, under terms & conditions of offer, that:

> …Housing Finance means Housing Finance Company of Kenya Limited, a mortgage finance company incorporated in the Republic of Kenya, whose address is care of Post Office Box Number 30088 Nairobi and includes its **successors and assigns**…

The Court further relied on the precedence in Civil Appeal 206 of 2008 *City Council of Nairobi & Wilfred Kamau Githua T/A Githua Associates vs Nairobi City Water & Sewarage Co Ltd.*[4] The case involved privity of contract and contractual assignment. The appellate court observed that a contract cannot confer rights or impose obligations on strangers. That whilst it may be clear in a simple case, it may not be so obvious where there are several contracts, or several parties or both. For example, in the case of multilateral contracts, collateral contracts, irrevocable credits, contracts made on the basis of memorandum & articles of a company, collective agreements, contracts with unincorporated association and mortgages, surveys and valuations.[5]

The Court then concluded that, from the above, HFCK assigned its interest in the contracts of letters of offer to HFC as contracted by parties and as spelt out in the precedence. Not to let eyes off the hook, the arbitration agreement is one of the rights and interests assigned.

Implications of the decision

In principle, the court pronounced that where there are several contracts, or several parties or both, privity of contract is inconsequential. The decision bears the following consequences:

i. A parent company can enter into a contract that binds its subsidiary, without its knowledge or consent, despite the two being completely independent persons; or

ii. A company can transfer or assign an agreement to arbitrate to a third party without consent from the other main party in a contract; or

iii. Existing parties to a contract might not need to enter into a novation agreement to substitute a party to a contract if it involves a parent and a subsidiary company.

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[4] *City Council of Nairobi v Wilfred Kamau Githua t/a Githua Associates & another, Court of Appeal, Civil Appeal 206 of 2008,* Judgement of the Court of Appeal of 28 July 2008 eKLR.

[5] *City Council of Nairobi v Wilfred Kamau Githua t/a Githua Associates & another,* para 34.

As a fundamental rule, companies are separate legal entities irrespective of whether they carry out their business under a group structure or not.[6] Separate legal personality implies that a contract is only binding upon the legal person, for instance, a limited liability company, which appears as a party thereto. As a consequence, an arbitration clause or an arbitral award only binds the specific company which agreed to arbitrate. The rule complements the privity of contract rule that requires that mutual rights and obligations arising under a contract shall only be binding upon the parties to it.

The decision of the court failed to take into account that there are special relationships between parties to a contract to which they gain confidence to enter an arbitration agreement. Therefore, whether in enforcement of an arbitral award or institution of arbitral proceedings, parties maintain that special relationship until they agree otherwise. This special relationship is characterised as *intuitu personae*.

Intuitu personae

An intuitu persona is considered as an implied factor that bars the assignment of a claim.[7] In the scope of assignment of claims, *intuitu personae* presents that an arbitration clause is not transferred to the assignee if the original contract was concluded with regard to the fact that the other contracting party was chosen for a specific reason.[8] Therefore, possible assignees and other entities acting on behalf of the assignor would not be able to perform as well as the original contracting partner.[9]

The ICSID tribunal in *Venessa Venture v Venezuela*,[10] while making a determination on the *intuitu personae* arguments submitted by parties, held that

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[6] William W Park, *Non-signatories and international contracts: An arbitrator's dilemma in multiple parties in arbitration,* Oxford University Press, 2009, 16.

[7] Mertcan Ipek, 'Assignment of contractual rights and its effect on arbitration' Marmara Üniversitesi Hukuk Fakültesi Hukuk Araştırmaları Dergisi, C22, S1, 522-524. Available at https://dergipark.org.tr/en/download/article-file/274363 accessed on 18 October 2022

[8] Andrea Vincze, 'Arbitration clause – is it transferred to the assignee?' 1 *Nordic Journal of Commercial Law* (2003), 5-6.

[9] Vincze, 'Arbitration clause – is it transferred to the assignee?', 6.

[10] *Venesa Venture Limited v Bolivarian Republic of Venezuela,* ARB (AF) 04/6, ICSID (2013), 148-149.

there are two indicators that have to be drawn to conclude the *intuitu personae* relationship:

(i) The process through which an investor was considered among other investors;

(ii) Personal relationship with the investor. This means that there has to be a very unique characteristic of the investor that led to its consideration.

Further, there are some obligations under a contract that are so personal in nature that they can only be performed expressly by the party that has assumed the obligations under the contract.

Additionally, the Swedish Supreme Court invented a third indicator-consideration; that if the investment was concluded based on a confidential and personal relationship, an automatic transfer of an arbitration agreement to the assignee of contractual rights is precluded in such circumstance.[11]

In the preceding paragraphs, it is not enough for a contract, in the description of parties, to capture that a party '*…includes its successors and assigns…*' as sufficient consent to assign an arbitration agreement. The court ought to have looked at the relationship of the parties and why the applicant choose HFCK as the financier before declaring that HFC, that HFCK assigned its rights to, was competent to pursue its rights under the arbitration agreement. A written agreement between the main parties to the contract ought to have been made.

In *Enka Insaat Ve Sanayi AS v OOO 'Insurance Company Chubb*',[12] the Supreme Court of the United Kingdom was confronted with an almost similar circumstance. In the case, the Supreme Court agreed that since there was no signed agreement to novate, the contracts had not been novated and the parent company did not acquire the liabilities under contracts entered into by the subsidiary company. This included the arbitration agreement.[13]

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[11] *Bricklayers, Masons and Plasterers Intern. Union of America v. Boyd G. Heminger*, Supreme Court of Sweden (1997), 129-131; *MS Emja Braak Shiffarts KG v. Wärtsilä Diesel Aktiebolag,* Rev. Arb (1998), 431-433.

[12] *Enka Insaat Ve Sanayi AS v OOO "'Insurance Company Chubb*", Supreme Court of United Kingdom (2020), 38.

[13] *Enka Insaat Ve Sanayi AS v OOO 'Insurance Company Chubb'.*

Conclusion: What next for courts

A recommendation to the courts would be that when approached with a case that involves assignment of rights to a third party that was not privy to the contract, the following should be considered:

i. Whether there is an express agreement or clause in the main contract that parties agree to assign their rights and responsibilities including the arbitration agreement; or

ii. Whether there is a novation agreement between the main parties to substitute either of the parties during the performance of the contract;[14] or

iii. Whether there is a unique or special relationship between the main parties in the contract, in case there exists no agreement or clauses to assign or transfer an arbitration agreement.[15]

If courts choose to look way from the above recommendations, a party in a contract might take advantage and breach the contract, and at the same time, assign its rights and the agreement to arbitrate, without consent of the other party. It can go as far as assigning the contract to a third party that is incapable of performing the specific terms of the contract, or even a third party that is on the brink of being declared insolvent. Furthermore, the fundamentals of consent to arbitrate are usually based on confidence between the parties, if assignment of such rights is permitted without express consent, then the confidence to arbitrate is vitiated.

If the matter and specifically the issue on privity and independent third parties will not be overturned by the appellate court, it will remain the law.

[14] *Enka Insaat Ve Sanayi AS v OOO 'Insurance Company Chubb'.*

[15] *Venesa Venture Limited v Bolivarian Republic of Venezuela.*