

Freedom of Contract and Unconscionable interests Rates: *Court of Appeal's 'final say'*

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Introduction

The recent Court of Appeal decision in *Kanwal Sarjit Singh Dhiman v Keshavji Jivraj Shah* (Civil Appeal E380 of 2023) [2025] KECA 1264 (KLR) offers crucial guidance on the enforcement of high-interest loan agreements and the limits of party autonomy in the face of unconscionable contractual terms. The case centred around a loan advanced in 1996 with an interest rate of 36% per annum compounded quarterly, leading to a potential liability of Kshs. 69 billion based on a principal sum of

Kenya Shillings Four Million (Kshs. 4,000,000.00) over nearly three decades. The matter raised critical questions including on the enforceability of the interest clause, the validity of a vesting order following the setting-aside ex-parte judgment, as well as the

applicability of statutory timelines which bars to proprietary claims. It also discussed the tension between a borrower's protection and a lender's rights within Kenya's contractual jurisprudence.

At the High Court

The matter before the High Court was heard following a successful appeal in which the Court of Appeal had set aside an ex-parte judgment obtained by the lender, Jivraj Shah, which had led to the sale and transfer of the borrower's property to the lender pursuant to vesting order issued by the court. At the High Court, the lender sought to recover the loan and retain the property, arguing that the borrower had defaulted and that the contractual terms, including the 36% compounded interest,

should be enforced as agreed between the parties.

The borrower's counterclaim challenged the validity of the loan enforcement, asserting that the interest rate was unconscionable and that the transaction amounted to an unlawful banking practice contrary to public policy and the Banking Act. The borrower further sought the return of his property, arguing that the sale and transfer were invalid due to the prior setting aside of the ex-parte judgment.

The High Court, in its analysis, took the view that the agreement was a private transaction, and absent statutory caps on interest rates between private parties, the court should respect party's autonomy, in accordance with the long-established principle on privity of contract. The judge held that the 36% interest was freely agreed upon, dismissing arguments of unconscionability despite the potentially enormous financial liability. The court also upheld the lender's position that the

borrower's counterclaim for the recovery of the property was time-barred under the

Limitation of Actions Act, considering it as arising from a contract claim.

Consequently, the High Court dismissed the borrower's counterclaim, upheld the lender's claim for recovery of the loan, and retained the transferred property to the lender as valid.

This decision reflected a strict interpretation of party autonomy in contractual negotiations, placing emphasis on the freedom to contract while limiting judicial intervention in the

private agreements of parties, notwithstanding the harsh consequences that might result from the enforcement of agreed terms over extended periods.

The borrower was dissatisfied with the High court's decision, and lodged an appeal to the Court of Appeal.

At the Court of Appeal

On appeal, the Court of Appeal adopted a more equitable approach to the issues that were subject of determination. It first addressed the validity of the vesting order under which the lender had acquired the borrower's property, holding that the setting aside of the ex-parte judgment automatically nullified all consequential orders, including the vesting order and the subsequent sale. The court clarified that the effect of setting aside a judgment is to restore the parties to the position they were in prior to the judgment, thereby invalidating enforcement measures taken under the now-nullified decree.

Turning to the issue of unconscionability, the Court of Appeal analysed the 36% compounded interest rate over the extended period and found that while party autonomy is respected under Kenyan law, courts have the power to intervene where contractual terms are oppressive or shock the conscience. The court found it unconscionable that a Kshs. 4 million loan would accrue to Kshs. 69 billion, observing that such enforcement would be grossly oppressive and unjust. The court applied principles from cases including *Ajay Indravadan Shah v Guilders International Bank*

Ltd and National Bank of Kenya Ltd v Pipeplastic Samkolit, which implied that courts can strike down terms that undermine public policy or create unconscionable results.

The court rejected the argument that the lender's conduct constituted illegal banking business, noting that a single or isolated transaction involving interest does not contravene the Banking Act if it does not amount to habitual business requiring licensing. It found no evidence that the lender was engaged in unlicensed banking, thereby preserving the validity of the transaction as a private lending arrangement.

Importantly, the Court of Appeal clarified that the borrower's counterclaim for the recovery of the property was not time-barred, distinguishing proprietary claims from contractual claims, and holding that the borrower was entitled to reclaim his property due to the nullification of the vesting order.

While holding the interest clause unenforceable due to unconscionability, the court balanced equity by ordering the borrower to refund the outstanding principal of Kshs.4 million, with interest at 12% per annum (the court rate) from the date of the High Court judgment. This prevented unjust enrichment on the part of the borrower, ensuring that while the lender could

not enforce oppressive interest, he retained the right to recover the funds actually advanced.

The court further ordered that should the borrower fail to refund the outstanding principal within the stipulated timeframe, the lender would be entitled to recover the amount through the sale of the property, reflecting a pragmatic balance between borrower protection and lender recovery rights.

Conclusion

The Dhiman v Shah decision is a significant addition to Kenya's jurisprudence on unconscionable contractual terms, lender protection, and the equitable limits of party autonomy. The case reaffirms that while parties are free to contract, Kenyan courts will intervene to prevent the enforcement of terms that are grossly oppressive or unjust, particularly in lending contexts where high-interest rates compounded over time result in financial liabilities that undermine fairness and public policy. The judgment also underscores that borrowers cannot evade repayment of principal sums advanced under such agreements, as courts will prevent unjust enrichment by ensuring lenders recover the funds actually disbursed, albeit on equitable terms.

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