

**UNIVERSITY OF RWANDA  
COLLEGE OF ARTS AND SOCIAL SCIENCES  
SCHOOL OF LAW**

**Critical Analysis Of Protection Of Secured Creditors Against Debtor's Fraud In Commercial Recoveries Under Rwandan Law**

Thesis submitted in partial fulfilment of  
academic requirements for the award of a  
Master's Degree in Business law

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**Kigali, October 2019**

## **DECLARATION**

I Patience BAIBARE, hereby declare that, to the best of my knowledge, the work presented hereinafter “*critical analysis of protection of secured creditors against debtor’s fraud in commercial recoveries under Rwandan law*” is my original work. It has not been presented elsewhere as a dissertation or for any other academic purpose. For other sources that were consulted while carrying out this work, references were duly provided in footnotes and bibliography.

I declare that no portion of the work referred to in the Dissertation has been submitted in support of an application for another degree or qualification of this or any other university or other institution of learning.

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## **APPROVAL**

I hereby certify that I have supervised and hereby recommend for the acceptance the thesis entitled: *The critical analysis of protection of secured creditors against debtor's fraud in commercial recoveries under Rwandan law* in partial fulfilment of the requirements for the award of a Master's Degree in Business Law. This project has been submitted with my authority as the University supervisor.

**Supervisor name: Dr. MUNYAMAHORO René**

## **DEDICATION**

The Almighty God for His Unfailing Grace and Love,

My beloved Husband **MANIRAMPA PATRICK**, My baby Girl **IRERA ATARAH JAEDYN**

My parents and Siblings (Joseph, Peninnah, Roberts, Sharon, Richards, Joshua, Penelope and Patricia),

The rest of my family, friends and Colleagues,

Intercessors in the Evangelical Restoration Church

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## ACRONYMS

<b>BPR :</b>	<i>Banque Populaire du Rwanda LTD</i>
<b>RDB:</b>	Rwanda Development Board
<b>BRD:</b>	Development Bank of Rwanda
<b>FRW:</b>	Francs of Rwanda
<b>UCC:</b>	Uniform Commercial Code
<b>U.K:</b>	United Kingdom
<b>US:</b>	United States of America
<b>IMF:</b>	International Monetary Fund
<b>TC:</b>	Commercial court (Rwandan jurisdiction)
<b>SC:</b>	Supreme Court (Rwandan jurisdiction)
<b>CHC:</b>	Commercial High Court (Rwandan jurisdiction)
<b>HC:</b>	High Court (Rwandan jurisdiction)
<b>VOL:</b>	Volume
<b>Ibid:</b>	<i>Ibidem</i>
<b>Nº:</b>	Number.
<b>O.G:</b>	Official Gazette
<b>p.:</b>	Page.
<b>Para:</b>	Paragraph
<b><i>Et al:</i></b>	et alia
<b>Ed.</b>	Edith
<b>Vs.</b>	Versus

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## **ABSTRACT**

This Creditor protection has long been taken for granted as a benefit of the creditor. While securities can provide creditor protection, the protection is not complete, nor is it available in all cases. Sometimes the security cannot be affected, can diminish, can be intentionally destroyed or disposed in any maliciously way leaving the creditor at the mercy will of the debtor.

Therefore, this paper reviews the limitations of this creditor protection to secured creditors and how secured creditors are protected during the commercial recoveries under Rwandan laws. This is majorly focusing on ordinary commercial recovery. Indeed, when one looks at all Rwandan laws regulating such legal arena, they do offer several options as forms of protection to secured creditors, nonetheless the most among the options offered remains sell of the mortgage or pledge of which this doesn't not guarantee protection to a secured creditor utmost.

Hence this paper tackles proposes mechanisms on how secured creditors are protected from fraudster debtors during commercial recoveries while making reference to particular case laws and doctrines.

## GENERAL INTRODUCTIONS

### 1. BACKGROUND TO THE STUDY

It has been asserted that, one factor which determines the extent of losses is the recovery rate on loans and bonds that are in default. The recovery rate measures the extent to which the creditor recovers the principal and accrued interests due on a defaulted debt.<sup>1</sup> Therefore, it has been submitted that every well-functioning market economy needs an efficient insolvency system, an efficient and effective insolvency system which builds confidence among credit providers, resulting in increased credit and depleted borrowing costs as well as better legal risk management systems which can reduce the risk of large losses and to increase a financial firm or creditor's resilience to large losses.<sup>2</sup>

Indeed, the extension of credit is predicted of repayment, and its costs are influences of the risks and potential for default as well as the associated costs and delays of recovery. Therefore, for any system to attract loans and investment, it requires repayment risk to be reasonable and manageable.<sup>3</sup>

Thus, we find that, in most of the legal systems, there are forms of dimension of creditor protection, regarding the source and scope of incentives and remedies, which are through two mechanisms: legal rules and contracts with creditors.<sup>4</sup>Therefore, Rwandan Legal System inclusive has its ways too for protecting secured creditors, where you find that whenever debtors whether legal or natural persons fail to pay his/her or its debts, the secured creditor has several remedies to help in collecting the money from that particular debtor, of which some might require court involvement and some might not. In non-court involvement methods, the secured creditors might try to first contact the debtors directly to recover the debt.

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<sup>1</sup> N. Mora, *What Determines Creditor Recovery Rates?* Federal Reserve Bank of Kansas City, Economic Review 2<sup>nd</sup> Quarter, 2012, p.80.90 at <https://www.kansascityfed.org/publicat/econrev/pdf/12q2Mora.pdf>

<sup>2</sup> A. Ferrando and A. Moro, *Creditor protection, judicial enforcement and credit access*, Daniela Maresch LL.M, No. 1829, 2015, 140p. available at <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1829.en.pdf>

<sup>3</sup> World Bank and International Monetary Fund, *Financial Sector Assessment: A Hand Book*, The international Bank for Reconstruction and Development, Washington DC, 2005, p.230-231

<sup>4</sup>B. E. Adler and M. Kahan, *The technology of creditor protection*, University of Pennsylvania Law Review, Vol. 161, 2013 NO. 7, 2013, p.1777 at <http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?....>

However, since the concerned debtors here are secured, it implies that the creditor shall have the right over the pledge or mortgage should the debtor fail to pay. Particularly in Rwandan Jurisdiction, a secured creditor before evoking his rights over the pledge or mortgage, they will first seek authorization to sell or lease the property from the Registrar General if that's the option the creditor opts for.<sup>5</sup> This process is not discredited in its entirety as less protective, but rather it's discredited for placing this burden on the creditors, as well as making the process rather lengthy and tiring.

We further find that, the essence of this law or all other regulations of various jurisdictions is to give the secured creditor an assurance of having the property to fall back on, upon failure of the mortgagor to meet his contractual obligation on the date fixed for payment of the mortgage debt.<sup>6</sup> So one wonders what happens if the rationale of securing debts is not protection enough to the creditors, this is when fraud is involved. A case in point can be when the security has been intentionally destroyed, or there was contractual misrepresentation, over evaluation of the property or any other form of fraud as this paper shall explore.

There are legal remedies available to creditors to recover a debt, but the related procedures are frequently time-consuming and potentially costly, and there is no guarantee that the creditor shall actually receive all of the funds owed. And before even the creditors' tries to recover or prior to taking any action against a debtor, the creditor must provide a reasonable time for payment on a demand loan or term loan. That time begins to run from the date of the demand for payment and not the date of the loan. Therefore, looking at the Rwandan legislation providing for protection of secured creditor in case of debtor's default, you find that creditors are still faced with difficulty in recovering their monies or even risking a chance of not recovering any at all.

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<sup>5</sup>Article 2 states that; *after a period of 30 days from the last notice issued by the mortgagee to the mortgagor to clear his/her debt, the mortgagee may request the Registrar General to issue a certificate allowing him/her to lease, sell or possess the mortgage. A copy must be given to the mortgagor.* Instructions of the Registrar General n° 03/2010/org of 16/11/2010 on modalities of lease, sale, public auction and mortgage acquisition (*Official Gazette n° special of 23/11/2010*)

<sup>6</sup>C. Nwagbara, *Enforcement of mortgage security in Nigeria*, Nigeria Police Academy, Global Journal of Politics and Law Research Vol.2, No.2, pp.52-63, European Centre for Research Training and Development UK p.52 , 2014 available at <http://www.eajournals.org/wp-content/uploads/Enforcement-of-Mortgage-Security-in-Nigeria.pdf>

## 2. PROBLEM STATEMENT

Under Rwandan law a secured creditor is offered some forms of protection during a debtor's default which the creditor can use during recovery process. These are contained under several legislations. However, in this particular paper the researcher shall, majorly on mortgage law, Law on securities and a few highlights on insolvency Law. The Law modifying and completing law on mortgage, in its articles 2 states that: *The mortgage contract shall contain clauses that grant the mortgagee the power to manage, lease, sell or take over the mortgage in case of the mortgagor's default. The mortgage contract shall also specify the time, place and terms of sale and the procedure to be followed in case of default. Where the mortgagor is in default, the mortgagee shall notify the mortgagor in writing of his/her choice to use one of the remedies specified in the preceding paragraph and transmit a copy thereof to the Registrar General.*<sup>7</sup> When one looks at the Insolvency Law too in Rwanda, the administrator is bestowed with power with permission from court to sell, lease, accept or burrow or mortgage the property.

Although creditors are offered this kind of modes of protection, such rights aren't self-executory in themselves implying that a permission to employ one of them must be first sought before the Registrar general and particularly on mortgage law. Although this is not a problem in its self, but it rather makes the process lengthy and tiresome. On the other side a creditor under Rwandan is protected during recovery when the Mortgage contract contained such a clause that being one condition upon which the creditor will have a right to sell, posses, manage or lease. This implies that the defaulting party might object to creditor's executing these rights upon the former's defaulting should their agreement fall short of a similar clause.

Therefore, it could be reasonably asserted that Secured Creditors under Rwandan Law are protected since they have the security to fall back too upon default, to possess, sell or rent. But indeed, these remedies shall fall short once there is involvement of fraud.

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<sup>7</sup>Law n°13/2010 of 07/05/2010 modifying and complementing law n°10/2009 of 14/05/2009 on mortgages (Official Gazette n° special of 14/05/2010)

However the core issue is that; even when secured creditors have the power vested in them by the security agreement, the issue remains that the mortgage or pledge remains in the possession and ownership of the debtor, who in turn is bestowed with rights to inform the secured creditor about any changes that might affect the security<sup>8</sup>. However, it I reasonable and findings that the Rwandan legal system should be structure in any way that Secured creditors have the ability not to depend on the information given by debtors since they can always act in ways favoring their interest.

A case in point is where a debtor may intentionally destroy or diminish the mortgage, automatically it is not in the interest of the debtor to inform the secured creditor, but such information is normally realized at a later stage when the creditor has no room for revering the situation. Hence, even if the creditor seeks a remedy in the court, it will not have satisfied the first intent, since the financial institutions always accord loans based on assurance of the security available not the recoverable ability of it through courts of law.

Under Rwandan Law again, there is what we call real property evaluation which refers to a process of determining the value of a real property based on market value<sup>9</sup> , thus, you find that the common practice in Rwanda, under mortgage law, financial institution or renown creditors before giving out a loan this process is carried out by a certified valuer, who in return makes a report and submits it to the party in question. It is against this report that most creditors base on to confer the loan. However, this has been problematic in a way that some valuers give such a huge value to the property in that at default of the debtor, the value is less to an extent that it cannot even cover the principle loan later alone the interests. Property valuers also have been known for conniving with the prospective debtor and giving wrong information and you find that the creditors' bases on a total misrepresented information which becomes a problem in recovery. In a nut shell a basic principle that states that all assets of a debtor are security for his debts when he does not reimburse them is not automatically and entirely true.

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<sup>8</sup>Article 13 para 1 of the Law N° 10/2009 of 14/05/2009 on mortgages (*O.G. n° special of 15/05/2009*)  
*This states that; any mortgage shall involve obligations of the mortgagor towards the mortgagee binding the mortgagor; to notify the mortgagee of any change affecting the nature of the mortgage.*<sup>8</sup>

<sup>9</sup>Article 2 paragraph 6 of Law N°17/2010 of 12/05/2010 establishing and organizing the real property valuation profession in Rwanda (*Official Gazette n° 20 of 17/05/2010*)

Therefore, summing up the issue is that when there is fraudulent ways or tactic involved in security agreement when subjectively or objectively, the secured shall not have that full protection as anticipated based on the given security.

### **3. RESEARCH QUESTIONS**

The research questions are formulated in such manner that would enable the researcher to fulfil the objective of this research paper, thus these are:

- 1) What are the forms of fraud highly encountered by secured creditors during commercial recovery?
- 2) What are the causes that compel debtors to engage in fraudulent practices in security transactions?
- 3) What are the remedies which can be opted by secured creditors during recovery in order for them to get a maximum protection as anticipated on entering the security agreement?
- 4) How can the Rwandan Legal system strengthen the protection of secured creditors without weakening one accorded to the debtors?

### **4. PURPOSE OF THE STUDY**

The aim of this research is to increase the understanding of the impact of the legal environment particularly creditor rights protection and how enforceable these are in our judicial system. This thesis shall make most of its reference to the law of mortgages.

### **5. RELEVANCY OF THE STUDY (SIGNIFICANCE)**

Findings of this research will have relevant policy implications for banks, firms, individuals as well as legislator. By improving the quality of the laws, it improves judicial enforcement system. It is also relevant that it will enlighten the public mostly the learned society more about the creditor rights are their protection and its principles, of which some aspirations can be obtainable to benefit Rwandan legal system.

This research is also of great importance in the sense that one should know the possible solutions that may be available to different insufficiencies in our laws

## **6. METHODOLOGY**

The techniques that were used in conducting this research include analysis of different doctrines as stated by various legal scholars, through consulting books and other different publications. Besides consulting books, the research shall also have to go through case laws and the provisions of different legal documents, interpretations of reports produced by different institutions concerned by the issue.

Therefore, this work is solely theoretical analysis of the law of mortgages in Rwanda making a reference to other laws regulating commercial recoveries and its Conclusion is based on that. As a result, we shall conduct in-depth study of the relevant laws, decrees, Ministerial orders, Instruction of various entities and other writings on the subject both hard and soft copies. However, a few none qualitative researches consultation shall be made to ascertain the perspective of Banks or financial institutions on this matter.

## **7. STRUCTURE**

This study is structured mainly in 2 chapters notably; the first deals with “General over view on creditors’ protection during commercial recoveries” while making most reference to Mortgage law and Insolvency and it contains preliminary information and clarification of important concepts and my research does not entail all protection underlying the creditors with immovable securities. It should also be noted that the study does not analyse the creditor’s protection in general but rather in the Rwandan jurisdiction context, even though the study looks at other different legislation’s provisions, with the purpose of having the Rwandan position’s picture. This will compel this research to making a comparative study of different systems as regards to the regulation of creditors’ rights.

The second chapter analyses the forms of fraud laws conferring protection to secured creditors by exactly tackling forms of fraud that Secured creditors meet. This same chapter shall elaborate on how secured have employed various forms of protection and how court have handled or treated the fraud encountered by secured creditors while protecting them. Why among several remedies offered to creditors by Laws a few are used most than the others.



Then the work ends with researcher's findings as well as conclusion with recommendations to respective institutions based on the findings of the paper.

## **CHAPTER ONE: GENERAL OVER VIEW ON CREDITORS' PROTECTION AND DEBTORS' FRAUD DURING COMMERCIAL RECOVERIES**

This chapter aims at giving to the reader the basic understanding of the theories surrounding the research topic while setting out the general considerations of secured CREDITORS' PROTECTION with the aim of breaking down all that is worth to be known about Secured CREDITORS' PROTECTION and commercial recoveries under Rwandan law in comparison to other jurisdictions while tackling key problematic issues encompassed in those issues

### **I.I GENERAL NOTIONS AND UNDERSTANDING OF CONCEPTS**

This section covers the most important concepts which ought to be defined before they are analysed in details such that, there is no misconception of some essential concepts.

#### **I.I.I Collateral**

In general sense collateral is referred to as an asset pledged by a borrower to a lender until a loan is paid back. If the borrower defaults, then the lender has the right to seize the collateral and sell it to pay off the loan.<sup>10</sup>

Under Rwandan law, collateral is defined as personal property that is Subject to a security interest,<sup>11</sup> this is particularly in respect to moveable properties. The same definition was upheld by the Rwandan laws in the former law of securities of 2009. The concept is commonly referred to as mortgage or security but it is left undefined under the mortgage law. Therefore, in the sense of the treatment of Rwandan law, these two verses seem to mean the same, to refer to the property given by the burrower to the lender such that one

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<sup>10</sup>B. Balkenhol and H. Schütte, *Social Finance Programme Working paper* ; Law and Collateral Substitutes, No. 26, 2<sup>nd</sup> Ed. Collateral International Labour Office Geneva, available at [http://www.oit.org/wcmssp5/groups/public/---ed\\_emp/documents/publication/wcms\\_117987.pdf](http://www.oit.org/wcmssp5/groups/public/---ed_emp/documents/publication/wcms_117987.pdf)

<sup>11</sup>Article 2 paragraph 3 of Law n°34/2013 of 24/05/2013 on security interests in movable property(*Official Gazette n°21 Of 27/05/2013*) (Hereinafter referred to as law on securities)

can obtain a loan and at the same time it acts as protection should the borrower default in payment. Therefore, this is the same meaning that shall be maintained throughout this paper analysis.

### **I.I.II Secured Creditor**

By virtue of the law on securities a secured creditor is person who holds a security interest under an agreement concluded with his/her debtor for purposes of payment priority and registration of security interest.<sup>12</sup> Some scholars have defined the same as those creditors whose debt is secured on one or more of the company's assets, such as property.<sup>13</sup> A certain instance can be when an individual or an entity borrows money from a financial institution, and the lender asks for a title deed as a security in case of default, the lender in that instance is a secured creditor. Therefore, a secured creditor has priority access to the assets pledged as collateral which might be personal or real.<sup>14</sup>

### **I.I.II Debtor**

A debtor is one who owes a debt or the performance of an obligation to another, who is called the creditor,<sup>15</sup> whereas a creditor is an individual to whom an obligation is owed because he or she has given something of value in exchange.<sup>16</sup> Under the Uniform code it is defined as "a person having an interest in the collateral other than a security interest or a lien; a seller of accounts, chattel paper, payment intangibles, or promissory notes; or a consignee.<sup>17</sup> In respect to obligations, a debtor has an obligation to timely pay back the

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<sup>12</sup>Article 2, 18<sup>o</sup> of the Law N<sup>o</sup> 34/2013 of 24/05/2013 on security interests in movable property (Official Gazette n<sup>o</sup>21 Of 27/05/2013) - (Law on security in moveable's herein after)

<sup>13</sup>*Creditors Their duties and powers* available at <http://www.iayo.ie/admin/wp-content/uploads/ODCE-Quick-Guide-Creditors.pdf>

<sup>14</sup>R. O. Caminal, *Creditor equality, secured transactions, and systemic risk: a complex trilemma*, *Law And Contemporary Problems*, Vol. 81, Queen Mary University of London, 2018 available at <https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=4858&context=lcp>

<sup>15</sup>X, available at, <https://legal-dictionary.thefreedictionary.com/Debtors>

<sup>16</sup> *Ibid*

<sup>17</sup> Uniform Commercial Code, Section 9-102(a)(28).

principal amount of the loan and subsequently pays the interest on the loan<sup>18</sup> so as to avoid penalties for late payment imposed as per the bank regulations.<sup>19</sup>

#### **I.I.IV Security agreement**

It has been defined to mean an agreement that creates or provides for a security interest.” It is the contract that sets up the debtor’s duties and the creditor’s rights in event the debtor defaults.<sup>20</sup> It governs the relationship between the parties to a kind of financial transaction known as a secured transaction. The Rwandan law on securities defines it as an agreement that creates or provides for a security interest and includes a writing that evidences a security agreement.<sup>21</sup>

From the Roman law perspective security agreement is recognized in four arrangements i.e. where the debtor vests both ownership and possession with the creditor, where the debtor vests ownership with the creditor, but retains possession, where debtor retains ownership, but transfers possession to the creditor and where debtor transfers neither possession nor ownership to the creditor, but only grants a secured interest in the case of default.<sup>22</sup> But under Rwandan Law the debtor remains in the possession of the security but entrusted with the obligation of informing.

#### **I.I.V Creditor’s protection**

In general, it has been asserted that the notion of creditor protection has altered over years where by various judicial acts have been revised and modified.<sup>23</sup> Nonetheless, creditor has still been referred to as; laws that protect both the creditors and burrower upon payment

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<sup>18</sup> Article 5 of Regulation No.14/2011 on the publication of tariff of interest rates and fees applied by banking (*Official Gazette No.30 Bis Of 25/07/2011*)

<sup>19</sup> *Ibid*

<sup>20</sup> Uniform Commercial Code, Section 9-102(a) (73).

<sup>21</sup> Article 2 paragraph 2 of Law on Securities.

<sup>22</sup> R. J. Goebel , *Reconstructing the roman law of real security*, Tulane Law Review, Vol. XXXVI, 1961 ,P.30-35 available at <https://pdfs.semanticscholar.org/43f9/c307628580e551c53d9caae104881bef78a2.pdf>

<sup>23</sup>H. Marquis, *Creditor protection*, Sun Life Financials, p.5 available at [http://www.ci.com/advisingtheclient/sfunds/pdfs/seg\\_sun\\_cred\\_prot.pdf](http://www.ci.com/advisingtheclient/sfunds/pdfs/seg_sun_cred_prot.pdf)

defaults.<sup>24</sup> It has been furthered argued to mean steps take to protect one's assets from collection by creditors.

Indeed, it is averred to be the laws that protect both the creditor and borrower in case of payment defaults. These similar laws confer protection to creditors against defaulting borrowers.<sup>25</sup> And the essence of any transaction by way of mortgage is that a debtor confers upon his creditor a proprietary interest in property of the debtor.<sup>26</sup> But in this particular context of this paper, it shall precisely mean protection of creditors upon default of payments against burrowers particularly those who are fraudster.

### **I.I.VI Fraud**

Fraud is majorly perceived in criminal context; however, its traces can be found in contract and tort law. Many scholars have asserted that fraud is a term that has never been exhaustively defined and this can be attributed to the number of different kinds of conduct to which this word is applied. Therefore, several scholars have tried to elaborate or define this element as an act of using deceit such as intentional distortion of the truth of misrepresentation or concealment of a material fact to gain an unfair advantage over another in order to secure something of value or deprive another of a right. Fraud can be grounds for setting aside a transaction at the option of the party prejudiced by it or for recovery of damages.<sup>27</sup> To other scholars while defining it in legal perspective, fraud has been termed as a generic category of criminal conduct that involves the use of dishonest or deceitful means in order to obtain some unjust advantage or gain over another.<sup>28</sup>

In the Australian Government's Fraud Control Policy (Commonwealth of Australia 2000), "fraud" is described as inducing a course of action by deceit or other dishonest conduct,

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<sup>24</sup> D. Maresch, *et al*, *Creditor protection, judicial enforcement and credit access*, Working Paper Series NO. 1829, European Central Bank, 2015, p.10 available at

<https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1829.en.pdf?73b801d79490646e88a69b0cb5cfc2c>

<sup>25</sup> *Business Pundit* at <http://www.businesspundit.com/encyclopedia/accounting-2/creditor-protection/>

<sup>26</sup> *Swiss Bank Corporation vs. Lloyds Bank Ltd and Others* Buckley LJ, 1982] AC 584 at 595

<sup>27</sup> L. Vasiua *et .al* , *Defining Fraud: Issues for Organizations from an Information Systems Perspective*, 2003, Deakin University, p.7 , available at <http://www.pacis-net.org/file/2003/papers/is-strategy/175.pdf>

<sup>28</sup>G. R. Smith, *Defining, Measuring, and Reporting Fraud Risk Within Your Organisation' in Applying Risk Management to Implement a Proactive Fraud Prevention Strategy in Financial Services*, I.I.R. Conferences, Parkroyal Darling Harbour, July 2001,P 1-2 available at

<https://pdfs.semanticscholar.org/b060/f755a7944e594afcf80c9f65d50e1f34052c.pdf>

involving acts or omissions or the making of false statements, orally or in writing, with the object of obtaining money or other benefit from, or of evading a liability to, the Commonwealth.

According to *Howard vs. West Jersey & S. S. R. Co.*, Fraud, in the sense of a court of equity, properly includes all acts, omissions, and concealments which involve a breach of legal or equitable duty, trust, or confidence justly reposed, and are injurious to another, or by which an undue and unconscientiously take advantage is taken of another.<sup>29</sup>

However, fraud is not only an offence as depicted under the law providing offences and their penalties as well as the law governing companies but it is also a wrong under laws, like the law governing contracts, under this; it may be in organizations, between individuals, a firm, companies and other legal personalities. In most of these situations, there is always a creditor and a debtor which relationship is brought about by a contractual relationship.

Under Rwandan Law particularly article 174 of Law determining offences defines fraud as an activity done by any person who, by deception, obtains another person's property, whole or part of his/her finance by use of false names or qualifications, or who offers positive promises or who threatens of future misfortunes, commits an offence.<sup>30</sup> The Rwandan further recognizes fraudulent bankruptcy in company law as a crime,<sup>31</sup> and several others but which are not strictly in the sense of fraud under security agreements. However, the Rwandan Law under Law on contracts tackles Fraudulent or material misrepresentation.

## **I.II FORMS OF DEBTOR'S FRAUD**

This section tackles specific forms of fraud, which are contractual misrepresentation, over valuation, intentional destruction of the security, diversion of proceeds and fraudulent bankruptcy.

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<sup>29</sup> X, available at, <https://www.lawnotes.in/Fraud>

<sup>30</sup>Law n°68/2018 of 30/08/2018 Determining offences and penalties in general (*Official Gazette no. Special of 27/09/2018*) ( Herein after referred to Law determining offences)

<sup>31</sup> "a white-collar crime that involves a debtor who conceals assets to avoid having to forfeit them, an individual who intentionally files false or incomplete forms, an individual who files multiple times using either false information or real information in several jurisdictions, an individual who bribes a court-appointed trustee"

## **I.II.I Secured contractual misrepresentation**

This is one of the vitiating factors of a contract, in all, but the simplest of transactions, there will be some negotiations before a contract is made. Statements made during negotiations are classified by the courts as either representations or terms with the former being a statement which may have encouraged one party to make the contract but is not itself part of that contract, and the latter being a promise or undertaking that is part of the contract. Now, disputes generally centre around statements which have proved to be untrue: if that statement is a representation, it can give rise to an action for misrepresentation, whereas if it is a term, it can give rise to an action for breach of contract.<sup>32</sup>

The contractual misrepresentation that is of core importance in this paper is a fraudulent one; nonetheless it shall be analysed in the general sense of it.

### **I.II.I.I General Overview of contractual misrepresentation.**

A general contractual misrepresentation occurs, when one party made an untrue statement of which that statement was a statement of fact not a mere opinion, and it indeed induced the innocent party to enter into the contract. The statement may be, spoken, written, or even, by conduct. In the case of *Fletcher vs. Krell* (1873), a woman applied for a post of a governess without revealing the fact that she had previously been married. At that time, this may well have been a factor that would have affected the employer's decision to employ her but despite this the court held that her silence did not amount to a misrepresentation.<sup>33</sup>

Under common law however, there are situations when the law does impose a duty to disclose information and remaining silent about a material fact in any of those circumstances can therefore amount to contractual misrepresentation as here-under analyzed; Contracts requiring, utmost good faith "*uberrimae fidei*" like insurance contracts, sale of shares in a company, sale of land where utmost good faith is required on matters

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<sup>32</sup> C.Elliott and F.Quinn, *Contract law*.8<sup>th</sup> Ed. Harlow: Pearson education limited, 2011.

<sup>33</sup> *Ibid.*

affecting title to land although not physical defects, in most of these situations, the contract can be rescinded although damages are not awarded.<sup>34</sup>

A contractual misrepresentation is said to arise within the period prior to the formation of the contract during negotiations which are held between the contracting parties. It has been further argued to denote an unambiguous false statement of fact or law which is addressed to the party misled and has to be material and which induces a contract. Therefore, misrepresentation can be broken down into three constitutive elements;

- The first be the representation which must be unambiguous false statement of fact or law;
- The party addressed must have been misled and
- It must be an inducement to entry into the contract and possibly it must also be material.<sup>35</sup> For an inducement to be constituted as on, then the representee must be aware of the statement; does not know that the statement is untrue, must have relied on the statement; and does not have reasonable grounds for doubting the accuracy of the statement.<sup>36</sup>

The claim for inducement does not depend on the fact that the representee could have verified the accuracy of the statement or whether he/she is depended on his or her own investigations in finding fact and could not ascertain the truth.<sup>37</sup>

To this Judge Bowen, L.J asserted that, facts which are known to both contracting parties are mere expression of opinion, but it becomes a rather misrepresentation when the facts are not equally known to both sides, then the statement of opinion by the one who knows the facts becomes a misrepresentation. <sup>38</sup>

Under Rwandan law, contractual misrepresentation which is not specifically defined by the law, but rather enumerated as misrepresentation of fact which accrues in four forms as here below;

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<sup>34</sup> *Ibid.*

<sup>35</sup> P.M. Eggers, *Deceit; The lie of the law*, Informa Law, London 2009, p.120-124

<sup>36</sup> F. W. Li, *Legal systems in Asian-business law ;contract law in Singapore*, 31 May 2018 p.37 available at <https://www.aseanlawassociation.org/papers/ALA-SGP-ch5-BusinessLaw02-ContractLaw.pdf>

<sup>37</sup> Supra note 32

<sup>38</sup> *Smith vs. Land and House property corporation*, (1884) LR 28 Ch

- an assertion which does not conform to the truth;
- a misleading conduct;
- an action intended, or known to be likely to prevent another from learning the truth;
- Non-disclosure of a fact knowing that the disclosure would prevent the other party from making a mistake.

The non disclosure is considered as a fraudulent action.<sup>39</sup> Deducing form the wording of the this law it can be asserted that Rwandan jurisdiction only recognises one type of misrepresentation which material or fraudulent misrepresentation since In the four ways of conducted of how a contractual misrepresentation can be expressed, one can deduct an intention of the doer in every conduct.

### **I.II.I.II Liability for contractual misrepresentation.**

Looking at various scholarly writings as well as how various jurisdictions have treated this concept, a nearly agreeable element is that for a representation to be actionable, it must have been a statement of fact. Such a statement can be made expressly in writing or orally or may be implied from words or conduct, Inducement alone, however, is not enough and it must be shown that the defendant intended for the representee to be induced by their misrepresentation the representation relied on must have been false.

To this, the US courts have affirmed that: Liability for misrepresentation occurs when there is a duty, if one speaks at all, to give the correct information. There must be knowledge or its equivalent that the information is desired for a serious purpose; that he to whom it is given, intends to rely and act upon it; that if false or erroneous he/she will because of it be injured in person or property. Finally, the relationship of the parties, arising out of contract or otherwise, must be such that in morals and good conscience the one has the right to rely upon the other for information, and the other giving the information owes a duty to give it with care.<sup>40</sup>

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<sup>39</sup> Article 50 of Law N°45/2011 OF 25/11/2011 Governing Contracts (*Official Gazette n° 04bis of 23/01/2012*) (*Hereinafter referred to as law governing contracts*)

<sup>40</sup> *International products co. Vs. Erie Railroad Co.* 237 U.S 402 (1915) AT 338



On another note, keeping quiet about a change in circumstances can also amount to a misrepresentation; a case in point is the case of *With vs. O'Flanagan* where the claimant entered in negotiations with defendant's medical practice where it was represented that the defendant's practice took around £2000 per year, however due to the defendant's illness the practice had declined and by the time it was taken over it was nearly non-existent.<sup>41</sup> The claimant contended rescinding the contract. The court at first instance dismissed the case affirming that the representation was true. However, the Court of Appeal overruled the decision averring that the defendant's representation was meant to induce the applicant into entering the contract which means that the representation was untrue since the claimant deserved to know the change of circumstance.<sup>42</sup>

Partial revelation too amounts to a misrepresentation where in the case of *Dimmock vs. Hallet* (1866), the seller of land told a prospective buyer that the farms on the land were let but did not mention that the tenants were about to leave. Omitting this fact presented such a distorted picture of the true situation that the court held there had been a misrepresentation in fact.<sup>43</sup> This too seems to be encircled in Article 50 paragraph 4 as long as the part that has been left out would prevent the other party from making a mistake once disclosed.

Another contract which requires disclosure of information is one of a fiduciary relationship like that between parents and children, solicitor and client, trustee and beneficiary, and principal and agent etc. a party can always show that he or she placed some trust in the other and the other therefore had influence over them. This however under our law seems like 'undue influence' provided under article 57 of the law governing contracts.<sup>44</sup>

The court of appeal however suggested in the case of *Banque financiere de la cite vs. west gate insurance* (1989) that a party might incur liability for remaining silent where the

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<sup>41</sup> *With vs. O'Flanagan*, Court of Appeal, (1963) Ch 575

<sup>42</sup> *Ibid*

<sup>43</sup> C., Elliot and F.Quinn, *Contract law*, Ed. 8<sup>th</sup> Harlow: pearson education limited, 2011.

<sup>44</sup> *Ibid*.

courts found; there was a voluntary assumption of responsibility by one party and reliance on that voluntary assumption by the other.<sup>45</sup>

A statement must be one of fact as described under Article 50. Merely delivering an opinion will not create an actionable misrepresentation. In *Bisset vs. Wilkinson* (1927) where Bisset was selling land in New Zealand to Wilkinson, who planned to use it for sheep farming. The land had not been previously used for sheep farming but during the negotiations, Bisset expressed the view that if the land was worked properly, it could support 2,000 sheep. This was actually not the case. However, his statement was just taken to be a mere opinion as both parties knew that the land had never been used for sheep farming.<sup>46</sup>

### **I.II.I.III Forms of contractual Misrepresentation**

This sub section deals with exploring the forms in which contractual misrepresentation can be performed. We shall see that a misrepresentation can be out of negligence or lack of care or it can be intentional, the it shall be elaborated in details are herein below;

#### **a) Fraudulent misrepresentation**

Fraudulent misrepresentation has been identified with intentional misrepresentation.<sup>47</sup> It means that if the maker of the representation which is false has no honest belief in the truth of his/her statement when he makes it. To this Lord Herschel ruled in *Derry Vs. Peek* Case that fraud is proved when it is shown that false representation has be made knowingly or without belief in truth or recklessly, careless whether it be true or false.<sup>48</sup> Therefore to form a fraudulent misrepresentation the following constitutive elements must be met:

- ✚ a false representation of material fact;
- ✚ with knowledge or belief as to its falsity, or with reckless disregard as to its truth or falsity;
- ✚ with an intent to induce the other party to rely on the misrepresentation;
- ✚ justifiable reliance on the misrepresentation by the others; and

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<sup>45</sup> *Ibid.*

<sup>46</sup> *Ibid.*

<sup>47</sup> W. Page Keeton *Et al.*, *Prosser and Keeton on the law of torts*. Ed.5<sup>th</sup>, West Group, 1984, P. 105 & 107.

<sup>48</sup> *Derry vs. Peek*, 14 App Case 337, House of Lords, Judgment of 1<sup>st</sup> July 1889, p.374

✚ Damage or injury caused to the plaintiff by the reliance.

A relevant case here is in the case of *Redgrave v Hurd* where the solicitor was selling his practice and so told the buyer that it was worth 300 pounds a year and invited him to check this by inspecting the papers in his office. Had the buyer done this, he could have known that the practice was actually worth no more than 200 pounds. However, the court of appeal held that the buyer had relied on the seller's word, and was entitled to do so, even if he had the means to discover that it was untrue<sup>49</sup>. Another case, refer to; *Jeb fasteners ltd v Marks bloom & Cos Ltd*.

Under Rwandan law of contracts in its article 51, it requires that for a fraudulent misrepresentation to be present, *the maker knows or believes that his or her assertion is not in accordance with the facts, is not sure if what he or she states or implies as reality is true and knows that he or she does not have the evidence of his or her assertion*.<sup>50</sup>

For example, in the case of *Pantoja-Cahue v.s Ford Motor Credit Co*, where the plaintiff Mario Pantoja-Cahue was seeking damages from defendant Ford Motor Credit; the plaintiff purchased a 2000 Ford Explorer from auto dealer Webb Ford, a native Spanish speaker, negotiated the purchase with a Spanish-speaking salesperson at Webb. Plaintiff signed what he thought was a contract for the purchase and financing of the vehicle, with monthly installment payments to be made to Ford. The contract was in English. Some years later, plaintiff discovered the contract was actually a lease, not a purchase agreement. Plaintiff brought suit against Ford and Webb on August 22, 2003, alleging fraud. The motion was dismissed even at appeal level affirming that the court of first instance did not error and thus ruled that an act of fraud must be unfair and a deceptive conduct, thus the plaintiff did not support his conclusory legal statements that Ford and Doe's conduct were unfair. Indeed, what lacked in this matter is that Pantoja made a presumption not based on the representation of Ford.<sup>51</sup>

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<sup>49</sup> *Redgrave vs. Hurd*, Court of Appeal, Judgment of 28<sup>th</sup> November 2019

<sup>50</sup> Art. 51, Law governing contracts.

<sup>51</sup>*Pantoja-Cahue v. Ford Motor Credit Co*, Case No-1-06-1234, Appellate Court of Illinois, Judgment of 17<sup>th</sup> August 2007

## b) Negligent Misrepresentation

When a party makes a false statement, not purposefully but carelessly, believing the misrepresentation is true, the doctrine of negligent misrepresentation arises. Pursuant to this doctrine, a misrepresentation made with an honest belief as to its truth nonetheless may be deemed negligent, and thus actionable. A duty of care owed to the plaintiff by the defendant, a false statement of material fact by a defendant, negligently made with the intent that the plaintiff rely on it, causation in fact (that is, actual reliance on the part of the plaintiff), justifiable or reasonable reliance, proximate causation, and damages.<sup>52</sup>

It has been put forward that a mere omission of facts will not constitute a negligent misrepresentation of claim, but rather there must be made as an affirmative statement which causes a justifiable reliance.<sup>53</sup> Therefore, it implies that for the negligent misrepresentation to accrue there must be an existing relationship between the parties and a duty of fiduciary. A particular example in this context is the case of *Hedley vs. Heller*. In this case Hedley Byrne relied upon a recommendation made by a bank called Heller & partners ltd on a business called Easipower. The later defaulted on money it owed Hedley and a claim of negligent misrepresentation was made but lost.<sup>54</sup>

However there are some contentions on the element of fiduciary duty where various courts have interpreted it differently, a case in point is the case of *Central States Stamping Co. v. Terminal Equipment Co & Lake County National Bank* (Para 28), where the court held that; “a duty to disclose information does not depend on the existence of a fiduciary relationship, but rather, arises “in any situation where one party imposes confidence in the other because of that person’s position, and the other party knows of this confidence”.<sup>55</sup> Nonetheless these assertions have been brought forth when the party in question is the lender.

Indeed, the above assertion was established by House of Lords in *Byrne v Heller & Partners* where they stated in obiter that there can be liability for negligent misrepresentation on

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<sup>52</sup> *Mc Nierney v. McGraw-Hill, Inc.*, 919 F. Supp. 853, 862 (D. Md. 1995)

<sup>53</sup> R. E. Kaye, *Lender Liability and Banking Litigation*, Ed. 2<sup>ND</sup>, Law journal press, 2006, P.48

<sup>54</sup> *Hedley Bryne and Co Vs Heller & Partners Limited* (1964) as cited by J. O’Riordan, A2 Law for AQA, Heinemann Educational Publishers, 2003., p.78

<sup>55</sup> *Central States Stamping Co. v. Terminal Equipment Co & Lake county National Bank*, Court of Appeal 6<sup>th</sup> Circuit, Judgment of Feb 21<sup>st</sup> 1984

the normal principles of tort, where there was a special relationship between the parties. It is however still not very clear on what is special relationship but broadly speaking, it appears that such a relationship will only arise where the maker of a false statement has some knowledge and skill relevant to the subject matter of the contract, and can reasonably foresee that the other party will rely on the statement. This was the case in *Esso Petroleum Co Ltd v Mardon* (1796).<sup>56</sup>

The Rwandan Law general perspective of the contractual misrepresentation is that, it renders a contract voidable<sup>57</sup> under Rwandan law depending on the type of misrepresentation that has occurred with regards to Article 54 of the law governing contracts. This means that the consequence of a contract having been formed on the basis of a misrepresentation is for the contract to be voidable at the request of the party who is the victim of the misrepresentation. It is not void because this denies that party the right to continue with the contract if that is in their interest.<sup>58</sup>

### **c) Innocent Misrepresentation**

This context has been argued to refer to when a party makes a representation that he or she honestly believes to be true, and there is no negligence in the formation of this belief, yet the misrepresentation actually falsely represents material facts, the misrepresenting party is only liable for an innocent misrepresentation.<sup>59</sup> This is to mean that a misrepresentation was made but the representor can indicate how he/she had reasonable grounds to believe their statement was true. Indeed, it was at first used to describe all misrepresentations that were not fraudulent.<sup>60</sup> Therefore it is usually not actionable since it has a lot of similarities with common mistake.

Having elaborated on what scholars, judges and various jurisdiction say on contractual misrepresentation, it is rather arguable that the treatment of fraudulent misrepresentation

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<sup>56</sup> Supra note 41.

<sup>57</sup> Art. 54, Law governing contracts.

<sup>58</sup> C.Tuner, *Unlocking Contract Law*. Ed.4<sup>th</sup>, New York: Routledge, 2014.

<sup>59</sup> F. J. Cavico, *Fraudulent, Negligent, and Innocent Misrepresentation in the Employment Context: The Deceitful, Careless, and Thoughtless Employer*, Vol. 20 Campbell L. Rev. 1, 1997, p.56-58 available at <https://scholarship.law.campbell.edu/cgi/viewcontent.cgi?article=1328&context=clr>.

<sup>60</sup> Supra note 43

should not be a standard of rendering a contract void and null, but sometimes if such is remediable to the extent that the anticipated benefit of the contractor as they were at the beginning of entering into that agreement are attainable.

### **I.II.II Intentional destruction of mortgage**

Even if this section is majorly concerned with intentional disposition of a collateral/security. We shall not overlook the fact that disposition of the security or collateral can be non-intentional or what has been termed as involuntary disposition. This can be in case of fires, accidents in case of pledges, or theft. <sup>61</sup> This means that both forms of disposition of collateral shall be covered as hereunder.

While interpreting involuntary and voluntary disposition specifically in respect to insurance matters, the Rhode island Supreme Court argued in case of *Universal C.I.T. Credit Corp. v. Prudential Investment Corp.*, where the collateral which secured the debtor's obligation to the secured party was a 1964 Diamond T tractor, which was later completely destroyed in an accident and the secured party attempted to reach the insurance fund as "proceeds" of the collateral over the claim of an assignee of the debtor's interest in the insurance policy. The Rhode Island Supreme Court held for the assignee in part on the ground that "*the destruction of the tractor was involuntary conversion, therefore it's not a disposition; since the wrecking was not intentional the insurance would not be taken as the proceeds of the collateral to be used*". <sup>62</sup>

However, there has been a differing argument where the courts have argued that without putting in consideration the ways of disposition of the collateral, the secured creditor cannot recover the same for an insurance policy. This has been a policy of property damage insurance, which is a personal contract that does not attach to or run with the title to the property insured. Therefore, a creditor, whether simple or secured, has no right in the first

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<sup>61</sup> C. S. Bjerre, *secured transactions inside out: negative pledge covenants, property and perfection*, Cornell Law Review, Vol. 84, 1999, 305p available at

[https://law.uoregon.edu/images/uploads/entries/Carl\\_S.\\_Bjerre\\_secured\\_trans.pdf](https://law.uoregon.edu/images/uploads/entries/Carl_S._Bjerre_secured_trans.pdf)

<sup>62</sup> *Universal C.I.T Credit corporation Vs. Prudential Investment Corporation et al.* Appeal No.4 , Supreme Court of Rhode Island, Judgment of August 25, 1966

instance of a loss to the proceeds of the insurance taken out by the owner and made payable to him, in the absence of agreement to insure for the benefit of the creditor. <sup>63</sup>

Looking at some foreign Jurisdictions, particularly the United States of America, it is argued that; the Debtor is required to step out of the way of the creditor's exercise of its legal rights, and to reasonably cooperate with the creditor to obtain possession of the collateral where feasible. Therefore, it can be argued that the debtor can be found to be legally responsible for the cost of the lost or abandoned collateral where the debtor has not acted in good faith. This would include situations where the debtor intentionally destroyed the collateral, or where the debtor intentionally conveyed possession of the collateral to a party who cannot be located. So long as the debtor has acted in good faith with respect to abandoned or lost collateral securing a loan, the Debtor should not have to worry about being responsible for paying the secured as anything other than a general unsecured creditor. <sup>64</sup>

The legal issues that can arise in these situations of lost collateral can be complicated. Sometimes the debtor will be required to meet a burden of proof that the debtor acted in good faith even though the collateral securing a loan cannot be located. The debtor may have to work with his or her attorney to obtain discovery documents from any third party, such as an auto dealer, to track down the title history of the collateral. The most important thing for the debtor is to always act honestly and in good faith with respect to creditors both before and after the completion of the loan transaction.<sup>65</sup>

Under Rwandan law, it can be argued that International destruction is one of the commonly practiced forms of fraud in the commercial sector which is not only a wrong doing but also a crime under Rwandan law. This is elaborated about under Article 178 of the law determining offences where its states that, *any debtor, creditor or any other person who mortgaged a property, destroyed or embezzled the mortgaged property, commits an offence* and continues to state the punishment upon conviction. However, the law does not specifically define what intentional destruction of mortgaged property. Nonetheless,

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<sup>63</sup> *Rath Vs. Aerovias interamericans de Panama*, Supreme court Trial Term, New York County, Judgment of 1953, Paragraph 140

<sup>64</sup> Chapter 13 of US Code: Title 11: BANKRUPTCY

<sup>65</sup> *Ibid*

deducting from the above provision, we can ascertain that this element requires intention; *one must have maliciously destroyed or embezzled the mortgaged property.*

Therefore, the onus of proof still remains with the creditor to prove to the court that the debtor acted in bad faith, and this has seemed to be a difficulty burden since the debtor as the possessor and owner of the security and have the full information on whatever circumstance they might undergo.

### **I.II.III Over valuation of the collateral**

This is tackled under the Banking system in Rwanda, where all pledged collaterals or mortgages to the bank are valued by, approved valuers by BNR hence some collaterals can be extremely over-valued, which may propel the bank to give a lot of money as loan considering the misrepresented value of the property. However, to mitigate this fraud or risk, most banks have internal valuers who do cross valuation considering against the value of the external valuer. An even the Central Bank may require another valuation to be undertaken by a valuer of its choice,<sup>66</sup> a process that is hardly followed except. Important to note, if both the internal, and BNR (external) valuers are manipulated or bribed by the property owner, still the risk of fraud is mostly likely to be suffered.

For example, a customer fraudulently presenting to the bank a land title of a big land for a large sum of a loan, after defaulting the bank realizes the land size is way too small as compared to what was presented to the bank. This puts the bank at a risk of a loss while the debtor who is the customer in this case is unjustly enriched. Important to note here is that over valuation of the collateral seems to be a chip off the old block of contractual misrepresentation even-though the latter is quite broad compared to the former. This risk shall be projected by some articles that we shall come to discuss later on in the law governing companies particularly those relating to fraudulent bankruptcy.

A case in point is the case of *Prosecution vs. Iyamuremye*, the former entered into a loan agreement with AB Bank for 11,000,000 Frw and failed to honour his obligations. MUNYAMARERE Robert and NYIRANDIMUBANDI Drocelle gave their plot as a mortgage to

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<sup>66</sup> Article 24 par 3 of the regulation n°12/2017 of 23/11/2017 on credit classification and provisioning (*official Gazette n° 49 bis of 04/12/2017*)



the said loan where they misled the Bank by confirming that the property was worth 23,000,000 Frw yet its actual value is 400,000 Frw in collaboration with Loan officer Musabe Gilbert. The case was lodged before the Intermediate court of Nyarugenge which sentenced Placide and Gilbert to 3 years imprisonment.<sup>67</sup> The defendants appealed against the decision before the High Court under case under **RPA 00491/2018/HC/KIG** where it is pending ruling of the court.

In view of the above, it is evident that, the secured creditor even if he will be able to recover his monies it will have taken a not only a lengthy process but even the goal end anticipated will not have been attained, base the core element of security agreement was fraud.

#### **I.II.IV Diversion of business proceeds**

There are other frauds between creditor and debtor like Diversion of business proceeds which happens when say, a client takes a loan from a bank and promises that all his business proceeds will be going straight to the server (bank), but later diverts the proceeds to another bank contrary to the agreement.

#### **I.II.V Forgery**

Forgery is a crime in the sense that it occurs when a person makes, draws, and alters a document with the intention to commit fraud, or even one writes a document and say another person did it. While counterfeit is a criminal simulation it is done with the intention to make the fake product to appear original. Article 276 talks about forgery, falsification and use of forged documents, any person who, in any manner, forges or alters documents by forged signature or fingerprint, falsifying documents or signatures or impersonation, forging agreements, its provisions, obligations, or discharged obligations commits an offence. Any person, who with fraudulent intention, produces a false written document, causes to write false statements or produces a conflicting declaration, is considered to commit the offence of forgery.

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<sup>67</sup>*Prosecution vs. Iyamuremye Placide & Musabe Gilbert*, Case no. RP 00131/2018/TG/NYGE, Intermediate court of Nyarugenge, Judgment of 18<sup>th</sup> June 2017

However in general sense of commercial practices unless taken in a strict sense of a criminal act, this can also fall under the contractual misrepresentation which can be subjective when it regards to the one signing it who may be forging a signature or a power of attorney or objective in respect to objective is case there are case of forgery of documents like mortgage papers, presentation of forged title.

Let us look at a clear example of Rudacyahwa Alfred Vs. AB Bank; AB Bank entered into a loan agreement for 12,000,000 **Frw** with BAMURANGIRWA Leatitia, against which she pledged two cars PLAQUE RAB 646S worth 6, 562, 500 Frw and PLAQUE RAB 839N worth 9.625.000 Frw using a power of attorney of her husband Rudacyahwa since they were under separation of property regime. Leticia defaulted in payment; thus, the Bank sold the pledges which could not satisfy the loan thus the Bank went to recover the rest from court and the case was ruled in their favour awarding them a total of **14,303,559Frw**.<sup>68</sup>

It was not long after the ruling that , Rudacyahwa lodged a case against AB bank seeking annulment or invalidation of the security agreement , asserting a forged power of attorney as at that time he was in Canada so there is no possible way he could have signed the power of attorney before the Civil status Officer in Kigali. The case was heard at first instance before commercial till the supreme court Kigali, and indeed the court inclined to Rudacyahwa's assertions and affirmed that the Power of attorney was forged, thus annulling the security agreement which meant that the bank was ordered to reinstate the vehicles, and was awarded damages of 1, **875,000frw**<sup>69</sup>

Indeed this has been rampantly used as form of evasion of surety rights where upon defaulting by the principle debtor , the sureties always allege forgery of their signature, Indeed a particular case in point was Nyiramuruta case who alleged a forged signature after having been taken to court as a surety by AB bank , however this was declined by court on two accounts; first by forensic lab test results which proved the signature to be the same and second that fact that the same person was always notified of all unfolding

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<sup>68</sup> *AB Bank vs. Bamurangirwa Leatitia*, case no. RCOM01139/2016/TC/NYGE, Commercial Court of Nyarugenge , Judgment of 23<sup>rd</sup> February 2017

<sup>69</sup> *AB Bank Rwanda Ltd vs. Rudacyahwa Alfred*, Case no. RCOMAA 00020/2017/SC, Supreme court , Judgment of 22<sup>nd</sup> June 2018

progress of the principle debtor, even demand notice for late payment but that fact was only evoked by the surety only after having been sued in courts. Thus, jointly with the principle debtor they were ordered to pay the outstanding loan owed to AB BANK.<sup>70</sup>

Therefore these a few highlighted issues have remained the major difficulties faced by the secured creditors even if at the onset of it one may easily assert that such creditors are protected.

### **I.III POSSIBLE CAUSES OF FRAUD AMONG DEBTORS**

As the earlier section have put forward on the forms of fraud highly encountered by secured creditors, this section shall majorly focus on what are the possible cases of such fraud in security transactions:

#### **I.III.I Transactional Distance**

By transactional distance, one is referring to geographical proximity between the typical borrower and the lender. Indeed, it has been argued that in the past days, the borrower and lender dealt with one another directly with respect to the loan application and most of the other requirements that had to be satisfied before the lender funded the loan.<sup>71</sup> But in recent days, there has come up a policy of intermediaries in financial transactions, who occasionally act as agents for one or both of the parties and such intermediaries can sometimes include mortgage brokers, appraisers, title insurers, surveyors, and closing officers.<sup>72</sup>

Consequently, the use of mortgage brokers eliminates direct contact between lenders and buyers, as in some states like US, not only does the mortgage broker select the lender, or select a small list of prospective lenders for the borrower to consider, but the broker

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<sup>70</sup>*Nyiramuruta Bertilde & others vs. AB Bank Rwanda Ltd*, Case No. RCOMAA 00013/2018/CA, Court of Appeal Judgment of 14<sup>th</sup> June 2019

<sup>71</sup>J. C. Smith, *The Structural Causes of Mortgage Fraud*, Syracuse Law Review, Vol. 60, University of Georgia, 2010, 480-497, available at

[http://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=1845&context=fac\\_artchop](http://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=1845&context=fac_artchop)

<sup>72</sup> *Ibid*

typically serves as the channel for all communication between the borrower and lender until the closing of the loan.

Thus, the above practice has not only created transactional distance between borrowers and lenders substantially but also adds to lender risk. So even when such a go-between is not corrupted in the sense that he /she is compelled to give an account of information that he /she knows it is untrue, nonetheless the a fraudsters debtor can still manipulate one with low level of competency to affirm an account of false information which in turn the liaison turns into a record that appears to be fine on its face.<sup>73</sup>

### **I.III.II Great demand for Profit**

Indeed, the great demand for profits has also increased the fraudulent ways among debtors. For example, Banks in Rwanda to be precise AB Bank has this kind of policy, where the more burrowers a creditor line officer brings in, the more rapid his/her promotion will be. This implies that such situation puts the officers in a state where they shall not be minding about paying keen attention on who the Bank is lending money to but rather anticipating that the Bank is gaining a lot of profits and looking also at self interest of promotion.

As a result, the prospective debtors manipulate and takes advantage of the situation and either uses forged documents or intentionally gives false information that will favour him/her or uses none existing land parcel which in the end will result to several cases of fraud as discussed in this paper. In the end Decisions are shall be influenced by pressure to meet goals while decisions are subjective, based on the level of trust in the loan officer. (This is according to the information given by one officer of the Bank who desires his name not remain anonymous.)

### **I.II.III Rising demand for Homeownership**

The above fact might have also possibly increased fraudulent debtors particularly in respect to mortgage frauds. A case in point is particularly the state of US where

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<sup>73</sup> *Ibid*

homeownership rates hit 64.2%,<sup>74</sup> it is said that; Homeownership has been on the rise since 2016, when it hit a 50-year low of 62.9%. Thus, due to this rise, you find that there is a decrease in home records compelling the demand for homes to rise and in the more fraudulent mortgage applications can be filed, as homebuyers try to get an edge in a competitive home-buying field.

#### **I.III.IV Wilful negligence and improper appraisal of credit officers**

This is where you find the Bank officers have willingly neglected the loopholes in the application documents of the prospective debtor or indeed connived with debtors to create fictitious mortgages or guarantors, in the end Fictitious pledge or mortgage agreement are permitted, where the proceeds of the loan might be shared with both the fraudster as well as the loan officer a fact that shall only be discovered during debt recovery, since the involving party is an insider who shall always cover up the act.<sup>75</sup> This is indeed what happened in the case of Iyamuramy Placide (reference to Sub section 1.2.3).

Thus, if appraising clients is the core key in the loan cycle which involves screening client to ensure that they the loans disbursed shall be fully paid without any hindrances or objections, its ineffective will automatically lead to such cases of fraud.<sup>76</sup>

#### **I.III.V Bad faith of client**

It is believed that the relations between a financial institution and its burrowers is based on the fact that there is a time gap between when the loan is disbursed and when it shall be fully paid. Thus, if a particular loan is given merely depending on the future repayment of the debtor, the moral hazard in this element becomes crucial. More so the borrower has better information about his/her economic circumstances than the lender. Thus, together

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<sup>74</sup>United States census bureau , USA Census Data available at <https://www.census.gov/construction/nrc/pdf/newresconst.pdf>

<sup>75</sup> CENTRAL VIGILANCE COMMISSION, *Analysis of top 100 bank frauds* , New Delhi, 2018 , p.42 available at <http://www.cvc.nic.in/sites/default/files/new1111.pdf>

<sup>76</sup> R. Aliija and B. Wakabi, *The effect of Loan appraisal Process Management on Credit performance in microfinance Institutions (MFIs); A case of MFIs in Uganda*, International Journal of science and Research, Index Copernicus Value. 2015, p.2285 available at <https://pdfs.semanticscholar.org/defe/1b81da0e5145f5460acc3c05ff7a28e26274.pdf>

with bad and the well versed position of the burrower on his/her status has created many opportunities for fraud, deceit and misjudgement.<sup>77</sup>

### **I.II.VI Lack of strong institutional systems**

This is also a likely reason to have caused such frauds; this is where you find that Banks or financial institutions do not have strong systems to determine which client has the capacity to pay or one whom lacks it. Indeed, this is where you find that debt recovery is seen as a continuation of arrears management. This is what has been known as failure in the methodology application; such as giving loans that exceed clients' capacity to pay and over-indebtedness; client has poor references or a poor attitude towards paying on time; there is no cross-checking of information to verify consistency, or documentation control; there are no clear policies.<sup>78</sup>

In a nutshell, there are several possible causes of fraud perpetrated by debtors which can even range to illiteracy where the local citizens believe any financial need shall be settled through acquiring a loan and in the end such citizen might given in false information unknowingly or even due to need to meet targets from the officers such minor fraudulent details are not paid attention to. Financial institutions lack monitoring and evaluation process to know where its money shall be employable, the progress of the start -up burrowers if their representations are true, to keep a close connection with burrowers, which is the most attributing factor of failure to locate the fraudster once fraud is discovered.

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<sup>77</sup> K. Gratzner, *Default and Imprisonment for Debt in Sweden: From the Lost Chances of a Ruined Life to the Lost Capital of a Bankrupt Company*, p.17 available at <https://www.diva-portal.org/smash/get/diva2:212886/FULLTEXT01.pdf>

<sup>78</sup> ACCON Insight, *Best Practices in Collections Strategies*, 2008, P.2 available at <https://www.smartcampaign.org/storage/documents/Tools and Resources/ACCIONBest Practice in Collection Strategies.pdf>

## CHAPTER TWO: CREDITOR'S PROTECTION AND REMEDIES IN CASE OF DEBTORS' FRAUD IN COMMERCIAL RECOVERIES

This chapter analyses available guarantees and protection of secured creditors in case of debtors' fraud. It will highlight powers of creditors upon defaulting debtors. Creditors want assurances that they will be repaid by the debtor; an oral promise to pay is no security enough which indeed may be difficult to prove. A signature loan is merely a written promise by the debtor to repay, but the creditor is stuck holding a promissory note with a signature loan only!<sup>79</sup>

On the other hand, we see that debt recovery has greatly shifted where by debtors have departed from facing inhuman punishments like imprisonments though some States do still have them as some forms of protecting creditors, to instead an enlightened resilience on property remedies.<sup>80</sup>As Mark Howard asserted that; a creditor is offered a greater protection by taking a mortgage or charge or pledge over the assets belonging to the borrower, since the creditors rights are propriety and can be asserted as against the asset even if that particular asset has been passed to a third party.<sup>81</sup>

It is therefore argued that if a mortgage is correctly *granted* and *protected*, the security is binding as against anyone who later acquires it or any interest attached to it.<sup>82</sup> Apart from the obvious protection of having the security to fall back too upon default, secured creditors, have other rights which they can evoke preceding the rights over the security such as right to payments, or rescission of contracts and several others it shall be enumerated hereunder. Hence this following writing shall cover other forms of protection conferred to secured creditors while tackling the forms of protection contained within the secured creditor's right over the security.

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<sup>79</sup> D. May *et.al*, *Legal Aspects of Corporate Management and Finance; Introduction to Secured Transactions*, flat world publication, 2012. P.979

<sup>80</sup>B.Kercher *et. al*, *Consumer Debt recovery law*, ed. 2<sup>nd</sup>, The Federation Press, 2002, p.5

<sup>81</sup>M. Howard QC *et, al*, *Butterworths Banking Law Guide*, LexisNexis Butterworths, Reed Elsevier, 2006, p. 311.

<sup>82</sup>*Idem*, p.339.

## II.I MODES OF CREDITOR'S PROTECTION AND REMEDIES

The following sub section tackles how a party can rescind a contract in case she/he has opted for that remedy upon occurrence of contractual misrepresentation:

### II.I.I Rescission in case of contractual misrepresentation

Rescission refers to the remedy that disaffirms the contract. The concept derives from the Latin word *rescission, rescindere* which means to cut or tear open. Thus, rescission is referred to as a process by which a subsisting contract is avoided at the instigation of one of the parties, on account of some defect vitiating or otherwise tainting that party's entry into the contract such as fraudulent or innocent misrepresentation.<sup>83</sup> The remedy assumes the contract was properly formed, but effectively extinguishes the contract *ab initio* as though it never came into existence; and its terms cease to be enforceable.<sup>84</sup> This is an agreement to end the prior agreement in its entirety and not an agreement to alter or modify only a part of the agreement.<sup>85</sup>

However, there are some instances where such remedy is not available for example when it is impossible to restore parties to their pre-contract position. However this still a point of contention among scholars and different jurisdiction, for example Lord Browne Wilkinson indicate a great doubt while affirming that rescissions was not available since the shares in question had been sold by the plaintiff and could not be restored *in specie*.<sup>86</sup> Indeed, this writer seems to be in agreement that there are some where rescission cannot be applicable or cannot be the right remedy employable to redeem the injury for example when a loan has already be given and used, and its realised that there are grounds for annulling the contract, such annulment cannot redeem the situation. This shall be tackled more deeply as here under.

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<sup>83</sup> A. Burrows, *the law of Restitution*, Butterworth's, London, 1993, p.32

<sup>84</sup> E. M. Weitzenböck, *English Law of Contract: Misrepresentation*, Norwegian Research Centre for Computers & Law, 2012, p.15 available at <https://www.uio.no/studier/emner/jus/jus/JUS5260/v12/undervisningsmateriale/Misrepresentation.pdf>.

<sup>85</sup> E. Sherwin, *Non material misrepresentation: Damages, Rescission and the possibility of efficient fraud*, Loyola of Los Angeles, Law Review, Vol.36, Cornell Law Faculty Publications, 2003, p.1022 available at <https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1943&context=facpub>

<sup>86</sup> *Smith New Court securities ltd vs. Scrimgeour Vickers*, House of Lords, Judgment of 21<sup>st</sup> November 1996



### **II.I.I.I Forms of rescission**

As defined above, rescission has been termed as the most remedy for contractual misrepresentation yet again the most difficult one. Upon parties adopting the same remedy, the contract shall be void and null, implying *ab initio*; this shall not involve only cancellation of future executor obligations but also involves restoration of the parties to the positions they occupied before the contracts engagement.<sup>87</sup> Thus this form of remedy can take several forms, either mutually or unilaterally.

#### **a) Mutual Rescission**

Rescission of a contract may be affected by mutual consent of all parties to the contract. Mutual rescission can be affected without litigation. It can be written, oral or implied. This means that it can be implied from their unequivocal conduct that is inconsistent with continued existence of the contract. Indeed, this mutual rescission means that the parties enter into a new agreement to terminate the old agreement.

However, to accomplish an effective rescission; there must be evidence of the traditional requirements for the creation of a contract: an offer and acceptance, a mutual assent, a meeting of the minds on the terms of their agreement, consideration, and intent to rescind the former agreement on the part of both parties. Therefore, both parties agree to have the contract rescinded; they should indicate their intent and consent through a separate written document.

#### **b) Unilateral Rescission**

The unilateral rescission is that particular sanction which terminates the contract as a result of the unilateral manifestation of the creditor's will, without the intervention of the court of law.<sup>88</sup> The creditor's right to choose this form of termination of contract is an absolute and unlimited possibility. This kind of rescission is chosen by the creditor mostly when;

- when the parties have expressly agreed upon this matter;

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<sup>87</sup> J. O'sullivan, *Rescission as a self-help remedy: A critical analysis*, Cambridge Law Journal, Vol.59, Cambridge University press, 200, p.509

<sup>88</sup> D. Geanina, *The unilateral declaration of rescission - an extrajudicial mean of terminating a contract*, *Juridical Tribune*, Vol. 6, Special Issue, 2016, p.110-115, available at <http://www.tribunajuridica.eu/arhiva/An6v2/6%20lonas.pdf>

- when the debtor fails to complete or fulfil his obligations
- When the debtor did not execute his obligation although he was summoned to do so.<sup>89</sup>

In the researcher's analysis, this rescission of contract in loan agreement upon debtor's default is not often feasible but rather in the earlier formation of a contract before any contractual obligation is executed. Indeed this is what was affirmed in by I.F pop where he argued that; for Rescission to occur in loan agreement the contractual obligation must not have been executed and that first obligation which is not executed must be of greater importance to mean that the creditor is no longer entitled to expect the designated result from the contract.<sup>90</sup>

### **II.I.II Right to Payments**

Under this protection and by virtue of the contractual relationship between the creditor and the debtor, when the loan is due, then the creditor is entitled to receive his/her payment back. Under Rwandan Law this can be ascertained under Article 64 of the Law of contracts which provides that; *Contracts made in accordance with the law shall be binding between parties. They may only be revoked at the consent of the parties or for reasons based on law. They shall be performed in good faith.*<sup>91</sup>

By virtue of this and in regard to mortgage or pledge contract, notwithstanding any other informality in the contract, the secured creditor has right to payments, once the payment is due. This is especially seen when secured creditors at first may not evoke any other rights but upon debtor's default they first write a demand notice of payment and by virtue of this, secured creditors are exercising their right to payments, this has been commonly known as defaulting notice.<sup>92</sup>

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<sup>89</sup> *Ibid*

<sup>90</sup> L. Pop, I.F.Popa, S. I. Vidu, *Curs de drept civil. Obligații*, Universul Juridic Publishing House, Bucharest, 2015, p. 218.

<sup>91</sup> Law n°45/2011 of 25/11/2011 governing contracts (*Official Gazette n° 04bis of 23/01/20120*)

<sup>92</sup> P. L. Kunkel & others, *Agricultural Business Management: Foreclosure of Security Interests in Personal Property*, Farm legal series, 2015, University of Minnesota p.3 available at <https://conservancy.umn.edu/bitstream/handle/11299/199833/foreclosure-of-security-interests-in-personal-property.pdf?sequence=1&isAllowed=y>

Indeed, it is a common practice in a loan agreement for a creditor to essentially provide in the event of default, “immediately” demand repayment of the amount outstanding on that particular credit facility. Looking at secured creditors in particular, such demand always entails that if in the debtor fails to comply with that demand, any security obtained shall become enforceable.<sup>93</sup>

Therefore, regardless of the type of sale, it is argued that the lender must provide reasonable notification to the debtor and any other secured creditor before any sale. Ten days is considered reasonable notification. The notice generally tells the debtor what will be sold; whether the sale will be public or private.<sup>94</sup> However the reasonableness of time varies from country to country, in Rwanda it seems to be 30 days.

This has proved to be some form of protection where creditors sometimes get to recover their monies without selling or attacking the collateral in anyway. A case in point is the case of *AB Bank vs. Ndekwe Serge* who had entered into a loan agreement with the Bank for a loan of 10,000,000Frw while pledging the vehicles , upon defaulting or failure to pay the Bank could not get the pledges as the debtor refused to give them up, so the Bank opted to lodge the case before the court but also issued defaulting notices to the defaulting debtor through its lawyers who in turn submitted to the notice and offered to pay the loan which had accumulated to 18,723,000Frw and the Bank withdrew the case before its preliminary session marking its closure. Indeed, what the court rendered as judgment is acceptance of the Bank’s withdrawal of the case.<sup>95</sup>

However, the above issue has been misinterpreted by creditors where by some issue just a demand and there and then want the payment to be executed, and this has been the core

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<sup>93</sup>P. Cho and S. Khan, *Demanding repayment: what is reasonable: the reasonable notice requirement in LISTER V. DUNLOP*, Kronis Rotsztain Margles Cappel LLP, p16 available at <https://www.krnc-law.com/Demanding-Repayment-What-is-Reasonable.pdf>

<sup>94</sup> P. L. Kunkel & others, *Agricultural Business Management: Foreclosure of Security Interests in Personal Property*, Farm legal series , 2015, University of Minnesota p.3 available at <https://conservancy.umn.edu/bitstream/handle/11299/199833/foreclosure-of-security-interests-in-personal-property.pdf?sequence=1&isAllowed=y>

<sup>95</sup>*AB Bank Vs. Nsanawe Ndekwe Serg*, Case no, RCOM 01868/2017/TC/NYGE, Commercial court of Nyarugenge (then), Judgment of 5<sup>th</sup> February 2017

issue what some payments and not recovered. Indeed, what is advocated for under this demand notice, is that the defaulting debtor must be given reasonable time in which to pay.<sup>96</sup>

Some foreign courts have interpreted the above assertion as defaulting notice; which implies that this is laws given for a creditor who believes in good faith that a debtor is in default may give the debtor a written notice of the alleged default, and, if the debtor has a right to cure the default, the creditor gives him/her the notice of right to cure.<sup>97</sup> Unfortunately not most debtors when issued with defaulting creditors do respond with a notice to secure but most keep silent till the days given expire for other processes to commence.

For example, the Supreme court of Canada in the case of *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd*, it was stated that; *even though a loan agreement itself expressly states that a creditor is entitled to repayment of a loan “on demand”, a debtor must be given a reasonable amount of notice upon which to act.*<sup>98</sup> So the issue is not that upon default, all unpaid principal and interest owing shall “forthwith become due and payable and the security becoming enforceable but whether the procedure in enforcing the security offers reasonable time enough for the debtor to pay the amounts owing.<sup>99</sup>

A creditor that demands repayment pursuant to its rights under a demand loan agreement must provide a debtor with a reasonable amount of time to comply with that demand. What is reasonable is a question of fact that ultimately will depend on the circumstances of a particular case, either to how much is owed or if the security might be at risk of disappearance.

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<sup>96</sup>Supra note 71

<sup>97</sup>M. Waibel, *Engagement between Creditors and Sovereign Debtors: Guidance on setting up Creditor Committees*, University of Cambridge, 2017 , 16p, available at [https://www.un.org/esa/ffd/wp-content/uploads/2017/09/EGM-sovereign-debt-paper\\_Waibel\\_26Aug2017.pdf](https://www.un.org/esa/ffd/wp-content/uploads/2017/09/EGM-sovereign-debt-paper_Waibel_26Aug2017.pdf)

<sup>98</sup> *Ronald Elwyn Lister Ltd. vs. Dunlop Canada Ltd*, Case no: 15955, Supreme Court of Canada, Judgment of 31<sup>st</sup> May 1982, p. 726

<sup>99</sup> P. Cho and S. Khan, *Demanding repayment: what is reasonable: the reasonable notice requirement in LISTER V. DUNLOP*, Kronis Rotsztain Margles Cappel LLP,

On another note, this mode is always opted when there is a misrepresentation, the innocent party can rescind the contracts when there are no bars to rescission. This entails setting aside of a contract and the restoration of the parties to the positions which they would have occupied had there been no contract.<sup>100</sup>

### **II.I.III Preferential Right**

It is averred that; a secured creditor is not only protected against defaulting borrower but also the against competition creditors. This means that; the core benefit of a secured transaction is the protection obtained when a creditor evoking a security interest in his debtor's property is likely to find himself/herself in competition with a wide assortment of other claimants, and in that instance the secured creditor is given priority for payment.<sup>101</sup> Furthermore, if the debtor becomes insolvent, his secured creditors have the right to appropriate as much of their collateral as is necessary to satisfy their claims in full before the debtor's unsecured creditors get anything.<sup>102</sup>

Conversely, some scholars have claimed this protection to be unfair arguing for the principal of fairness of all creditors. But this motion has never be sustained uniformly, and as a result it as be contended that; it's fair since creditors get to choose their own debtors freely and even set the terms under which the same will be observed.<sup>103</sup> Indeed this fairness upholds the principle of freedom of will of contractor or autonomy of the will<sup>104</sup>; both parties have the ability to choose terms and conditions. Therefore, the claim of fairness which requires equal treatment for all creditors has been on several occasion challenged, because the law has to recognise that When a debtor grants a security interest

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<sup>100</sup>P. F. P. Higgins, *Rescission for innocent misrepresentation*, Malaya Law Review Vol.5, No.1, 1963, National University of Singapore , pp.74 available at <https://www.jstor.org/stable/pdf/24861673.pdf>

<sup>101</sup> T. H. Jackson and A. T. Kronmunt, *Secured Financing and Priorities Among Creditors*, The Yale Law Journal Vol. 88: 1143, 1979, p. 1146, available at <https://pdfs.semanticscholar.org/f707/5d39689d9b0a8b1747f56efe6c155aeaff60.pdf>

<sup>102</sup>*Ibid*

<sup>103</sup>*Ibid*

<sup>104</sup> *It implies that people are free to organize their relationships, undertakings and to conclude any contract that is suitable for them. Parties must have freedom to conclude or not conclude a contract as well as freedom to choose who to contract with, freedom to determine the content and the terms of contractual provisions and then the freedom to depart from the types of contract as presented in their Code of obligations see E. Bucher, The Law of Contracts*, ed. 3<sup>rd</sup>, Kluwer Law International, The Hague, 2008, p. 5.

to one of his creditors, he increases the riskiness of other creditors' claims by reducing their expected value in bankruptcy.<sup>105</sup>

Preferential rights in the Rwandan context in mostly evoked in the insolvency matters during liquidation, where a secure creditor is granted priority to be paid separately or to retain the assets. To this very point the law states in its article 197 paragraph one that; *The Secured creditors or the holder of right of retention of secured movable or immovable property shall be entitled to separate satisfaction or retention of secured assets in accordance with the relevant laws.*<sup>106</sup> But the unique element of this provision is contained in its paragraph 3; where for the above to be evoked the secured asset must have been registered. This is deduced from the fact that, the preferential right depends not on the date of the existence of the debt, but rather on the date upon when the secured asset was registered.<sup>107</sup> Literally it means that; should a creditor have a secured non registered asset, he/she will have no grounds to evoke the preferential right but will rather be treated as any other creditors.

Another element contained within the Rwandan laws is that if the secured assets do not cover the whole debt of the secured creditor, then she/he will have to join other unsecured creditors and be paid like any other creditor for the remaining portion. From the wording of article 197 Para 5 of Law on insolvency<sup>108</sup>, it is evidently deductible that, should the secured assets fail to cover the whole debt, the recovery of the remaining is done without treatment of preferential right.

However, from the practices of Rwandan jurisdiction, many secured creditors with secured assets not registered at Rwanda Development board have indeed always opted for recovery through court system, and the courts without hesitation have awarded the creditors the amount recoverable. In this instance, it implies that once the judgment

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<sup>105</sup> W.M.Bratton Jr, *Corporate Finance in the Law School Curriculum*, Duke Law Journal, 1985, p.237 available <https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2907&context=dlj>

<sup>106</sup> Article 197 para 1, of the Law N° 23/2018 of 29/04/2018 relating to insolvency and bankruptcy (*Official Gazette n° Special bis of 29/04/2018*) (Law on insolvency herein after)

<sup>107</sup> Article 197, para 3, of the law on insolvency states that; *The preferential right to payment from a secured asset shall depend on the date of registration of the security and not on the date upon which the debt came into existence*

<sup>108</sup> *If the value of the security is less than the amount of the secured claim, the secured creditor may claim as unsecured creditor for any balance due* (Law on insolvency)

obtains the binding forces, then not only the secured assets but rather the whole assets of the debtor are subject to execution; then creditors can get payment in any of the creditor's property. This is deducted from article 215 of law on procedure which states that; *any person with a final judgment or an enforcement order may request a court bailiff to proceed to the seizure of his/her creditor's property in accordance with relevant laws.*<sup>109</sup>By virtue of this clause, it is not a matter of question whether the creditor had any secured asset and never registered them whether by will, omission or negligence.

We can refer to *Development Bank of Rwanda Vs. Kategaya Godfreey*, where the latter had a loan of 20,000,000Frw from BRD of which he failed to pay, but had mortgaged a certain plot of land which was not registered. Upon default of payment the case was taken to Commercial court-; of which during the hearing the defendant asserted to have even requested the bank to sell the mortgage "*Yanavuze yuko yasabye BRD kugurisha ingwate yamuhaye ariko ngo ntabyo yakoze*". And the court to this very argument asserted that there was not clause in the agreement that required the BANK to sell the mortgage. In the end the Court ordered the defendant to pay the Bank **15,533,000Frws regardless of the mortgage.**<sup>110</sup> However this shall be discussed deeply under the secured creditor' rights of court recovery.

#### **II.I.IV Right to sell the security**

Chigozie Nwagbara avows that; even when the creditors are conferred with the right to sell, that particular right is dependent on condition that; the power of sale must have arisen in the sense that the mortgage debt must have become due and that the power of sale must have become exercisable. This means that the power of sell to be exercisable the creditor must have issued the required notice to pay to the defaulting debtor and the debtor must be in arrears.<sup>111</sup>

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<sup>109</sup> Law No 22/2018 of 29/04/2018 relating to the civil, commercial, labour and administrative procedure (*Official Gazette n<sup>o</sup> Special of 29/04/2018* )(Law on procedure herein and after)

<sup>110</sup> *BRD vs. Kategaya Geoffrey*, Case No-RCOM 01027/2018/TC, Judgment of 28<sup>th</sup> February 2018, 5p.

<sup>111</sup>C. Nwagbara, *Enforcement of mortgage security in Nigeria*, Nigeria Police Academy, Global Journal of Politics and Law Research Vol.2, No.2, pp.70, European Centre for Research Training and Development UK p.52 , 2014 available at <http://www.eajournals.org/wp-content/uploads/Enforcement-of-Mortgage-Security-in-Nigeria...>

To this, some scholars have argued that, when looking at such conditions one could reasonably assert that the law gives an enormous impression that it's in only in those two conditions that the creditor must exercise their rights or appoint a receiver.<sup>112</sup> Indeed, under this remedy or option granted to the creditor upon the debtor's default is open in nature under many jurisdictions Rwanda Inclusive.

The Rwandan law particularly the Mortgage law, it is stipulated as; *The mortgage contract shall contain clauses that grant the mortgagee the power to manage, lease, sell or take over the mortgage in case of the mortgagor's default.*<sup>113</sup> However this is not self-executory, it means that before these rights are exercised, the creditors or mortgagee must inform the debtor on the choice selected among the three options granted, this is pursuant to the same article paragraph 2 and 3. *The first pre-condition under the above clause, it can be deducted that for secured creditors to evoke the right to sell upon debtor's default, there must have been a clause in the security agreement that provided for the same.*

Indeed, what we find lacking is that the same law merely states that; the creditor among the option or remedies he/she has, the right to sell is inclusive. Consequently, parties can opt to allow the debtor to sell on his/her own or forcefully sell can be opted for, which usually happens through public auction. It is particularly stated that; *the mortgage contract shall contain clauses that grant the mortgagee the power to manage, lease, sell or take over the mortgage in case of the mortgagor's default.*<sup>114</sup> However this is not self executor, it means that before these rights are exercised, the creditors or mortgagee must inform the debtor on the choice selected among the three options granted, this is pursuant to the same article paragraph 2 and 3.

The Rwanda laws further provide that; upon request from the mortgagee, the Registrar General shall issue a permit allowing the sale of the mortgage. The instructions go ahead to describe what must constitute the permit to sell, the mortgage to be sold, the value, owner

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<sup>112</sup>F. O. Onaamson, *Law and creditor protection in Nigeria*, Malthouse press, Nigeria, 2017, p.295

<sup>113</sup> Article 2 of Law n°13/2010 of 07/05/2010 modifying and complementing law n°10/2009 of 14/05/2009 on mortgages (Official Gazette n° special of 14/05/2010) (*Law on mortgages herein after*)

<sup>114</sup> Article 2 of LAW N°13/2010 of 07/05/2010 modifying and complementing law n°10/2009 of 14/05/2009 on mortgages (Official Gazette n° special of 14/05/2010) (*Law on mortgages herein after*)



of the mortgaged property, description, location and several others.<sup>115</sup> This implies that this right is evoked by the secured creditor only after the registrar general has approved the permit to sell.

Indeed, to sum up conditions set by Rwandan law for a secured creditor to sell a security they are as follows;

- There must be a clause in the contract providing for sell as an option upon debtor's default to pay.<sup>116</sup>
- The security must have been registered with the Registrar general at Rwanda Development
- The sell must be preceded by notice for defaulting and communication to sell where and when.

The following are the modes of sale of a security.

#### **i. Voluntary sale of collateral**

This involves instances where the defaulting debtor is allowed to sell the collateral on his/her own term on grounds of hoping to obtain a better price. Indeed, this does not favor the defaulting debtor alone, but it has been argued that it is also opted for by several secured creditors as they may think that a better price can be obtained for the collateral if the sale is held directly by the borrower.<sup>117</sup>

A case in point under Rwandan Law is the Case of *Kagofero vs. Skol* that Banque Populaire (BPR) intervened in voluntarily. Kagofero Michel had entered into a loan agreement with BPR for 149,600,000Frw Rwandan Francs, on various dates between years 2005 to 2017, which had accumulated to 160,851,025 Frw by the time he failed to pay. Having mortgaged several securities against this loan, upon receiving the notice to pay within in 30 days from BPR, the defaulting party requested BPR to allow him to sell the securities himself without

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<sup>115</sup> Article 7 of the Instructions of the registrar general n° 03/2010/org of 16/11/2010 on modalities of lease, sale, public auction and mortgage acquisition (*Official Gazette n° special of 23/11/2010*) (hereinafter referred to as registrar general instruction)

<sup>116</sup> *The security interest agreement shall contain a clause authorizing the creditor to seek repayment from collateral taking into consideration the nature of the security interest and the market price.* (Law on Securities article 20)

<sup>117</sup> Supra note 79, p.2

them being auctioned publically. However, He had another loan with SKOL thus the later had caveated his security SKOL thus obstructing the dispossession. Indeed, it's allowed practice to caveat property such that diminishing of the property is halted. So, the case started in Commercial court till commercial High Court where it was ruled that SKOL should remove its caveat such that Kagofero can sell his property, a right granted to him by his creditor BPR. <sup>118</sup>

## **ii. Forced sell of a collateral**

Under Rwandan law, it is indeed what has been tackled briefly in the upper sections, this is where the creditor, must get the authorization of the registrar general such as to sell the mortgage.<sup>119</sup> Then upon receiving the notification, the registrar general may approval the terms of sell and his/her decision shall be notified to the both the mortgagee and the mortgagor within 24 working hours from the time the document has been approved.<sup>120</sup>

Upon approval then, the announcement shall be published in the news papers 15 days before the auction at least three times.<sup>121</sup> The receiver is tasked with obligation to sell the mortgage with a reasonable price according to the changes on the market and its value stated in the selling terms and conditions document<sup>122</sup> which must be affected at least when they are five (5) bidders.<sup>123</sup>

The Rwandan Law forbids an auction to be postponed more than three times within a period of 30 days. In the event it has been postponed three times, the highest bid shall be the price of the mortgage. Thus, the successful bidder will take the mortgage, and he/she pay on spot, after three days an auction report shall be prepared and submitted to registrar general<sup>124</sup> who will verify it within 7 days.

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<sup>118</sup>*Kagofero Michel Vs. Skol Brewery*, Case no. RCA 00349/2018/HC/KIG, Commercial High Court, Judgment of 8<sup>th</sup> July 2019

<sup>119</sup> Supra note 92

<sup>120</sup> *Ibid*

<sup>121</sup> Article 10 of Registrar general instruction

<sup>122</sup> Article 11 of Registrar general instruction

<sup>123</sup> Article 12 of Registrar general instruction

<sup>124</sup> *Within 3 working days from the day of the auction, the person responsible shall write a report on its proceedings containing the following information; Proof that selling terms and conditions were honored, The identity of the winning bidder, The price of the mortgage, All auction running costs, The amount to be paid to the mortgagee, Challenges encountered in the auction process.*

What is obtained from the auction is distributed<sup>125</sup> as follows, where secured creditor shall be entitled to apply the proceeds of sale of the collateral to;

- the reasonable expenses of retaking, holding, preparing for disposition, and disposing of the collateral, including reasonable legal counsels' fees and legal expenses incurred by the secured creditor as well as any other services performed in relation to the collateral;
- the enforcement of obligations secured by a senior security interest;
- the satisfaction of the obligation secured by the security interest of the enforcing secured creditor;
- the satisfaction of obligations secured by any subordinate security interest in the collateral;
- The secured creditor shall account to the debtor for any surplus.<sup>126</sup>

What is contradicting is that registrar general instruction states that it's the receiver to apply the proceeds yet the law on securities states that it is the secured creditor; however, from practice it is always the receiver that distributes the proceeds of the sale of the collateral. From the Rwandan practice if the sale of the collateral has not satisfied the whole outstanding debt, then the secured creditor is still bestowed with the right to recovery through courts, which would imply that the rest of the none security payment of debtor can still be subjected to repayment from, if there is a success on the case.

However, the point of contention on this matter has mostly been on difference between the value at the entry of security agreement and the one at which it is sold. A case in point is the Kamali Alphonse vs. BBPR. The claimant challenged the public auction which had taken place over his property before the Commercial court seeking its annulment while asserting that the Receiver did not indicate the value of the property. The commercial court based on the instruction of the registrar general and overruled the petition asserting that the permit to sell is not required to indicate the price at which the mortgage shall be sold.<sup>127</sup>

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<sup>125</sup> Article 17 of Registrar general instruction states that; the Registrar General gives the right to a receiver to pay in accordance with the law on security interests in movable property.

<sup>126</sup> Article 22 of the Law on securities.

<sup>127</sup> Kamali Alphonse vs BPR And Others, Case no. RCOM 02080/2017/TC/NYGE, Judgment of 9<sup>th</sup> March 2018

The plaintiff was not satisfied with the decision so he appealed before the High Commercial court evoking article 11 of instruction of registrar general; *the receiver has the responsibility to sell the mortgage with a reasonable price according to the changes on the market and its value state in the selling terms and conditions document, thus claiming that the receiver should not allow bidders to bid a price lower than the value registered at registrar general's office. The court ruled on the matter by asserting that article only bestows the power to the receiver to sell the mortgage starting from a reasonable price value, and article 12 grants the highest bidder to take over the mortgaged, thus the court ruled in the disfavour of the plaintiff.*<sup>128</sup>

Another case in respect to the above is the case of *Kyamagwa Hubert Vs. AB Bank* who lodged a case before commercial court challenging the auction over his property UPI: 5/01/12/03/1624 as he was not satisfied with the valueer's price of the property, seeking from the court to stay the scheduled public auction. The point of his argument was over ruled since he did not bring a contradicting report to ascertain that at least his property might have been undervalued by the Bank's property valuer. The court based on the law of LAW N°17/2010 OF 12/05/2010 establishing and organising the real property valuation profession in Rwanda in its article 136<sup>129</sup> indicating what procedures to follow if one is not satisfied with the valuation price and there was no evidence that Kamangwa ever challenged the valuation before seizing the commercial court with jurisdiction on the matter.<sup>130</sup>

#### **II.I.V Secured creditor's right to manage the collateral**

In general, well-functioning secured creditor transactions framework involves efficient property registries that allow creditors to track ownership and lending of assets, enforceable rules. Therefore, we find it important to note that taking over collateral if

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<sup>128</sup>*Kamali Alphonse vs. BPR & Others*, Case No. RCOMA 0023/2018/CHC/HCC, Commercial High Court, Judgment of 18<sup>th</sup> September 2019

<sup>129</sup> *Where a party does not agree with a real property valuation, he/she shall refer the matter to the Council. In such case, the Council shall select other certified valuers who shall decide other valuation methods to be used. In case the dispute is not settled, it shall be submitted to competent court of Law (LAW N°17/2010 OF 12/05/2010 establishing and organising the real property valuation profession in Rwanda, Official Gazette n° 20 of 17/05/2010)*

<sup>130</sup>*Kyamagwa Hurbert Vs. AB Bank*, Case No. RCOM 00898/2019/TC, Commercial court, Judgment of 22<sup>nd</sup> May 2019.

borrower defaults ultimately those that are protected by depositors confer a protection as they lower credit risk.<sup>131</sup> However, this mode of protection is not in any way elaborated about by the laws of Rwanda except merely stating it.

If one closely looks at this it could be equally referred to as administration of the property which mostly done in insolvency matters by secured creditors largely to generate dividends for the unsecured creditors.<sup>132</sup> Indeed, this is what is upheld and practiced under Receivership in Cayman island where by a secured creditor can enforce its security, either realise the secured property and obtain full repayment of the debt owed, the receiver can sell and or manage the security.<sup>133</sup>

### **II.I.VI Creditor's ability to lease the collateral**

The Rwandan laws provide that," upon the mortgagee's request, the Registrar General shall issue a certificate allowing him/her to lease a mortgage. The certificate must stipulate the following: - The name of the property owner, - The name of the mortgagor, - Description of the mortgage, - The location of the mortgage, - The date to lease the mortgage".<sup>134</sup>

The mortgagee and the mortgagor must sign the mortgage lease agreement with one copy to be given to the Registrar General within 7 working days from the signing of the agreement.<sup>135</sup> When the loan has been paid, the mortgagee shall report on how the rent from the mortgage has been used. After the report has been ratified by the Registrar General, the mortgagee must give a written acknowledgement to the mortgagor stating that

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<sup>131</sup> Inter- America Development Ban, *Unlocking credit; the quest for deep and stable banking* , Johns Hopkins University Press, Washington D.C, 2005, , P.164

<sup>132</sup> J. C. Anderson, *Secured Creditors: Their Rights and Remedies Under Chapter XI of the Bankruptcy Act* , Louisiana law Review, Vol.36, 1975, p.4 available at <https://digitalcommons.law.lsu.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=4131&context=lalrev>

<sup>133</sup> X, *Cayman islands companies -a guide to the enforcement of security-Receivership*, available at <https://www.lexology.com/library/detail.aspx?g=6a5d32b2-7010-49e8-a344-e1504577b905>

<sup>134</sup> Article 3 of Instructions of the registrar general n° 03/2010/org of 16/11/2010 (*Official Gazette n° special of 23/11/2010*)

<sup>135</sup> Article 5 of of Instructions of the registrar general n° 03/2010/org of 16/11/2010 (*Official Gazette n° special of 23/11/2010*)

the debt has been paid off, that the mortgage has been given back to the owner in accordance with provisions on release of mortgage.<sup>136</sup>

## **II.I.VII Secured creditor's right to take over the security**

Under this form of protection creditors are bestowed with rights to take over the collateral upon default of debtors. This is what has been known as repossession in some States.<sup>137</sup> Under the United States of America for example, a secured creditor is permitted to take possession of the collateral on default unless the agreement specifies otherwise, he/ she take possession of the collateral or without removal, may render equipment unusable and dispose of collateral on a debtor's premises.<sup>138</sup> Indeed it is further argued that this repossession must not violate the peace or harmony of the defaulting debtor, however the debtor would be better off voluntarily deliver the collateral according to the creditor's instructions, but if that doesn't happen, "self-help" repossession is allowed so long as the repossession can be accomplished without breach of peace.<sup>139</sup>

Taking over collateral while breaching the peace of the debtor has been interpreted by several scholars as well as some courts. In the case of *Koontz*, the defendant creditor, sent repossession agents to repossess the plaintiff's car after the plaintiff defaulted on his payments. The car was parked in the plaintiff's front yard. The plaintiff heard the repossession in progress and ran outside in his underwear shouting "Don't take it" to the agents. The agents did not respond and proceeded to take the car.

The plaintiff argued the repossession breached the peace<sup>140</sup>, Chrysler filed a complaint against Koontz seeking a deficiency judgment<sup>141</sup>, and Koontz filed an affirmative defense

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<sup>136</sup> Article 6 of Instructions of the registrar general n° 03/2010/org of 16/11/2010 (*Official Gazette n° special of 23/11/2010*)

<sup>137</sup> Supra note 79, P.1006

<sup>138</sup> Section 9-609 of the Uniform Commercial Code 1952

<sup>139</sup> Supra note 79, at p.1007

<sup>140</sup> *Connotes conduct which incites or is likely to incite immediate public turbulence, or which leads to or is likely to lead to an immediate loss of public order and tranquility. Violent conduct is not a necessary element*

<sup>141</sup> *Refers to a judgment rendered in favor of a creditor for the difference between the unpaid balance of a debt secured by a mortgage and, under the traditional common law approach, the amount paid by the high bidder at a public sale of the mortgaged property conducted for the satisfaction of that debt.* (See A. M. Weinberger *Tools of Ignorance: An Appraisal of Deficiency Judgments*, Washington and Lee Law Review, Vol. 72, St. Louis University

alleging breach of peace while possessing the car. Koontz contended that the trial court erred in finding that Chrysler breached peace because Koontz made an unequivocal protest to taking over. The court affirmed lacked of breach of peace cause "in general, a mere trespass, standing alone, does not automatically constitute a breach of the peace."<sup>142</sup>

Under the Rwanda law, the law merely states that in article 14 among the rights of the mortgagee upon default; to possess the mortgage in agreement with the mortgagor <sup>143</sup> an article modified and complemented by article 3 which provides that; *The mortgage contract shall contain clauses that grant the mortgagee the power to manage, lease, sell or take over the mortgage in case of the mortgagor's default. The mortgage contract shall also specify the time, place and terms of sale and the procedure to be followed in case of default.*<sup>144</sup> Taking a close look at this, the law there and then starts to tackle the procedures on how the right to sell shall be conducted leaving all other rights pending. These protections are supplement by the instruction of Registrar General.

In Articles 18, the instructions state that; *upon the mortgagee's request, the Registrar General shall issue a certificate giving him/her the right to take possession of the mortgage. This certificate shall stipulate: - The owner of the real estate - The mortgagee - Descriptions of the property, - The location of the property - The date the winning bidder shall take possession of the property. - An ownership certificate shall be issued to the new owner. One copy shall be handed to the registrar of land title and another one to the defaulting mortgagor.*

If one looks at the above, one might be convinced to reason that ownership tackled above is right to possess in the first place but that is not the case, indeed the ownership tackled there is for the winning bidder not the mortgage. The same can be deducted elements forming the certificate i.e. the winning bidder. Therefore, we see that all laws on this issue leave the

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School of Law, 2015, p.883 available at <https://scholarlycommons.law.wlu.edu/cgi/viewcontent.cgi?article=4454&context=wlulr>)

<sup>142</sup> *Chrysler Credit Corp Vs. Koontz*, Case NO. 5-95-0191, Appellate Court of Illinois, 5<sup>th</sup> District, Judgment of 16<sup>th</sup> February 1996

<sup>143</sup> Article 14, para 3 of the Law N° 10/2009 of 14/05/2009 on mortgages (*O.G. n° special of 15/05/2009*)

<sup>144</sup> Law n°13/2010 of 07/05/2010 modifying and complementing law n°10/2009 of 14/05/2009 on Mortgages (*Official Gazette n° special of 14/05/2010*)

procedures at the mercy of debtors, implied any procedure employed by a secured creditor can be easily opposable. Therefore, this method continues to be lawful but risky

### **II.I.VIII Power to sue upon default before court**

It has been argued that upon debtor's default, the creditor could ignore the security interest and bring suit on the underlying debt. However, creditors rarely opt for this remedy because it is time-consuming and costly. Most creditors prefer to repossess the collateral and sell it or retain possession in satisfaction of the debt.<sup>145</sup> On the other hand, recovery through court can be by deficiency judgment. As already elaborated above, it means that the creditor can recover the difference. Indeed, this is very common option employed by several creditors under Rwandan jurisdiction. This is stipulated in article 19 paragraph 2 which provides that; *Where the mortgagor is dissatisfied with the price, he/she shall refer the matter to competent courts.*<sup>146</sup>

A case in point is the case of *BPR vs. Kamali Alphonse*, where Alphonse had got mortgaged his property against a loan gotten from BPR, the former defaulted in payment and his property was mortgaged but could not satisfy the loan. Thus the recovery case was lodged before the commercial court recovering the remaining portion of loan amounting to 178,267,919Frw of which the court awarded to BPR.<sup>147</sup> This would be a similar case to *AB BANK VS MUTINI*, except that in this case, the Bank did not bother selling the property because it was located in non-strategic places in that a fair price would not be obtained, thus the Bank went straight to recover through court and the decision was rendered in its favor awarding it principle of 62,857,118Frw.<sup>148</sup>

Indeed, the above court can also be used by the creditor in what is known as garnishment<sup>149</sup>. Under the Law governing contracts in Rwanda, it is enumerated in Article

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<sup>145</sup> Supra note 79, P.1006

<sup>146</sup> Law N° 10/2009 of 14/05/2009 on mortgages (*O.G. n° special of 15/05/2009*)

<sup>147</sup> *Banque populaire du Rwanda vs. Kamali Alphonse*, case No; RCOM 01868/2018/TC, Commercial Court, Judgment of 18th January 2019

<sup>148</sup> *Mutini Thadeo vs. AB Bank*, Case NO. RCOMA 00253/2018/CHC/HCC, Commercial High Court , Judgment of 18th April 2019

<sup>149</sup> *legal process by which a creditor obtains a court order directing the debtor's third party anyone who owes money to the debtor) to pay directly to the creditor a certain portion of until the debt is paid.*



113 that a creditor does not only have power to execute against the third party but also to halt any disposal of any property that might adversely affect his/her interests.<sup>150</sup>

The Law relating civil, commercial, labor and administrative procedure provides that; *within thirty (30) days from the day when the judgment or any other enforcement act is final, the party that lost the case may contact the winning party in order to make an agreement on the execution of the court decision or the enforcement order.*<sup>151</sup> By virtue of this even if the law is not particular to creditor debtor relationship, but if a creditor has won against the debtor, then she/she is legally allowed to evoke this clause, in that case the defaulting and losing debtor will have 30 days to execute voluntarily lest forceful execution shall be implemented.

The above law in the same clause paragraph two further states that; *The debtor must also disclose his/her property from which payment may result through public auction, in case he/she does not comply with the agreement, and how the components of his/her property may respectively be sold.*<sup>152</sup> This again reverses the process, in that if even the remaining property were not mortgaged or pledged but after the creditor obtains the Judgment he/she has right to get payment from any property whether moveable or immovable.

## **II.II LIMITATION IN PROTECTION OF SECURED CREDITORS**

As it is asserted, in some cases mostly when debtor is a commercial entity not an individual, even when the creditor at default of the debtor has right to foreclose on the assets – that is, take possession of the assets for purposes of selling them, but nevertheless secured creditor efforts to foreclose on assets are automatically stayed; all collection efforts must stop once a company has filed for bankrupt.<sup>153</sup> This implies that in that instance the

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<sup>150</sup> Nevertheless, the creditor may exercise rights and claims owned by his/her debtor towards third parties unless such a right is exclusively personal to the debtor. The creditor may also personally oppose any acts performed by his/her debtor which adversely affect the creditor's rights.

<sup>151</sup> Article 247 of the Law No 22/2018 of 29/04/2018 relating to the civil, commercial, labour and administrative procedure (*Official Gazette n<sup>o</sup> Special of 29/04/2018*)

<sup>152</sup> *Ibid*

<sup>153</sup>M. Jenkins and D. C. Smith, *Creditor Conflict and the Efficiency of Corporate Reorganization*, University of Virginia, 2014, p.7, available at <https://bfi.uchicago.edu/sites/default/files/research/Jenkins%20and%20Smith%20Creditor%20Conflict%202014-05-29.pdf>

creditor's protection is weakened as he/she has to comply with the debtor's demand which might be detrimental to creditors interest, since debtors have been known for triggering bankruptcy to protect themselves.<sup>154</sup> (*One could refer to Good supply case a company that lodged a voluntary insolvency matter which stayed all recoveries against it in the end no property would be liquidated since there were never any property in the names of the company*)After commencement of bankruptcy petition, there is an automatic stay which prevents creditors from attempting to have the debtor pay on his debts until the case has concluded.<sup>155</sup>

To other scholars they have argued that indeed it's not insufficient of law that weakness the protection of creditors more so secured creditors, however the most complex problems faced by them are of creditors own making. It is asserted that secured creditors do not as a matter of practice avail themselves of many of the remedies which are in fact available, most of the creditors opt for the final remedy or sale or appointment of receiver while all other remedies are abandoned.<sup>156</sup> However, while concluding the above assertion, it was put forward to affirm the core rational that keeps on being analysed in this paper being the fact that the abandonment of other remedies by creditors is due to the fact that there are legislative restrictions on these rights which make some of these remedies less attractive thus not being opted for.<sup>157</sup>

More to the above scholars it was argued and put forward that upon debtor's failure to honor his/her obligations of payment, the creditor is entitled to several remedies to help collect the money, of which some of them are non-judicial self-help remedies and remedies that involve the courts. Therefore, you find that among those remedies secured creditors have rights to repossess or foreclose on goods pledged as collateral or mortgage if debtors' default on loan payments. The creditor can take back the property, sell it and apply the

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<sup>154</sup>M. Marinc and R. Vlahu, *The economics of Bank Bankruptcy Law*, Springer, Verlag Berlin Heidelberg, 2014, p .15

<sup>155</sup>*Intellectual property and transactional law clinic; what is bankruptcy?* University of Richmond, available <https://law.richmond.edu/academics/clinics-skills/in-house/ip-clinic/pdf/doclib-memo-what-is-bankruptcy.pdf>

<sup>156</sup>A. P. Henschman, *Remedies of secured creditors*, Western Australian review, p. 25-26 Available at <http://www.austlii.edu.au/au/journals/UWALawRw/1971/2.pdf>

<sup>157</sup>*Idem*

proceeds to pay off the debt. However, this too has proved insufficient since in most cases the creditor finds the sell price not enough.

It has also been argued by IMF that in some systems the creditor's rights enforcement framework remains weak and inefficient in some jurisdictions. By this IMF asserted in their report that this weakness can be seen in auction procedures which are weak and insufficient in respect to enforcement and foreclosure in that they allow frivolous objections by the debtor and provide for overly strict requirements on minimum bids and multiples auctions with no value added.<sup>158</sup>

It is further argued that creditor's protection is weakened where debtors have power to object and cause delay in enforcement. Debtors are bestowed with inordinate power to object and cause delay during enforcement proceedings out of proportion to the need to protect their rights. Such power leads to delay of sale of the assets leading to many of the inefficiencies and delays faced by the creditors. Upon occurrence, the creditor only gets their resolution through cumbersome overloaded and inefficient court system impliedly the realization of their rights happens at longer duration.<sup>159</sup> This has been a so very common practice in respect to securities forming patrimony under community regime of property for married debtors.

Vanessa Finch points out failure of creditors rights can stem from other creditors mostly in cases of bankruptcy. To this she affirms that creditors differ in knowledge, skill, leverage and cost of litigation. Therefore, the assumption powerful; creditors would agree to collectivise their claims to the poor alongside their weak brethren is questionable and to assume that all creditors have purely economic interests is also questionable; she calls this inequality of Animal farm.<sup>160</sup>

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<sup>158</sup>IMF, *Slavok Republic: Financial systems stability assessment*, IMF Country Report No. 02/198, Washington, D.C 2002, p. 200

<sup>159</sup>*Idem*

<sup>160</sup>V. Finch and D. Milman, *Corporate Insolvency Law: perspective and principles*, 3<sup>rd</sup> Ed. Cambridge University Press, Cambridge, 2017, p.31-33

## **GENERAL CONCLUSION**

Although secured creditors seem to have this kind of protection which is having the security to fall upon to upon debtor's defaulting in payment, this seems to have been weekend by fraudulent ways employed by debtors, either in the prior engagement of contracting or thereafter during the execution of contracts. Hence forth, we note that fraudster debtors have continued to become rampant or common in Rwanda, a fact that cannot only be attributed to the loopholes within the Rwandan Jurisdiction but also to the bad intention of the debtors, weakness in the financial instructional policies as well as others external factors better the increased market price of homes or the unexpected business failures of some of debtors mostly when they are start-up companies the unforeseen contingencies.

The bad intention of debtors seems to be a core a reason where many have found lack of willingness to pay loans coupled with diversion of funds by borrowers, while exploiting the wilful negligence and improper appraisal by credit officers. Thus, weak protection of secured creditors from fraudulent debtor is not a one-sided issue therefore it can be eradicated form both angles; from creditors strengthening their institutional frameworks and policies as well as the government work on the loopholes of legislation that are taken advantage of.

## RECOMMENDATIONS

Having elaborated the above and in respect to our research findings we would recommend:

The enactment of laws and adoption of regulations with some clauses particularly to the procedures to be followed while secured creditors are evoking their rights such as when creditors opt to manage the collateral, lease as well as takeover. The RWANDAN laws particularly the Instructions to the registrar General, the Law on Mortgage, and securities all they elaborate about in details are the procedures in respect to sell but not other things; therefore, they too must be elaborated.

The Rwandan Laws should look at how property registrar can be accessed by financial institution in order to ascertain who the owner of the property is the location and perhaps ascertain the master plan for that specific property to avoid entering into a security agreement over a property with zero price value because of its location. This can reduce the risky involved in connivance between property valuers and the debtors, forging the valuation price or even sometime the images of the property mortgaged.

Indeed, in relation to the above, there should be more awareness of existence and functionality of Credit Reference Bureau. Indeed, the existence of this is not only unknown to several creditors but also non helpful as the entity hardly releases any information. This can enable creditors to know a certain debtor has a loan, track record of payment records, thus creditor could inquire and base on such information while extending Credit facility such that they take an informed risk. This is done in USA under consumer credit.<sup>161</sup> The credit bureau should also help in collection process like issuance of warnings or notices.

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<sup>161</sup> Creditors such as banks and mortgage companies loan money to consumers. These creditors keep a record of how well an individual consumer pays back the money that he/she owes. If a consumer pays late or does not pay the full amount that he/she borrowed, that negative information is reflected in the consumer's record. The creditors then send this record of a consumer's payment history to the credit bureau reporting agencies. The credit bureaus collect all of the payment history information for a single consumer as reported by all of that consumer's various creditors. Then the credit bureaus compile the consumer's payment history information into a file. In the future, when the consumer wants to borrow money from a new creditor, the creditor sends a request to the credit bureau for the consumer's credit file. The credit bureaus send the file to the creditor, which uses it to decide whether or not to loan money to the consumer (see M. Greg Braswell and E. Chernow , *Consumer Credit Law & Practice in the U.S*, U.S. Federal Trade Commission) p.6 available at [https://www.ftc.gov/sites/default/files/attachments/training-materials/law\\_practice.pdf](https://www.ftc.gov/sites/default/files/attachments/training-materials/law_practice.pdf)

Categorisation of credit facility in Rwanda could facilitate the recovery process. This is to mean that there must be legal credit facility with particular regulations in respect to that particular. A case in point is the USA of America where consumer credit<sup>162</sup> is different from other credits. This can enable the financial institutions who are the most common creditors in Rwanda to categorise interests such that a general interest rate is not applied uniformly to whichever creditor, a fact that might have laid a heavy burden of debtors resulting to high rates of debtor defaulting as well as defrauding.

Another strategy for reducing arrears or defrauding debtors particularly for financial institutions is to loan only to micro entrepreneurs (in respect to legal persons) at least who have been in business for at least more than twelve months. This is so, because businesses are most likely to fail within the first year of operation so if they have existed for at more than least twelve months on the owner's money, the infusion of money from the financial institutions should be at a lower risk than if the business is a start- up, more so that a moratorium period in Rwandan is not fixed. This is to mean that financial institutions must have proper adequate and proper appraisal as well as proper client selection.

Undoubtly these examples of best practices can guide the Rwandan legislator in enacting appropriate laws for the protection of secured creditors in financial services, particularly against fraudsters' debtors.

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<sup>162</sup> A consumer credit system allows consumers to borrow money or incur debt, and to defer repayment of that money over time. Having credit enables consumers to buy goods or assets without having to pay for them in cash at the time of purchase. (M. Greg Braswell y Elizabeth Chernow , Consumer Credit Law & Practice in the U.S, U.S. Federal Trade Commission) available at [https://www.ftc.gov/sites/default/files/attachments/training-materials/law\\_practice.pdf](https://www.ftc.gov/sites/default/files/attachments/training-materials/law_practice.pdf)

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