

# LEGAL REQUIREMENTS OF A SECURED CREDIT TRANSACTION

## INTRODUCTION

Secured credit transaction (SCT) is a powerful tool for economic development in every nation. Credit transactions come with a level of risk. It is defined as a “business arrangement by which a buyer or borrower gives collateral to the seller or lender to guarantee payment of an obligation”<sup>1</sup> while security is “anything that makes money more assured in its payment or more readily recoverable”.<sup>2</sup>

SCT involves a lender advancing loan to a borrower and in return the lender acquires the borrower’s interest(s) or right(s) in its property which serves as security for the assurance, protection and indemnification. Such interest or right in the security could be a proprietary or possessory interest or even both. A security should be such that can pay the lender for the debt and other obligations occasioned by the borrower’s default.

Security could be real property such as land, building and its appurtenances, goods or chattels, produce or intangible property such as stock, shares, debentures, guarantees, indemnity, life policies, intellectual property rights (trademark, patents, copyright).

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<sup>1</sup> Bryan A. Garner, *Black’s Law Dictionary* (9<sup>th</sup> edn, Thomson Reuters, 2009) 1475-1476.

<sup>2</sup> John S. James, *Stroud’s Judicial Dictionary of Words and Phrases* (4<sup>th</sup> edn, Vol 5) 2470.

## PRE-REQUISITE CONDITIONS FOR A SECURED CREDIT TRANSACTION

### PARTIES TO A SECURED CREDIT TRANSACTION

The parties to be involved in secured credit transactions must be juristic (or an incorporated body) persons because it requires entering into an agreement<sup>3</sup> which is enforceable and admissible in law when entered into by juristic persons. A juristic person includes natural persons and incorporated bodies such as a company (section 38 of the Companies and Allied Matters Act (CAMA), CAP C20, Laws of the Federation of Nigeria 2004), incorporated trustee (section 598 CAMA) and business name (section 568-589 CAMA).

### LEGAL CAPACITY OF PARTIES TO CONTRACT

Parties to SCT must be legally capable to contract else the contract may be void *ab initio*, voidable and legally unenforceable. Generally, every natural person is vested with the capacity to enter into legal relations such as a contract. However, there are certain class of persons who sometimes are exception to this general rule.

They include:

#### ➤ INFANTS

Any person not up to eighteen years of age is a child as provided in section 18, Child Rights Act (CRA), 2003.<sup>4</sup> A loan contract entered into by an infant is void and unenforceable; so also is the security given for the contract. However, where there

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<sup>3</sup> Every Secured Credit Transaction is required to be in writing. Statute of Frauds Act 1677, s 4.

<sup>4</sup> The eighteen (18) years of age is however questionable and arguable because the CRA is has not been adopted in many states in the Nigeria. About 11 states predominantly Northern states have failed to adopt the Child Rights Act, 2003. They are Adamawa, Bauchi, Borno, Gombe, Jigawa, Kano, Katsina, Kebbi, Sokoto, Yobo and Zamfara states. See Nike Adebawale, 'Why Every Nigerian State must Domesticate, Implement Child Rights Act' (*Premium Times*, June 24, 2019) <<https://www.premiumtimesng.com/health/health-features/336790-why-every-nigerian-state-must-domesticate-implement-child-rights-act.html>> last accessed 6 November 2019.

was an indemnity it will be enforceable.<sup>5</sup> In a situation where the loan (money) has not been received by the infant (borrower), the security is recoverable by the infant (borrower).<sup>6</sup> In a vice-versa situation the infant (borrower) the security is irrecoverable regardless that it is a void contract.<sup>7</sup>

#### ➤ PERSONS OF UNSOUND MIND

A person of unsound mind can enter into a valid and enforceable loan contract for loan during his lucid moment. This means that the borrower can recover even if the contract loan is not refunded. An exception however to the validity of such SCT aforementioned is when the other party (that is the lender, mortgagee) is aware of the person's medical condition of insanity.

#### ➤ ILLITERATES

For an illiterate to be a party to a SCT, the lender is expected to ensure that the illiterate party is aware and fully grasps the intent of the loan contract being entered into especially to the extent that the property is to serve as security for the loan. In practice and in accordance with the provision of the Illiterate Protection Law<sup>8</sup>, an illiterate jurat is inserted in the contract which proves that the illiterate party was well guided and fully comprehends the transaction.

#### ➤ QUALIFIED/UNQUALIFIED PERSONS

There are situation where persons with qualified capacity becomes a person with an unqualified capacity. This is when a person or company's legal capacity to contract

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<sup>5</sup> See *Yeoman Credit Ltd v Latter* (1961) All ER p. 294.

<sup>6</sup> See *Valentini v Canali* (1889) 24 Q.B.D. p. 166; *Pearce v Brain* (1929) All E.R. Rep. 627.

<sup>7</sup> I. O. Smith, *Nigerian Law of Secured Credit* (first published 2001, 1edn, Ecowatch Publications (Nigeria) Limited, Lagos, 2006) 19.

<sup>8</sup> CAP 67, Laws of Lagos State 1994.

swings as a pendulum. For instance a drunkard in a drunken state can be said to possess unqualified capacity to contract. The same is applicable to an insolvent or a liquidated company or a bankrupt person. In an unqualified state, SCT should not be entered into.

## TRUSTEES

A trustee(s) cannot borrow money or enter into a SCT on behalf of the people, association or body using the trust property as security without being vested with the power to do so. This power is required to be expressly stated in the trust instrument (usually a deed) or a statute. A lending trustee is vested with the fiduciary duty to ensure that there is legally and viable security for the loan to be advanced. Lending trustees are advised to desist from security that goes beyond the property itself to extend to the business activities carried on the property,<sup>9</sup> or subject to a contributory mortgage<sup>10</sup> nor an equitable mortgage.<sup>11</sup> A lending trustee is also to appoint an expert valuer and rely on the valuer's report when lending is to be done based on the value of a trust property.<sup>12</sup>

## VALIDITY OF AGREEMENT

A contract for SCT should be entered into for a legal purpose else the security is automatically unenforceable. The intentions of the party should also be expressly

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<sup>9</sup> Ibid

<sup>10</sup> This is a secured registered mortgage made over land, collateral securities and with supporting guarantees that involves the pooling of resources from different contributors in order to advance a loan to a mortgagor(s). See *Webb v Jones* (1888) 39 Ch. D. p. 660.

<sup>11</sup> This is a form of mortgage transaction that does not meet all the requirements of law but is entered into by an agreement. It can also be created by the deposit of the mortgagor's original title deeds or documents to the mortgagee and is vested with the right to foreclose and sell the security (mortgaged property) in an event of non-repayment of the loan. See *Webb v Ledsam* 69 ER p. 508.

<sup>12</sup> *Smith* (n 7) 22.

stated and parties must freely enter into the contract without any form of influence such as mistake, misrepresentation, duress or undue influence. In an event of the contrary, a party can rely on or plead the defense of *non est factum*<sup>13</sup> which may therefore render the contract voidable and unenforceable.

SCT must duly fulfil the requirement of Governor's consent<sup>14</sup>, stamping<sup>15</sup> and registration<sup>16</sup> so as for it to be enforceable and admissible as evidence in a Court of law.

### RELIABILITY OF SECURITY

The security given for the loan must be such that can liquidate the debt in the event of a default by the borrower.

### ASSURANCE OF TITLE

This is founded on the principle of *nemo dat quod non habet* meaning you cannot give what you do not have. Applying same to SCT, it is asserted that a borrower cannot give a property he does not own as security for a loan.

If the security given is a chattel(s) by a person who is not the owner, two issues are considered to determine whether the owner can recover the chattels. One is the status of the borrower's title as at the time of the SCT whether it was void or

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<sup>13</sup> This legal terminology can be literally interpreted as 'not his deed'. In law, this defense avails the party from executing obligations and liabilities arising from an agreement entered into and duly signed by the party.

<sup>14</sup> Land Use Act 1978 s. 22. Section 26 of LUA goes further to provided that if the Governor's consent is not sought and obtained, the transaction is void. Governor's consent is to be gotten by the borrower/ mortgagee. See Savannah Bank v Ajilo (1989) All N.L.R. 26. 3; Awojugbagbe Light Industry Ltd v Chinukwe (1993) 1 NWLR (Pt. 270) p. 485.

<sup>15</sup> Stamp Duties Act LFN 2004, s. 19, 22 & 23. Late stamping is penalised in form of fine(s) under the law. See Owoniboye Technical Services Ltd v UBN (2003) 15 NWLR, part 844, p. 545.

<sup>16</sup> Land Registration Act 1924, s 2. Registration aids in determining the priority of secured credit transactions carried out on the same security.

voidable.<sup>17</sup> A void borrower's title is tantamount to the owner's right to recover the chattel<sup>18</sup> while a voidable borrower's title is tantamount to irrecoverable chattels<sup>19</sup>.

The second issue to be considered is whether the owner gave the borrower his title documents which misled the lender to believe that the borrower was the owner of the chattels or whether the borrower was vested with the authority to enter into the SCT. In such circumstance, the chattel is irrecoverable by the owner. However, a tort of conversion action can be brought against the borrower by the owner for using the chattel in a way that is not in accordance with his right.<sup>20</sup>

## INVESTIGATION OF TITLE TO LAND

When the security is a land, the principle of *nemo dat quod non habet* principle also applies. It is essential to investigate and determine the authenticity of the borrower's title to the land. This can be done by carrying out a search at the lands registry or at the Corporate Affairs Commission (CAC). It also helps to know if the property has any form of encumbrance. In a situation where title is derived by government Grant, the borrower's title should be ascertained.

For a family land to be used as a security for a loan, the family must consent to same which is done by the approval of the family's accredited representatives that is the head of the family and the principal members of the family.<sup>21</sup> This power is

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<sup>17</sup> Ibid

<sup>18</sup> An example is where the borrower obtained the title from the owner by fraud. See *Cundy v Lindsay* (1878) 3 App. Cas p. 459.

<sup>19</sup> Sale of Goods Act 1893, s.23. *Philips v Brooks* (1919) 2 KB p. 243.

<sup>20</sup> Sale of Goods Act 1893, s. 25.

<sup>21</sup> See *Alao v Ajani* (1989) NWLR (Pr. 113) p. 1.

exercisable by the consensus of all of representatives.<sup>22</sup> In a situation where the family acts through their attorney, the power of attorney must expressly vest the power to use the property as a security and same must be duly signed and registered.

## VALUATION

Valuation is the value of an asset or liability based on stipulated criteria and as at specific date or period of time. It is to be carried out by an expert valuer and has the responsibility of “ascertaining whether the security’s value can adequately cover the debt and still have a positive difference”.<sup>23</sup> Valuation is required to take into consideration the following; the purpose of the valuation which determines the basis of the valuation (MV or MLV) and the method of the valuation of the security.<sup>24</sup> This helps in knowing the margin of safety, that is, the difference in the debt and the value of the property. Valuation should also entail an integrity test to determine if the property is in a perfect working or usable condition.

## ISSUE OF ACQUISITION

The borrower is required to investigate to know whether the issue of acquisition or compensation is pending on the property being the security for the SCT.

## COMPLIANCE WITH PLANNING REGULATIONS

In a situation where the security is an already-built property or about to be built, the structure must be done in accordance with extant Town Planning Laws and

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<sup>22</sup> See *Jacobs v Oladunni Bros* (1935) 12 NLR p. 1; *Solomon & Ors v Mogaji* (1982) 11 SC p. 1.

<sup>23</sup> W. O. Odudu, ‘Property Valuation as a Tool for Secured Credit Transactions’ (1999) 23(3) *Journal of the Nigerian Institute of Estate Surveyors and Valuers*, 48-52; Namnso Basse Udoekanem, ‘Valuation of Urban Commercial Properties in Nigeria for Secured Credit Lending: Issues and Developments’ (2018) 5(1) *International Journal of Built Environment and Sustainability* 68-77.

<sup>24</sup> Namnso (n 23).

Regulations. In addition, all planning permissions required as they relate to the security should be duly sought and obtained.

### **MARKETABILITY/POSSIBILITY OF SALE**

A lender is advised to consider the geographical location and value of the property to be used as security. A security given for a loan must be marketable and sellable. This involves looking beyond the value of the property to determine the 'possibility of sale'. Whether in the case of a default by the borrower, the lender will be able to market and sell off the security considering where:

- i. the property is located: will people be willing to buy a property in that area?
- ii. the feasibility of the cost of the property: can people afford to buy a property of that amount range?

### **BORROWER'S LIST**

A lender is also expected to be meticulous in carrying out search on the intended borrower at the Collaterals Registry, Asset Management Corporation of Nigeria, Credit Bureau to be fully aware of the financial status and credibility of the intended borrower before advancing a loan.

### **CONCLUSION**

Unlike other countries, in Nigeria the issue of security is considered firstly before a loan is advanced. This is because in Nigeria, it is regarded as the most effective way to assure the lender of receiving back the advanced loan.

As the name connotes SCT involves assurance, protection and indemnification from the risk of loss. To this end, it is important that the above-mentioned legal requirements are to be well satisfied so that the purpose of the security in the credit transaction is not defeated so that viability of the security, efficacy of the transaction and protection under the law will be ensured. Further, in the event of a conflict it serves as an instrument of justice and ensures avoidance of loss by parties.

It is imperative to state that with more issues arising from SCTs and foreseeability of futuristic problems, there is a likelihood of more requirements introduced to guide the workings of SCT.

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