

AFRICA RISK CONSULTING

Kenya Monthly Briefing July 2016

Kenya Summary 12 July 2016

Chief justice Willy Mutungwa resigns one year early to avoid a vacancy at the top of the Supreme Court during the August 2017 general election. Supreme Court deputy chief justice Kalpana Hasmukhrai Rawal and justice Philip Tunoi retire, leaving the court short of a quorum. Jamii Bora Bank (JBB) says an information memorandum did not reflect the true position of Uchumi Supermarkets before its \$5m investment. Maersk Oil & Gas A/S says it will prioritise its Kenya-based assets after losing its Al-Shaheen (Qatar) contract. However, Denmark-based A.P. Moller–Maersk Group is due to complete a strategic review in the third quarter, which will determine Maersk Oil's future in Kenya. The government acquires sole control of Kenya Petroleum Refineries Ltd (KPRL), owner of the idle Mombasa oil refinery.

Supreme Court chief justice resigns

Supreme Court chief justice **Willy Mutungwa** resigned as planned on 16 June.¹ Mutungwa's successor will rule on disputes relating to the August 2017 election, making the appointment especially significant. Constitutional age restrictions meant Mutungwa was due to retire in June 2017.² Article 167 of the 2010 constitution sets the retirement age for judges at 70.³ However, Mutungwa chose to step down early to avoid a vacancy at the top of the Supreme Court during the August 2017 general election.⁴ Mutungwa will become **Commonwealth** special envoy to the **Maldives**.⁵

Mutungwa was appointed chief justice in June 2011.⁶ He was the first chief justice under the **Constitution of Kenya, 2010** that increased judicial independence.⁷ The contested results of the March 2013 general election tested the nascent court's authority but Mutungwa resisted political pressure to rule in favour of the result. He also earned a positive reputation as a judicial reformer willing to curb judicial corruption.⁸

The legal sector has welcomed Mutungwa's willingness to step down, saying it was further evidence of his integrity.⁹ However, his resignation may undermine the authority of the judiciary at a time when popular confidence in its neutrality is low.¹⁰ In his resignation address, Mutungwa criticised Kenya's political leadership, noting a persistence of ethnic politics.¹¹

Mutungwa's conduct contrasted with that of Supreme Court deputy chief justice **Kalpana Hasmukhrai Rawal** and justice **Philip Tunoi**, both of whom challenged the constitutional age limit for judges.¹² Rawal and Tunoi claimed that their appointments under the old constitution meant they should not

¹ Africa Review, 16 Jun 2016.

² Africa Review, 16 Jun 2016.

³ Africa Review, 16 Jun 2016.

⁴ Africa Review, 16 Jun 2016.

⁵ Capital FM, 17 Jun 2016.

⁶ Capital FM, 17 Jun 2016.

⁷ Capital FM, 17 Jun 2016.

⁸ www.freedomhouse.org

⁹ Source, law firm partner, Nairobi

¹⁰ Source, law firm partner, Nairobi

¹¹ Source, law firm partner, Nairobi

¹² Source, law firm partner, Nairobi

have to step down until 74, the previous constitutional term limit. In May, an **Appeals Court** ruling upheld a **High Court** ruling that all judges must retire before 70.¹³ Tunoi should therefore have retired in June 2014 and Rawal in January 2016.¹⁴ Tunoi and Rawal appealed to the Supreme Court, but it was unable to secure a quorum as the two justices could not rule on their own case and others recused themselves after previously backing the mandatory retirement age of 70.¹⁵ The inability of the Supreme Court to fully hear Tunoi and Rawal's case means that the Appeals Court ruling stands.

Before her retirement, Rawal – as deputy chief justice – would have acted as interim chief justice, potentially during the general election. Rawal is a controversial figure who was named in the so-called **Panama Papers**, leaked documents from **Panama City (Panama)**-based law and corporate services company **Mossack Fonseca & Co**, as using offshore companies to acquire international property.¹⁶ The **International Consortium of Investigative Journalists** analysis of the documents appears to show that Rawal was a director or shareholder of four **British Virgin Islands**-based companies, following her appointment as a high court judge.¹⁷ Rawal's husband was a director or shareholder of seven other companies used to buy and sell high value property in **London (United Kingdom)**.¹⁸

“There's certainly nothing to suggest that Rawal did anything illegal but offshore structures are not currently politically palatable, meaning there was little appetite for her entirely reasonable argument that they are perfectly legal and legitimate corporate practices.”¹⁹

There was also concern that previous rulings favouring individuals linked to the ruling **Jubilee Alliance** in cases related to the **International Criminal Court (ICC)** might encourage allegations of political favouritism should the Supreme Court need to rule on the 2017 general election.²⁰ Justice **Njoki Susanna Ndung'u** initially scheduled the Supreme Court hearing on Rawal and Tunoi for after Mutunga's resignation.²¹ Critics saw this as an attempt to sideline Mutunga, and as part of a broader division in the Supreme Court between liberal and pro-government justices.²²

Deputy chief justice **Mohamed Ibrahim** holds the presidency of the Supreme Court until the **Judicial Service Commission (JSC)** makes a permanent chief justice appointment.²³ Under the old constitution, the president alone would appoint the chief justice. The JSC now puts forward a single nomination that the president and national assembly must approve. There is no timeline for this process, with legal sources warning that it may take up to six months.²⁴

Until the replacements for Mutunga, Rawal and Tunoi are appointed, the Supreme Court lacks a quorum. The Supreme Court can hear cases with less than five justices, but cannot issue full rulings.²⁵

Jamii Bora Bank complains it was misled in Uchumi acquisition

Jamii Bora Bank (JBB) CEO **Samuel Kimani** has told shareholders that incorrect information resulted in its \$5m acquisition of **Nairobi Securities Exchange (NSE)**-listed **Uchumi Supermarkets** shares in 2014.²⁶ Kimani's comments highlight the need for investors to undertake pre-investment integrity due diligences. JBB acquired a 15.8% stake in Uchumi in 2014 during a rights issue that

¹³ Source, law firm partner, Nairobi

¹⁴ Capital FM, 17 Jun 2016.

¹⁵ Capital FM, 17 Jun 2016.

¹⁶ Daily Nation, 4 Apr 2016.

¹⁷ Daily Nation, 4 Apr 2016.

¹⁸ Daily Nation, 4 Apr 2016.

¹⁹ Source, fiduciary services executive, UK.

²⁰ Source, law firm partner, Nairobi

²¹ Capital FM, 17 Jun 2016.

²² Daily Nation, 10 Jul 2016.

²³ Africa Review, 16 Jun 2016.

²⁴ Source, law firm partner, Nairobi

²⁵ Capital FM, 17 Jun 2016.

²⁶ Daily Nation, 7 Jun 2016.

raised \$9m to finance the retail chain's expansion and to clear supplier debt.²⁷ The government holds a 14.67% stake in Uchumi.²⁸ Kimani claims that the information memorandum did not reflect the true position of Uchumi.²⁹

*"Kimani has admitted to investing shareholder funds in a junk investment. The comments caused uproar amongst shareholders, analysts and depositors as Kimani acknowledged a grave error in judgement. Kimani has said the Uchumi prospectus was at best 'a work of fiction'."*³⁰

Following the rights issue, JBB became Uchumi's majority shareholder and obtained a seat on the board.

*"This is when trouble began. The plan was simple; JBB was to use Uchumi's branch network for expansion by opening a bank branch inside Uchumi's 30 plus stores. This would have saved the lender significant costs incurred during branch set up. Second, the bank planned to marshal deposits by opening accounts with Uchumi's suppliers and offer services such as invoice discounting."*³¹

JBB dismissed Uchumi CEO **Jonathan Ciano** who was credited with turning the retailer to profitability but sinking it into unsustainable debt once again.³² Suppliers cancelled contracts with Uchumi due to non-payment.³³ The Uchumi board contracted **KPMG** to conduct a forensic audit which revealed systematic corporate malpractice under Ciano.

*"From top management supplying the chain (a gross conflict of interest), signing of kickback motivated contracts and fraudulent accounting, the forensic audit exposed an ailing company whose symptoms were covered in glossy albeit cooked results and good public relations."*³⁴

Uchumi is seeking \$50m to turn round the company. However, there are questions about the competence of JBB and the **Capital Markets Authority (CMA)** during the original issue.

*"Just how the transaction advisors prepared the prospectus, the CMA approved and why JBB did not do its homework are all questions stakeholders are asking. For JBB the situation is more concerning since it has shareholders who are more sensitive about compliance rules and regulations."*³⁵

United States-based private equity firm **Equator Capital Partners, LLC** is one of the investors in JBB.

JBB's shareholder troubles come at a time when small commercial banks are vulnerable to customer withdrawals. The collapse of three banks in Kenya over a one-year period, due to management misconduct and weak corporate governance structures, has made depositors extra vigilant (see *ARC Briefing Kenya May 2016*).

*"Depositors have tended to flee to safety on any whiff of banking malpractice."*³⁶

Shareholders are demanding to know why the JBB management did not undertake an integrity due diligence.

"As JBB and other stakeholders await what action the CMA will take, they still cannot escape culpability. Had there been an effort to carry out non-financial due diligence it would have been evident that something was wrong. For months there were empty shelves and suppliers were

²⁷ Daily Nation, 7 Jun 2016.

²⁸ Daily Nation, 7 Jun 2016.

²⁹ Daily Nation, 7 Jun 2016.

³⁰ Source, journalist, Nairobi

³¹ Source, journalist, Nairobi

³² Source, journalist, Nairobi

³³ Source, journalist, Nairobi

³⁴ Source, journalist, Nairobi

³⁵ Source, journalist, Nairobi

³⁶ Source, journalist, Nairobi

*grumbling that the retail chain had gone back to the days of delaying payments. Additionally in spite of shopping malls popping up all over **Nairobi** and satellite towns, no developer was signing Uchumi as the anchor tenant.”³⁷*

There is, however, broader criticism of the CMA’s regulation of the financial services sector. **Dubai Bank Kenya Ltd** and **Chase Bank Kenya Ltd** both closed after issuing CMA-approved bonds on the NSE (see *ARC Briefing Kenya May 2016*). In May, the government resurrected efforts for Nairobi to challenge **Mauritius** as the region’s international financial services hub. Kenya’s relatively robust financial sector and sophisticated banking system, combined with the convertibility of the Kenyan shilling, means it is well placed to attract increased financial services investment. Treasury cabinet secretary **Henry Rotich** on 27 May invited the private sector to comment on the proposed **Nairobi International Financial Centre Bill**.³⁸ The bill provides for the establishment of the **Nairobi International Financial Centre Authority** to manage the financial services sector. Former president **Mwai Kibaki** (2002-2013) first attempted to develop Nairobi as a financial services hub but progress has stalled.³⁹ Analysts have questioned the timing of the new legislation due to the possibility of increasingly aggressive international regulation on financial services hubs.

Maersk Oil to prioritise Kenya oil assets

Denmark-based **A.P. Moller-Maersk Group** subsidiary **Maersk Oil & Gas A/S** has said that it will prioritise its Kenya-based assets after losing its **Al-Shaheen (Qatar)** contract.⁴⁰ Despite the public pledge, there is oil sector speculation that Maersk may seek to sell Maersk Oil following the loss of the Qatar contract.⁴¹ France-based **Total** won a 30% stake in a 25-year contract to operate the Al-Shaheen field on 27 June, with state-owned **Qatar Petroleum** retaining the remaining 70%.⁴² Maersk Oil had operated the Al-Shaheen field since 1992. The oil industry expected that Maersk Oil would renew its 25-year production agreement due to expire in 2017.⁴³ However, in 2015 Qatar Petroleum put the field out for tender. Maersk Oil responded to the loss saying it will focus on its Kenya and **North Sea** assets. In Kenya, Maersk Oil acquired 50% of **Africa Oil Corp’s** interests in **Blocks 10BB, 13T and 10BA** in a November 2015 farm out deal.⁴⁴

Government acquires sole control of Mombasa refinery

Mauritius-based energy trading company **Essar Energy Overseas Ltd**, a subsidiary of **Essar Oil Ltd**, on 24 June sold its 50% stake in **Kenya Petroleum Refineries Ltd (KPRL)** to the Kenyan government.⁴⁵ Owner brothers **Shashikant** and **Ravikant Ruia** are restructuring Essar Oil before its proposed sale to **Russia** state-owned **Rosneft OAO**. Essar Energy sold its stake in KPRL for \$5m.⁴⁶ KPRL operates the 4 million tonnes per annum crude oil refinery in **Mombasa**.⁴⁷ However, the plant has been idle since its owners abandoned a \$1.2 billion upgrade in September 2013 after consultants declared it economically unviable.⁴⁸ Essar Oil has sought an exit since 2013. In March, energy cabinet secretary **Charles Keter** announced that the refinery would act as storage for marketers of imported fuel.⁴⁹ Keter said the state-owned **Kenya Pipeline Co** would operate the plant once Essar Oil had

³⁷ Source, journalist, Nairobi

³⁸ East African, 27 May 2016.

³⁹ East African, 27 May 2016.

⁴⁰ Reuters, 28 Jun 2016.

⁴¹ Source, senior analyst, oil sector

⁴² Reuters, 28 Jun 2016.

⁴³ Source, senior analyst, oil sector

⁴⁴ Africa Oil statement, 9 Nov 2015.

⁴⁵ Industrial Goods Monitor Worldwide, 25 Jun 2016.

⁴⁶ Industrial Goods Monitor Worldwide, 25 Jun 2016.

⁴⁷ Industrial Goods Monitor Worldwide, 25 Jun 2016.

⁴⁸ Industrial Goods Monitor Worldwide, 25 Jun 2016.

⁴⁹ East African, 28 Mar 2015.

exited.⁵⁰ Essar Oil acquired its stake in KPRL for \$7m in July 2009 from **Shell Petroleum Co Ltd, BP Plc and Chevron Global Energy Inc.**⁵¹

Kenya's dilapidated downstream sector resulted in price hikes as it is tied to import costs and global crude oil prices. The **Energy Regulatory Commission (ERC)** in June increased fuel prices. In Nairobi, the price of super petrol increased 2.2% to 86.17 Kenya shillings (KSh) (\$0.85), diesel 4.5% to KSh73.71 (\$0.73) and kerosene 7.5% to KSh50.80 (\$0.50).⁵² In Mombasa, the price of super petrol is now KSh82.78 (\$0.82), diesel KSh70.36 (\$0.70) and kerosene KSh47.98 (\$0.47).⁵³ Additionally, the government in June imposed a new excise tax on kerosene.⁵⁴

Implications

The early resignation of Mutunga reduces the risk of an absence of leadership at the Supreme Court during the 2017 general election. The significance of the choice of Mutunga's successor increases the risk that the nomination process will become politicised. With political tensions already increasing, a credible candidate acceptable to both the ruling Jubilee Alliance and the opposition is vital if both are to view the Supreme Court as an independent arbiter both before and after the election.

The JBB investment in Uchumi may result in positive returns if suppliers agree to convert debt into equity or if the government is able to secure a loan. Regardless, the case highlights the importance of pre-investment integrity due diligences. Judicious pre-investment enquiries are a cost saving business tool.

Kenya's low risk and low cost acreage means it will remain attractive to Maersk Oil. However, Maersk is set to complete a strategy review process before the end of the third quarter, which may determine the future of Maersk Oil.

The idle Mombasa refinery is indicative of broader mismanagement of the fuel supply chain, which means that shortages and prices hikes will continue to impact businesses reliant on road transport. Fuel prices will continue to fluctuate as long as they are linked to import and global commodity prices. Further increases are possible, meaning higher transport costs for people and goods.

⁵⁰ East African, 28 Mar 2015.

⁵¹ Industrial Goods Monitor Worldwide, 25 Jun 2016.

⁵² www.erc.go.ke

⁵³ www.erc.go.ke

⁵⁴ www.erc.go.ke

About Africa Risk Consulting:

Africa Risk Consulting (ARC) is a pan-African consulting company that provides timely, relevant information and advice that enables its clients to take informed investment decisions and to safeguard their reputations.

ARC's core consulting services include integrity due diligence and corporate investigations, political advisory and country assessments, opportunity monitoring and reputation risk management. Most relevant to private equity firms is ARC's integrity due diligence and corporate investigations capability. Specifically, ARC offers pre-deal integrity checks to highlight red flags before negotiations start; full detailed multi-jurisdictional reputation due diligence; and supplier and senior hire vetting and repeat due diligence for compliance programmes. ARC is unique in that it offers a 10-day delivery for a routine integrity due diligence. ARC also offers a suite of corporate investigations services from immediate investigation, evidence gathering, e-discovery, forensic accounting and whistleblower support on one end to crisis media management and regular monitoring on the other.

www.africariskconsulting.com

About ARC Briefing:

ARC Briefing is ARC's essential online business information service.

Companies at any stage in their Africa expansion, whether building or communicating an Africa strategy, investing directly, expanding current operations, financing other investors, doing the legal leg-work or researching the Africa growth trend, need ARC Briefing.

ARC Briefing is an online information service keeping you:

- Up to date with Country Chronologies of business-critical events
- In the know via Country Briefings on political, economic, business and operating trends. Written in-country, ARC experts analyse and comment
- Ahead with Country Planner which details future elections, budgets, regulatory changes etc.

www.briefing.africariskconsulting.com

Getting in touch

Please contact us by email info@africariskconsulting.com or call + 44 (0) 20 7078 4080

Follow us on Twitter: [@ARCBriefing](https://twitter.com/ARCBriefing)