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MMAN INSIGHTS

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The Nairobi International Financial Centre

Does Kenya have what it takes to be the Next International Financial Hub?

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We cater for individuals, SMEs, large companies and the public sector. We advise both local and international clients, many of whom are drawn from our target industry sectors of Agribusiness, Financial Services, Energy, ICT, Retirement Benefits, Transport, Real Estate and Construction.

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MMAN ADVOCATES

SUZANNE MUTHAURA
Partner, MMAN Advocates

LETTER FROM THE EDITOR

Happy New Year 2018.

It is my pleasure to present the inaugural edition of MMAN's Insights publication through which we aim to provide both local and international investors with insights on doing business in Kenya.

In this edition we have brought together contributions and perspectives from several members of our team covering different aspects of the investment climate in Kenya that we believe will be interesting to those looking to or already doing business in Kenya. We begin by taking a view on Nairobi as an International Financial Centre, and also explore the opportunities presented to investors, both within the country and abroad, by devolution and the need for project funding within counties in the country.

A key element of connection between a nation and the rest of the world that heavily influences its economic development is its transport network and infrastructure. With other East African countries such as Tanzania and Ethiopia also investing heavily in their rail network, there is a drive towards ensuring that each country's transport network is up to par and that it is not left behind in this key facet of development. This pressure has created an even greater need for an analysis and evaluation of infrastructural projects especially because they involve significant investments and often heavy borrowing by Governments.

We have therefore included some of what we believe are key lessons that Kenya, and indeed the region, can glean from South Africa's implementation of their Gautrain.

We have also explored air transport connectivity both within Africa as is currently being tackled through the implementation of the Yamoussoukro Decision, as well as that between Kenya and countries outside Africa. Not forgotten is the complexity introduced by the use of drones which whilst presenting us with many commercial opportunities also create a need for regulation due to related dangers surrounding their implementation.

We have also included perspectives surrounding other Intellectual Property and Employment related issues affecting investors as well as legal developments in the country.

Please visit our website ***www.mman.co.ke*** in order to read further articles and publications and feel free to subscribe to receive more insights from our team at MMAN Advocates.

Enjoy your reading.

SUZANNE MUTHAURA

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Investing in Kenya

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- **RIGHTS, RESTRICTIONS & REQUIREMENTS TO INVESTMENTS**
  Rights, Restrictions and Requirements to Invest in Land Within Kenya

JANUARY • 2018

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THE NAIROBI INTERNATIONAL FINANCIAL CENTRE

The Next International Financial Hub?

International Financial Centres (IFCs) are countries or territories with specialised legal institutions and regulatory frameworks that facilitate the flow and investment of international capital. Examples include London, Dubai, Hong Kong, Cayman Islands etc.[1]

Kenya has recently taken significant steps in its goal to become an international financial services hub, by passing the Nairobi International Financial Centre Act, 2017 (the 'Act') which came into effect on 16th August 2017. The purpose of the Act is to provide a legal framework to facilitate and support the development of an efficient and globally competitive financial services sector in Kenya, in line with Kenya's economic development blueprint (Vision 2030) which focuses on creating ***a vibrant and globally competitive financial sector that drives creation of jobs and high levels of savings to finance Kenya's investment needs.***

This Article briefly looks at the key provisions of the Act illustrating how the Nairobi International Financial Centre ('NIFC'), a flagship project under the economic pillar of Vision 2030, purposes to contribute towards achieving Vision 2030.

1 http://www.ifcforum.org/ accessed on 28/09/17

OBJECTIVES OF THE ACT

The Act seeks to accomplish its objects through the NIFC Authority which is centered on the attraction and retention of firms to be known as NIFC firms.[2] These objects are summed up in three interrelated cornerstones namely:

1. To establish and maintain an operating framework for NIFC firms;
2. To develop strategies and provide incentive structures in collaboration with relevant agencies. These structures will go into supporting the operating framework in terms of attracting and retaining firms once this is in place;
3. To review and recommend legal and regulatory framework developments. These developments will be conducted by the Authority in conjunction with regulators such as the Central Bank of Kenya, Capital Markets Authority, and Insurance Regulatory Authority amongst others.

NIFC FIRMS

The law as set out has provided for certification of firms to be known as NIFC firms. A person intending to operate as a NIFC firm will be required to apply to the NIFC Authority in a prescribed form (yet to be published). Certification of these firms will allow a person (including companies) to operate under a framework to be provided by the NIFC and thereby receive certain rights and benefits to be determined and published by the Authority. The certification however, will still require a firm to seek necessary licenses from relevant regulatory authorities. For instance where the firm is a bank; beyond certification as an NIFC firm, it will still be required to obtain regulatory approval from the Central Bank of Kenya. Such an additional requirement may work against the object of the Act to attract firms into Kenya as it increases the approvals required for market entry instead of reducing the same as is the norm in other IFCs.

It is instructive to note that the general nature of the Act is to provide a foundational structure for the establishment of a financial hub. As relates to firms, the Act does not prescribe the steps for certification, which activities such firms may perform, etc. This is left to the Regulations which are yet to be drafted under the Act. Without the passing of the Regulations, and clear implementation of the objectives of the Authority as stated above, the Act will only be aspirational.

DISPUTE RESOLUTION

Introducing legal and institutional reforms that will make enforcement of justice more efficient is considered to be one of the most urgent steps towards a competitive financial environment in Kenya.[3] Dispute resolution in IFCs is integral in the process of enforcement of justice.

Most IFCs' legal systems are based on English common law. As a result, IFCs have legal sectors, judiciaries, and law enforcement authorities that are robust and reliable.

In order to be successful, IFCs must have high-quality legal institutions that can be trusted by investors to be fair and impartial and can be relied on by regulators to be rigorous and transparent. It's these legal and financial institutions that give IFCs their credibility and encourage people to do business there.

2 Section 6
3 Kenya's Vision 2030

The Act, in recognition of the important role of international arbitration in IFCs such as Dubai, London and Hongkong, has provided for the resolution of disputes through the process of arbitration. Kenya passed into law the Nairobi Centre for International Arbitration (NCIA) Act, 2013 as part of a supporting legal infrastructure to the NIFC.

The NIFC Act provides that disputes be resolved by the NCIA. The Act however is restrictive in its application of the NCIA as its provisions only relate to disputes between the NIFC Authority and NIFC firms. Further, the disputes to be addressed are restricted only to those relating to rights and benefits for NIFC firms.[4]

It remains to be seen what international arbitration mechanism will be utilised, if any, to settle disputes between NIFC firms themselves and other local or foreign firms as this has not been addressed by the Act

Separately, the law further sets up a Tribunal *to hear appeals against any decisions of the Authority.* Once again, the law focuses on disputes against an NIFC firm and the Authority.

Based on the foregoing, there is lack of clarity as to whether a dispute relating to rights and benefits of NIFC firms and also involving a decision of the Authority would be settled by the Tribunal or under arbitration at the NCIA.

Also, both mechanisms leave a gap in the settlement of disputes between firms themselves and; firms and other persons outside the confines of the Act. Will such disputes be handled solely by the commercial courts? If so, what then will be the role of international arbitration? Or, will disputes be handled by the NCIA or arbitral courts under the NCIA Act?

It remains to be seen what international arbitration mechanism will be utilised, if any, to settle disputes between NIFC firms themselves and other local or foreign firms as this has not been addressed by the Act.

One of the hallmarks of IFCs is certainty of law. Based on the current structure, it is arguable that the Act is yet to achieve this certainty and further, the Act has not taken the crucial step of creating a competitive financial environment through more efficient dispute resolution mechanisms.

However, the Authority does have the power to review and recommend developments in the legal, regulatory and institutional framework including mechanisms for judicial redress[5] and this will be an appropriate mechanism for it to provide the necessary clarification.

In conclusion, the Act only provides a foundational basis for the development of a financial hub. Its implementation in the identified priority areas (banking, insurance and reinsurance, capital insurance, and the stock market)[6] will determine its success going forward. Successful implementation of NIFC under the Act will also ensure that the benefit of attracting foreign direct investments[7] is achieved hence moving the country toward achieving Vision 2030.

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4 Section 32 of the Act
5 Section 7 (d) of the Act
6 Government of Kenya Cabinet Brief
7 http://www.vision2030.go.ke/economic-pillar/

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INVESTORS AND TALENT

Employment Issues Specific To Expatriates

This article seeks to address two major employment issues that are specific to expatriates both from an employer and employee perspective. These are immigration and tax related matters. We, however, will make mention of the Employment Act which is the primary legislation governing the employer-employee relationship in Kenya.

The Employment Act[1] provides the minimum employment conditions that must be satisfied by both the employer and the employee. It is therefore critical for a potential employer to familiarise themselves with the Act and ensure that they follow its provisions. A failure by the employer to do so may leave them exposed to a number of employment related claims as outlined therein.

One of the major issues affecting hiring of foreigners as employees is the work permit. Let us look at the considerations made when obtaining a work permit.

WORK PERMIT

It is compulsory for all expatriates working in Kenya to hold a valid work permit issued by the Director of Immigration Services (the Director). The Government of Kenya in line with its obligation to generate employment for its citizens has adopted a local employee protection policy the consequence of which

1 No. 11 of 2007.

is that only trained and competent citizens ought to run the economy of Kenya. As a result, there is a requirement for a work permit for expatriates, which stems from the Kenya Citizenship and Immigration Act[2] (the Act).

The Act provides that a person who is not a citizen of Kenya or an asylum seeker shall not enter or remain in Kenya unless she or he has a valid permit or pass[3]. The Act further provides that the presence in Kenya of any person who is not a citizen of Kenya shall, unless otherwise authorized under the Act, be unlawful, unless that person is in possession of a valid work permit or a valid residence permit or a valid pass[4].

The Kenya Citizenship and Immigration Regulations, 2012, categorises work permits into a number of classes that are dependent on the undertakings one wishes to engage in while in Kenya. These are (1) Class A - Prospecting and mining, (2) Class B - Agriculture and animal husbandry, (3) Class C - Prescribed profession, (4) Class D - Employment, (5) Class F - Specific manufacturing, (6) Class G - Specific Trade, Business or Consultancy, (7) Class I – Approved religious or Charitable activities, (8) Class K - Ordinary residents, and (8) Class M - Refugees[5].

Depending on the period of engagement, an expatriate employee will require either a Special Pass or Class D work permit. Where an engagement runs between three to six months[6], a special pass is ideal. In case the engagement is to run for more than six months, a Class D work permit will be required. This relates to persons offered specific employment by a specific employer.

2 No. 12 of 2011
3 Clause 34(1) of the Kenya Citizenship and Immigration Act.
4 Clause 34(2) of the Kenya Citizenship and Immigration Act.
5 Seventh Schedule of the Kenya Citizenship and Immigration Regulations, 2012.
6 Regulation 31(7) of the Kenya Citizenship and Immigration Regulations, 2012.
7 Section 40 if the Kenya Citizenship and Immigration Act

Obtaining a work permit is not automatic. The expatriate employee and the employer engaging the services of the expatriate must satisfy the various conditions given in law.

A work permit is only issued to expatriates who have an expertise that is not presently available in the Kenyan labour market and the employer ought to demonstrate that they have made efforts to fill the position from the Kenyan labour market with no success. Further, work permits will be issued on condition that the employer undertakes a training programme so as equip a Kenyan citizen with the requisite expertise to enable them to take up the position held by the expatriate upon expiry of the permit.

Applying for a Work Permit

Pursuant to the provisions of the Act[7], the application process and requirements for issuance of a work permit also apply to the renewal process. As soon as the application for issuance or renewal of a work/

Global mobility continues to grow in volume. Within the context of closely aligned international regulatory frameworks, the growth of cross-border acquisitions by sovereign wealth funds, lingering public investments in private business concerns, greater security co-operation between nations, and information technology that can identify and connect talent in an instant, global mobility becomes part of the new normal. Mobility of talent is fluid.

Source: PwC
Talent Mobility 2020: The Next Generation Of International Assignments

entry permit is lodged, the permit determination committee (Committee) which is tasked with determination and recommendation to the Director as to whether he may issue or renew entry/work permit evaluates the same. In exercising their functions, the Committee and the Director are governed by the provisions of the Act relating to migration control[8] .

The Kenyan Courts have held that in carrying out their role, the Committee and the Director must observe procedural fairness. This is especially so where a decision to decline an application for issuance/ renewal of a work permit is reached. The principles of procedural fairness in this process were espoused in the matter of ***Bolpak Trading Company Limited & 5 others v Cabinet Secretary for Interior & Co-ordination of National Government & 2 others [2017]***[9]. It is worth mentioning that the Courts have not wavered in quashing decisions by the Director, which in their determination, are devoid of procedural fairness.

CESSATION OF EMPLOYMENT

Employers of expatriates will be obligated to report a termination of the employment of the expatriate (circumstances notwithstanding), during the validity of the work permit, within 15 days of the cessation of employment[10].

FOREIGN NATIONAL CERTIFICATE (ALIEN CARD) REGISTRATION

After obtaining a work permit, the expatriate employee will be required to apply for registration as a foreigner [11]and obtain an Alien Card. Unlike the process of getting a work permit, the process of registering as a foreign national and obtaining an Alien Card is straightforward where the applicant is in possession of a valid work permit.

With the guidance of an immigration expert, the process for issuance/renewal of a work permit can be fairly easy and straightforward.

The second issue affecting hiring of foreigners as employees relates to Tax payments. The below details two items for consideration on this issue:

1. Kenya Revenue Authority (KRA) PIN Certificate

Once an expatriate employee obtains a work permit and an Alien Card, the next phase is to register with Kenya Revenue Authority as a taxpayer. The registration as a taxpayer is done online at KRA's iTax[12] portal. After the registration is complete, a certificate bearing a unique personal identification number (PIN) is generated.

The PIN is critical for all future payment of Tax by the expatriate employee, this comprises but is not limited to Income Tax deducted and remitted by the employer to KRA in line with the Income Tax Act. We further note that the expatriate employee will be required to file Income Tax returns every year.

2. Double Taxation Relief Treaty

It is also of interest to note that Kenya has entered into Double Taxation Relief Treaties with a number of countries. A Double Taxation Relief Treaty sets out the taxation provisions applied by the countries party to it. It is advisable for an expatriate employee and an employer engaging an expatriate to engage the services of a tax expert to obtain advice on double taxation

8 Part VI of the Act
9 Petition No. 62 of 2016 (Consolidated With No. 60 & 61 Of 2016)
10 Regulation 22 of the Kenya Citizenship and Immigration Regulations, 2012.
11 Regulation 46 of the Kenya Citizenship and Immigration Regulations, 2012.
12 https://itax.kra.go.ke

arrangements in place between Kenya and the country of origin of the expatriate and how the same affects tax deductions, remittances and annual filing of tax returns.

CONCLUSION

From the foregoing, employers need to make a number of considerations before engaging an expatriate. It is desirable to make an offer for employment conditional on the expatriate employee obtaining a work permit. Otherwise, an employer may be contractually bound to an employee who is legally barred from working in Kenya.

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DEVOLUTION & PUBLIC PRIVATE PARTNERSHIPS
Partnering with Counties

According to the Public Private Partnership (PPP) Programme report published by the PPP Unit[1] in September 2017, setting out the status of Kenya's PPPs, it was reported that 66 PPP projects are in the pipeline at various stages with six being county projects. Nairobi and Mombasa counties presently lead in PPPs with each county having two projects in the pipeline. To facilitate and further encourage private sector investment and finance under the Public Private Partnerships Act No. 15 of 2013 (the "Act"), new regulations have been introduced and amendments to the Act have been drafted.

In May 2017, the Public Private Partnership (Project Facilitation Fund) Regulations 2017 (the "PFF Regulations") were introduced to provide the framework for financial assistance to public entities in relation to PPP projects. The key points of the PFF Regulations are as follows:

- The Project Facilitation Fund (PFF) excludes viability gap funding for privately initiated investment proposals (unsolicited proposals) or projects procured before the Act came into force (pre – 2013 projects).
- The PPP Committee, whose members are the permanent secretaries of various ministries, are

1 The PPP Unit is a special purpose unit within Kenya's National Treasury which, amongst other functions, provides technical, financial and legal expertise to the PPP Committee and other public entities in relation to PPP projects

to approve all funding applications from a public entity or the PPP Unit, in addition to overseeing the operation and management of the PFF.

- The PPP Committee is to prioritise funding applications on a first-come first served basis.
- Subject to a public entity meeting the requirements set out under the PFF Regulations, it shall be able to request for funds :
    1. to meet third party costs (such as consultancy services related to the project, as well as, transaction and advisory services);
    2. to conduct the tender process, and other project preparation activities; and
    3. in relation to viability gap funding, to provide grants, finance or guarantee a project.
- The PFF is to provide funding for contingent liabilities arising from the implementation of a project.

A successful public entity applicant shall be required to enter into a tripartite agreement (Funding Agreement) between it, the PFF and the company awarded the PPP contract. Templates of the various types of Funding Agreements outlining the terms and conditions are to be provided by the PPP Unit in the near future.

The PFF Regulations are a welcome development. They have enhanced the existing PPP regulatory framework and provided an enabling environment for parties to discuss project risk allocation and management. This is particularly important for a nascent PPP market.

In 2015, the PPP (County Government) Regulations (the "County Regulations") were drafted with the intent to facilitate and regulate county government participation in PPP projects. Despite the County Regulations remaining only as a draft, Kenyan counties have been able to engage in PPPs within the existing legislative framework. Greater clarity is to be expected in this area as earlier this year, prior to the introduction of the PFF Regulations, the draft Public Private Partnership (Amendment) Bill 2016 (the "PPP Bill") was published. The PPP Bill, which is expected to be signed into law soon proposes the following key amendments:

- The definition of "contracting party" in relation to county governments is to be broadened to include county corporations.
- County governments are to prepare their own PPP priority lists (subject to the approval of the PPP Committee) and they are to be responsible for the management and administration of their PPPs.
- Cabinet and Parliament are no longer the bodies to approve PPPs, instead, the PPP Committee is to be the approval body. It shall approve the feasibility reports, the negotiated (including varied) commercial, financial and technical terms of a proposed PPP.
- Reports for the implementation of PPPs are to be submitted to the PPP Unit for review and approval. Presently, this role is under the PPP Committee; however, it is acknowledged that the PPP Unit has the requisite personnel to undertake the technical review and analysis of proposed PPPs.
- The PPP Unit, in relation to public entities, is to be responsible for assessing their capacity to undertake a PPP. Where the PPP Unit determines that a public entity lacks capacity, the public entity shall be required to consult the PPP Unit, to appoint a transaction advisor to assist it with the PPP.
- A bidder who is non-compliant to the terms of a tender shall have their bid rejected and shall not be entitled to compensation. In such an instance, the bidder shall be informed of the grounds for rejection of their bid. Presently, there is no requirement placed on a public entity to provide grounds for rejection.

The proposed changes are to provide clarity for public entities, investors and financiers in the roles and responsibilities of parties. As the local PPP market gains more experience, the laws and regulations of PPP shall continue to develop but more importantly, it shall promote an environment conducive to increase PPPs.

Despite the PFF Regulations and the draft amendments, counties face two notable challenges. First, the lack of in-house capacity to undertake the necessary PPP preparation and to negotiate financial and contractual terms for a PPP. Secondly, the need for county leadership to re-orient their development policies to include viable long-term projects.

Notwithstanding the challenges, the county governments and entities provide a great investment opportunity. Budgetary constraints require counties to seek alternative revenue streams to pursue their development agenda. In addition, devolution has fostered competition amongst the 42 counties. Furthermore, citizens are demanding higher standards of service, cost effective use of public resources, and for projects to bring meaningful change. Consequently, the political will to deliver only short and medium term development goals is being eroded.

Under devolution, counties are responsible for the delivery of services in relation to natural resources, transport (including roads), health services, housing, education and trade. Only four counties in Kenya have a PPP project in the pipeline and at most, two projects, when the same can be undertaken in several areas. The confluence of public demand for services and lower costs, legislative and policy development together with prioritisation of capacity building by PPP entities will result in an environment conducive for PPPs, particularly in the county PPP sector.

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While large infrastructure projects grab the attention of central government, infrastructure investment is important also at the sub-national level. Sub-national entities and governments including municipalities and provinces provide many essential and basic infrastructure services, such as solid waste management, water and electricity, health care, education, urban passenger transport, street lighting.

The traditional sources of financing are often inadequate to fund local and regional investment needs and local agencies often lack capacity and resources to deliver quality services. The sub-national entities often hold land in strategic locations which may be attractive to the private sector for commercial development. Private sector engagement through public-private partnership (PPP) projects at the provincial and local level can deliver infrastructure and service improvements at the local level whilst providing opportunities for the private sector.

Source: World Bank, Public Private Partnership in Infrastructure Resource Centre
http://ppp.worldbank.org/public-private-partnership/ppp-sector/sub-national-and-municipal-ppps/sub-national-and-municipal-ppps

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RIGHTS, RESTRICTIONS & REQUIREMENTS

Rights, Restrictions and Requirements to Invest in Land Within Kenya

Article 40 of the Constitution of Kenya ("Constitution") provides that every person has the right to acquire property of any description in any part of Kenya. This right is not absolute as the right to owning property is subject to some fetters and restrictions in relation to non-citizens. In this respect, the Constitution provides that a person who is a non-citizen may only hold land on leasehold tenure for a term not exceeding 99 years. Limited liability companies whose shares are not wholly owned by Kenyan citizens are considered to be foreign companies under the Constitution and are therefore subject to this restriction. Any document purporting to confer to a non- citizen a leasehold proprietary interest over land for a period of more than 99 years shall be construed to confer to the non-citizen only a 99 year leasehold term.

The Constitution, in making this provision, altered any pre-existing freehold interest or leasehold interest of a term exceeding 99 years, in land held by non- citizens before the Constitution's promulgation on 28th August 2010. Further, it also anticipates that subsequent transactions in land will conform to the law restricting ownership to non-citizens. When the leasehold interest expires, one can seek renewal of the expired lease which ordinarily is not arbitrarily denied.

PRINCIPLES OF LAND POLICY

The Constitution has spelt out the principles of Kenya's land policy applicable to land ownership, use and management. The land held, used and managed within Kenya must be within the purview of these land principles which are implemented through the National Land Policy adopted in 2009.

The land principles include, but are not limited to: equitable access to land; security of land rights; sustainable and productive management of resources; transparent and cost-effective administration of land; sound conservation and protection of ecological sensitive areas as well as elimination of gender discrimination in laws, customs and practices.

These principles apply to all land proprietors, placing certain restrictions to the utility of the land resource.

> **While every person has a right to own any property in Kenya, this right is subject to some restrictions relating to non- citizens regarding controlled land, agricultural land and the tenure of land ownership**

AGRICULTURAL LAND

Agricultural land is managed by the Land Control Boards under the Land Control Act (Chapter 302 of the Laws of Kenya). The Land Control Boards control dealings in agricultural land in Kenya to guarantee effective use and maintenance, economic development and improvement of agricultural land. Any natural persons or companies dealing in agricultural land therefore must obtain consent from the Land Control Board before completing any transaction related to agricultural land.

The Land Control Act provides for instances where the consent to deal in agricultural land can be granted or refused. This consent will not be granted in controlled transactions involving agricultural land such as sale, transfer, lease, exchange or partition to persons who are not Kenyan citizens or by private companies and cooperatives whose members or shareholders are not all Kenyan citizens.

This limitation can be addressed in several ways. One way is to make an application to the President for exemption from the application of the provisions of the Land Control Act. This exemption is granted at the discretion of the President. One can also obtain a concessional lease from the Kenyan Government. The Government has in previous occasions provided concessional leases over agricultural land to non-citizens, foreign companies and foreign states. These concessional leases are grants of leases for less than the market value by the Government as a business package incentive, to increase the economic development of an area or to promote the development of a community. For instance, the Kenya Government, through the County Council of Siaya, issued concessional leases for over approximately twenty thousand (20,000) acres to Dominion farms, a foreign company, for a term of twenty five (25) years.

Further, foreign investors can circumnavigate this restriction by changing the designated use of the land from agricultural to remove it from the ambit of the Land Control Act. When the use of the land ceases to be agricultural, the Land Control Board ceases to have a role in its administration. The Foreign investor can also use a private company whose shareholding is wholly Kenyan to acquire the agricultural land and later convert the company into a public company to which the foreign investors can take up shares.

CONTROLLED LAND

The Land Act (No. 6 of 2012) defines controlled land to include: land within a zone of twenty five (25) kilometers from the inland national boundary of Kenya, land within the first and second row from the highest water mark of the Indian Ocean, and any other land declared controlled land under any law or statute. The Land Act prohibits transactions in controlled land to ineligible persons without approval of the Cabinet Secretary. Ineligible persons means persons who are not Kenyan citizens or a body corporate which has non-citizens as shareholders as well as any national or county government other than that of Kenya. This restriction is in relation to any transfer for consideration, by way of trust, gift inter vivos or otherwise in controlled land.

This restriction to own controlled land by foreigners can be exempted upon application to the Cabinet Secretary. The Cabinet Secretary, in deciding whether or not to grant an application, must seek the approval of other relevant authorities.

CONCLUSION

In brief, while every person has a right to own any property in Kenya, this right is subject to some restrictions relating to non- citizens regarding controlled land, agricultural land and the tenure of land ownership . There are, as outlined in this article, some remedies available to overcome the limitations to enable foreign investors own the land to which these restrictions apply.

For more information or advice related to this topic please contact Nyawira on nkirubi@mman.co.ke

Projects

- **PROJECT FINANCING IN KENYA**
  What Can a Lender Expect
- **BANKABILITY**
  A Renewable Energy Perspective in Kenya
- **DEBT FINANCING**
- **THE NEW FIDIC YELLOW BOOK DISPUTE RESOLUTION PROCEDURE**

JANUARY • 2018

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PROJECT FINANCE IN KENYA

What Can a Lender Expect?

Typically, project finance has been utilised to finance projects in the power sector, the extractives industry, infrastructure development and in the construction of large real estate developments.

REGULATORY FRAMEWORK

Generally, the project finance structure and security package adopted by the parties as well as the underlying industry to which a project relates, determine the applicable regulatory framework.

As between parties, Kenya permits private parties to elect the jurisdiction that will govern the project agreements (including the financing agreements), English law being a popular choice.

Domestic law however applies:

- where one of the parties is the Government of Kenya, any state corporation or any county government, the project agreement entered into by such body is governed by the laws of Kenya
- where project assets are located in Kenya, such assets are held in accordance with Kenyan law
- where the security documentation secures assets situated in Kenya, such documentation will be governed by the laws of Kenya, to enable enforcement of security rights

- to all operational matters of a project or the project vehicle for which specific legislation exists, for instance those matters that relate to licensing, tax, insolvency, employment, company establishment and its administration.

In and of itself, a project finance transaction does not require government approval specific to the financing being obtained. Nevertheless, the projects that are being financed will be subject to sector specific laws and regulations, and in those cases, those projects require prior government authorisations, concessions, licences and permits before implementation. Lenders and investors would therefore ordinarily require that such government approvals are in place prior to financing the project. Fees are typically paid for such approvals.

Moreover, conventional project finance structures require the establishment of a special purpose vehicle to develop the project, own the project assets (including concessions, licences, permits and land), obtain loans from lenders and receive investments from investors. In the power sector and in the case of projects under the Public Private Partnership Act, such vehicles must be registered in Kenya.

FORMS OF SECURITY THAT ARE AVAILABLE

The nature of the security taken over project assets will depend on the provisions of the applicable law and negotiations between the lenders and the project company. In order for the lenders to have complete control, they may need to take comprehensive fixed and floating charges over the project's assets. For moveable assets, the financer would have a charge by way of debenture registrable in the Companies Registry. Where there are immovable assets, the law requires that a charge be created over these assets and be registered in the Lands Registry. A deed of guarantee can also be made in favour of the lender by a third party as security too.

Security documents need to be prepared by an advocate at fee as prescribed by the Advocates Remuneration Order. Attestation or notarisation fees are payable to the attendant advocates. The security documents then need to be assessed for stamp duty and stamp duty paid against the assessment together with bank charges. Further, various consents and clearances as necessary need to be obtained before filing the documents for registration at the relevant registry at a prescribed fee.

How is priority established?

Contractual and/or structural subordination of debt in Kenya is commonly done in Kenya through the devices of tacking and consolidation. On this basis, inter-creditor arrangements are common in our jurisdiction.

Tacking: A lender could make provision under the charge instrument to give further advances or credit to the borrower on a current and continuing account. Such further advance shall not rank in priority to any subsequent charge unless:

- the provision for further advances is noted in the register in which the charge is registered; or
- the subsequent chargor has consented in writing to the priority of the further advance.

Tacking will involve an inter-creditor agreement.

Consolidation: A borrower who has more than one charge with a single lender on several securities/ assets may discharge any of the charges without having to redeem all the charges.

On making a provision for consolidation, the borrower shall record that right in the register or registers against all registered charges so consolidated.

How can security interests be enforced?

In Kenya, charges rank according to the order in which they are registered.

Section 90 of the Land Act provides for the remedies available to the lender and the procedure in the event of default by the borrower as follows:

Upon default and if the default persists for 1 month, a written notice of demand should be issued to the borrower.

If compliance is not obtained within 2 months of the notice, the chargee may take up any of the following enforcement options:

- sue the charger/borrower for any money due and owing under the charge;
- appoint a receiver of the income of the charged property;
- lease the charged property, or if the charge is of a lease, sublease the land;
- enter into possession of the charged property; or
- sell the charged property.

Court action for secured amounts: It is an avenue available to the lender. However, a court can postpone the proceedings until the lender is seen to have exhausted other remedies available.

Option of appointment of receiver of the income of the charged property: If the option of appointing a receiver is taken, the chargee/lender shall give notice to the charger/borrower and such appointment can only be made upon lapse of 30 days of serving the notice.

Option to lease or sublease the charged property: The power must be provided in the charge instrument. The lender must serve 30 days written notice of this intention and can only exercise this right upon expiry of the notice period.

Option to take possession of the charged property: Upon the expiry of 30 days the notice of default, the lender must give the borrower at least 1 month notice of intention to take possession on expiry of notice period.

Option to sell: The chargee/lender can only effect the sale 40 days after effecting service of a notice to sell to the chargor/borrower. The notice is also to be served upon various persons named under section 96(3) of the Land Act.

A valuation of the charged property must be undertaken by a registered valuer. The selling value should be not less than 25% of the market value of the property.

The sale may be by private contract at market value or public auction with reserve price. Sufficient advertisement must be undertaken by the chargee/lender.

A chargee/lender exercising the power of sale may, with the leave of the court, purchase the property. It has to be proven to the court that this isthe most advantageous way of selling the land.

Court intervention: Generally, save for an action for the secured amounts, a court order is not necessary to enforce the security interest.

Period of enforcement: From the foregoing, the statutory waiting periods from the date of default is approximately between 1 month and 4 months. The timelines for realisation of any of the remedies resorted to will depend on the speed of the lender and other participants in the process. There could also be opposition proceedings lodged by the borrower which could further protract the process.

Effect of bankruptcy/insolvency proceedings on lender's ability to enforce its security

A creditor/lender holding a charge over the property of a bankrupt has the following three options:

- sell the property if the creditor has such right under the charge;
- have the property valued and proved in bankruptcy as an unsecured creditor/lender for the balance due (if any) after deducting the amount of valuation; or

- to surrender the charge to the bankruptcy trustee for the general benefit of the creditors and prove in the bankruptcy as an unsecured creditor for the whole debt.

The bankruptcy trustee may at any time by written notice require a creditor/lender holding a charge over the bankrupt's property;

- within 30 days after receipt of the notice, to choose one of the options above; and
- if the creditor/lender chooses 2nd or 3rd option, to exercise the chosen option within that period.

A creditor who fails to comply with the notice is deemed to have surrendered the charge to the bankruptcy trustee under the 3rd option for the general benefit of the creditors, in which case the creditor is required to prove its whole debt as an unsecured creditor.

Further, in the event the bankruptcy trustee forms an opinion that disposing of a charged property as though not charged would realise better returns, he/she may apply for a court order requiring the same.

Other forms of contractual protections available to lenders used in project finance lending in Kenya

In a project financed transaction, lenders may contractually protect their investments over and above the statutorily provided measures to ensure they recover their loan and the project company does not default on its loan through the following:

Warranties, undertakings and representations: The representations, warranties and undertakings required are often divided between positive and negative undertakings. They are used by lenders not so much as a basis for claiming damages but rather as potential events of default which permit the lenders to suspend drawdown, terminate lending, demand repayment and enforce security.

Cure rights: Cure rights allow the lenders to cure a breach of an obligation by the project company under one of the project documents. The relevant participants are required to notify the lender of the breach and if the lender does not cure the breach, the participants may proceed with their contractual remedies. Lenders at times like the option to cure before having to step-in.

Step in rights: Step in rights provide lenders a right to step in to the project company, when the project company is in breach of any of the project documents, cure the relevant breach and put the project back on track. The project company will, however, remain liable both during step in and after step out. The other participants are still bound to their contractual obligations with the lender as the substitute during the step-in period.

Novation: This is a heightened form of a step-in right. In this case, the lender as the substitute entity takes over the project company's role and the project company is removed from the project altogether. The project documents need to all provide for novation or alternatively, all must be renegotiated before the novation takes place.

Direct Agreements: Such contractual terms provide for the ability of the lender to step into the position of the borrower/sponsor in the event of a default under the project contract which default would otherwise entitle the project contractor in question to terminate or suspend the contract.

STATE OWNERSHIP AND REPATRIATION OF ASSETS

There are no laws requiring the state to own an interest in a project company. Kenyan law grants every person the right to private property and in so doing, generally protects against nationalisation or expropriation of national or foreign assets. Various

bilateral agreements also provide this protection to foreign investors. Exceptions can be found in:

- the provisions of such bilateral agreements
- the Foreign Investment Protection Act, Chapter 518 Laws of Kenya, which permits the Government of Kenya to expropriate foreign assets for purposes which are "in the public interest, on a nondiscriminatory basis, in accordance with due process of law, and against prompt and full compensation"
- the Land Acquisition Act, Chapter 502 of the Laws of Kenya, which permits the Government of Kenya to acquire land for the benefit of the public and against compensation to the registered owner of the land.

Maintenance of foreign currency accounts and restrictions on the payment of dividend/repayment of shareholder loans

Moreover, project companies can establish and maintain foreign currency accounts both locally and in other jurisdictions. There are no restrictions on the payment of dividend or the repayment of shareholder loans to a foreign parent. However, banks are required to obtain and provide documentary evidence on the relevant payment and must report foreign exchange transactions that are in the excess of USD 10,000 to the Central Bank of Kenya.

CHOICE OF LAW AND JURISDICTION

Will the courts recognise a choice of foreign law? Is English law a valid choice of law?

The courts of Kenya generally recognise and give effect to choice of law provisions in a contract. However, such provisions will not be upheld where specific statutory provisions exist requiring the application of Kenyan law. This requirement may be found in employment law, company law, insolvency law or real estate and security laws. English law is a valid and often favoured choice of law in Kenya.

Will the courts recognise a choice of jurisdiction?

The courts of Kenya generally recognise and give effect to choice of jurisdiction provisions in a contract. Nonetheless, under the Constitution of Kenya, the High Court of Kenya has unlimited jurisdiction, and has such jurisdiction notwithstanding choice of jurisdiction provisions in a contract. It is however settled law that where parties reach agreement as to governing law and jurisdiction, the High Court has discretion whether or not to stay proceedings brought in contravention of such provisions, and in the absence of compelling reasons to do otherwise, is bound to exercise its discretion in favour of a stay.

Will the courts recognise a foreign arbitral award or court judgment?

A foreign arbitral award or court judgment issued by a superior court of Australia, Malawi, Seychelles, Tanzania, Uganda, Zambia and the United Kingdom is recognised in Kenya and are prima facie registrable in Kenya pursuant to the provisions of the Foreign Judgments (Reciprocal Enforcement) Act (Cap 43 Laws of Kenya) and, once so registered, takes effect as though it were a judgment of the High Court of Kenya entered at the date of registration. A first instance judgment of an English superior court would be so recognised.

The Act applies to various judgments in civil proceedings, including where a sum of money is made payable and a judgment in civil proceedings under which movable property is ordered to be delivered to any person. There are certain judgments to which the Act does not apply, including to the extent that the judgment provides for the payment of a sum of money by way of exemplary, punitive or multiple damages, or if the proceedings were brought in contravention of an agreed choice of law

forum provision. In terms of procedure, the judgment creditor may apply to the High Court of Kenya to have the judgment registered within 6 years of the date of the judgment, or where there has been an appeal, the date of the last judgment in the proceedings. The effect of registration shall, for purposes of execution, be of the same force and effect as a judgment of the High Court of Kenya for Court of Kenya.

If the foreign judgement is not issued by a court recognised under the Foreign Judgments (Reciprocal Enforcement) Act, the claimant will need to file a new suit in the Kenyan courts.

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BANKABILITY
A Renewable Energy Perspective in Kenya

Kenya has vast renewable energy resources accounting for approximately 69% of Kenya's energy mix which currently includes biomass, solar, geothermal, wind, and hydropower. Following reforms to the energy sector in the 1990s, these resources are now exploited by the largely state owned Kenya Electricity Generating Company Limited which operates an estimated 75% of Kenya's installed capacity, with other smaller independent power producers making up the difference.

TOWARDS BANKABILITY

Although attractive, investors must consider the viability of potential projects and in doing so, assess, amongst other matters, the Government's commitment to such projects, as well as the bankability of renewable energy projects in Kenya.

In establishing bankability, the following should be considered:

- First, one needs to undertake a thorough due diligence of the project from a legal and technical standpoint. On the legal side, sponsors should look into the existing regulatory and institutional framework. A thorough regulatory review of the project should be conducted to ascertain the requisite approvals and consents necessary to develop the project. Where one will be looking at investing/lending into an existing project, or a

project under development, the due diligence should include an in-depth look at the sponsors and any project company that may have been set up, as well as the tax implications of the established set-up.

- Next, is the assessment of the portfolio and objectives of the targeted lender/investor. Project sponsors need to attract lenders whose aims in relation to size, scalability and objectives of the project are aligned for the duration of the lending and be ready to put in place appropriate exit strategies for such lenders/investors.
- The acquisition of appropriate land rights is another crucial matter for sponsors and lenders to consider. Land is an emotive issue in Kenya and proper due diligence is required to ascertain ownership or land use rights. In particular, one must consider how land was acquired. Were international performance standards followed? Is resettlement necessary? Where the site land is compulsorily acquired, the sponsors should consider the resulting compensation and resettlement implications.
- Stakeholder relationships that should be nurtured for the success of the project should also be considered. Kenya is increasingly pivoting towards enacting local equity and local content requirements. The contracting authority may require the sourcing of a certain percentage of staff, goods and services locally. Further, it may be easier for local partners to apply for and obtain land rights, consents and approvals. Fostering relations with the local partners, various government institutions and the local community where the project will be located, are all key to achieving project viability. In considering approval for an electricity generating license, the Energy Regulatory Commission considers the community development arrangements the sponsor has put in place.
- The project agreements such as the EPC contract, the O&M contracts and the PPA together with other ancillary contractual arrangements form the backbone of risk allocation for the project and are therefore vital in making a project bankable. It is crucial for the sponsor to obtain legal advice early on the key issues regarding these contracts. The same care should be extended to the development or equity arrangements relating to the project, including partnership surrender agreements, joint development agreements or public private partnership agreements.
- Decommissioning of the power plant and the related costs also require consideration.
- Finally, sponsors should take advice and develop appropriate innovative project finance structures including governmental letters of support, letters of credit in relation to off-taker payments, electricity payment ring-fenced escrow arrangements, partial risk guarantees, partial credit guarantees, among others, that mitigate investor/lender risk so as to attract capital.

CONCLUSION

In conclusion: Financing is key to the success of renewable energy projects. The financing arrangements and/or the bankability of a project, is often a delicate balancing act between satisfying lenders that their risks are adequately mitigated against by granting them a degree of control, while allowing the project and its sponsors some flexibility to develop and operate the project.

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DEBT FINANCING

In the business world, there are two main ways in which an organisation may source for funding. One way is through equity financing another is through debt financing. In equity financing, the organisation raises funds by selling and purchasing shares. Once the shares are sold, the shareholder is said to hold an ownership interest in the entity and could potentially make decisions to affect the entity's future. As shareholders, they are also entitled to dividends as the entity makes profits. On the other hand in debt financing, an entity raises funds by borrowing from a lender, with a promise to repay the money (usually with interest) at a later date[1].

A major difference between equity financing and debt financing is that, unlike equity financing, debt financing does not lead to dilution of the ownership interest in the entity. Additionally, with debt financing, the lender is only entitled to repayment of the agreed-upon principal of the loan plus interest and has no direct claim in the future profits of the company like a shareholder would have.

Methods of debt financing include issuing debt securities for and taking out a bank loan. Debt securities can be issued through notes, bonds and convertible debt. Convertible debt is the main discussion is this article.

1 Practical Law, Methods of raising debt finance, Practical Law UK Practice Note 9-201-8490 (2016)

CONVERTIBLE DEBT

Convertible debt in brief terms, is debt offered to a firm that switches to equity at a given time in the future; this may be after a pre-determined period of time or the passing of a certain contingency.

Some of the basic common considerations to be taken into account in a convertible debt deal include:

1. **Delayed Valuation:** Convertible debt provides a way for firms to avoid early unrealistic valuation while still being able to secure funds to conduct their business. This is particularly beneficial to start-ups where investment through equity financing is seen as risky. It is because of the risk that these investors are often referred to as 'angel investors[2]' as they inject funds in the firm with its growth in mind and not the possible profits that they may gain. This method ensures that the investor is protected as a debtholder until the pre-determined milestone has been achieved so that it can be appropriately valued. Thereafter, the investment is transferred from debt to equity.
2. **Interest rate earned:** A convertible note holder earns interest on the note and this accrued interest is added to the total value of the note once it converts to equity. This is also another feature to entice investors.
3. **Conversion trigger:** A firm can elect to specify the maturity date i.e. when the convertible notes are converted to equity. Usually, they occur around financing events e.g. meeting a certain revenue threshold.
4. **Discount rate:** Convertible notes can also carry a discount rate which sweetens the deal for the note holder. This means that the note holder gets to buy the newly valued stock at a discount from the initial stock price after valuation thereby getting more share value for the money[3]. In essence, it might be viewed as a reward for the investor who supported a risky start-up which ended up achieving success. It is at the point of conversion, where the firm is fittingly valued, that the investor is offered the discount rate to the true value of the firm's equity.

ADVANTAGES AND DISADVANTAGES OF CONVERTIBLE DEBT

The conversion from debt to equity is one of major reasons why convertible debt is viewed as the 'best of both worlds' with regards to investment. It is one of the major advantages of issuing convertible debt. This is because a debtholder in the entity's early stages, is assured that in case the entity is unsuccessful, they will be the first to be paid off. Additionally, as equity holders, they have a stake in the entity and receive dividends from its profits. As members of the company, they are also entitled to certain rights that are captured in the law such as attending annual general meetings[4].

Another advantage for the entity is that it retains its original equity holding during the vital early stages ensuring that its main vision is maintained without the influence of other outsider shareholders who would come in later after the maturity date. Any dilution of the ownership during this stage may have negative effects as it may be time-consuming when it comes to making important business decisions. The angel investors have no role in the running of the company leaving this function to the original equity holders who in most cases are the ones who had the vision of forming the firm.

2 Poland R. Stephen, Founder's Pocket Guide: Convertible Debt, Convertible Debt Fundamentals,p.9
3 Refer to Footnote 2 ,p.8
4 In Kenya, reference can be made to the Companies Act, No. 17 of 2015 specifically from section 92-121 and also throughout he Act itself

One of the disadvantages to the convertible debtholder is, once the debt is transformed to equity, the risk increases. Additionally, if the company goes under, they end up making a higher loss as the current debtholders are paid up first before any other party. This is because as equity shareholders, they are among the last to be paid. Another disadvantage for the angel investor is that as a debtholder, before conversion, have no control of the business and are left to be at the mercy of the original shareholders. This high risk situation may deter a number of investors from offering such debt to firms.

In conclusion, convertible debt offers the safety of debt and the capital gain of equity to the investor while helping the firm to secure funding to conduct its business.

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THE NEW FIDIC YELLOW BOOK DISPUTE RESOLUTION PROCEDURE

DISPUTE RESOLUTION UNDER FIDIC CONTRACTS GENERALLY

One of the reasons that the International Federation of Consulting Engineers (FIDIC) terms are so popular for construction contracts is the well-developed set of dispute resolution procedures.

Implementing infrastructure projects is by its nature a complicated undertaking in both technical and legal terms, involving a significant commitment of both time and money. Disputes over contract performance often arise between the investor and the contractor during the course of project implementation. If a dispute arises between the investor and the contractor while carrying out a project using the terms from FIDIC—whether the Conditions of Contract for Construction (known as the "Red Book") or for Plant and Design-Build (the "Yellow Book")—standard dispute resolution procedures will be available.

Parties to a dispute may seek a resolution from the Contract Engineer, the Dispute Adjudication Board [DAB], or, as a last resort, arbitration under international rules. Ultimately, the dispute resolution procedure is always under the control of the parties, who may adapt the procedure to suit their needs under the Particular Conditions of the contract.

IN A NUTSHELL,

THE PROCEDURE UNDER THE 1999 YELLOW BOOK IS AS FOLLOW

- Claims are submitted first to the Contract Engineer, as a sort of "first instance," and he has 42 days to uphold or reject the claim, providing a detailed justification for the decision. In practice, when the Contract Engineer is experienced and trusted by the parties, a dispute may be often be resolved immediately, on-site.
- If unresolved, it will then pass to the Dispute Adjudication Board [DAB], which is appointed jointly by the investor and the contractor and contains one or three members. It is possible to limit the panel to persons included in a list of potential members drawn up as an appendix to the contract at the time it is signed. The investor and the contractor also decide whether the Dispute Adjudication Board should act as a standing panel for the duration of the contract, or ad hoc.
- The DAB, which provides a sort of appellate review of decisions by the Contract Engineer, may also serve as a panel to which the parties may submit disputes directly, bypassing the Contract Engineer. The DAB generally has 84 days to rule on a dispute, but it may propose a different deadline for the parties' approval.
- The decision of the DAB is binding, and the parties are required to comply with it promptly, unless it is modified through a conciliation procedure or by an arbitration award. A party has 28 days to reject the decision by notifying the other party. If the decision is accepted, it becomes final.
- If a party is unsatisfied with the decision, the parties should attempt to resolve the issue amicably. If that fails, the dispute should then be resolved by arbitration, which is conducted under the Rules of Arbitration of the International Chamber of Commerce by a panel of three arbitrators, in the language determined by the parties.

A 2017 UPDATE TO THE YELLOW BOOK!

In December 2016, FIDIC presented a pre-release version of its second edition of Conditions of Contracts for Plant and Design Build ("the 2017 Yellow Book") [2ND Edition] the first upgrade in over 15 years.

FIDIC has made substantial amendments to the dispute resolution provisions in the 1999 Yellow Book, and amongst other issues, it has addressed the provisions relating to "binding but not-final" Dispute Adjudication Board ("DAB") decisions which have been the cause of persistent dispute since the 1999 Yellow Book was released.

Some of the notable points are:

- **Making a claim** – It provides one consolidated clause for claims, Sub-clause 20.2, under which both parties must progress their claims within the 28 and 42 day periods under Sub-clause 20.1 of the 1999 Yellow Book. It also includes a new procedure enabling a waiver of these time-limits in certain instances, which is clearly designed to provide some clarity and a mechanism for determining when a claim will be time-barred.

- **Engineer's role** – It has been expanded to include new functions and obligations. In relation to claims, the Engineer must (1) consult with the parties to attempt to reach agreement, and if no agreement is reached within 42 days, (2) make a "fair determination" within a further 42 days. It also includes an express requirement that the Engineer act "neutrally" in discharging the above duties, a position which is not clear in all jurisdictions. It should be observed that an Engineer's determination becomes final and binding unless a Notice of Dissatisfaction

[NOD] is issued within 28 days [a position which was non-existent in the 1999 Yellow Book]. A question however lingers as to how an Engineers determination is to be enforced

- **Avoidance of Disputes** – A new provision permitting the parties to jointly ask the DAB to informally discuss and/or provide assistance with any issue or disagreement has now been added. Parties are not bound to act on any advice given and this brings into question its practical effect. It appears to place the DAB in a potentially conflicting role of being a mediator in one instance and an adjudicator in another instance.

- **DAB decisions** – They are now expressly binding on the Engineer "whether or not a Party gives a NOD with respect to such decision". Another addition was a clarification that in the event the DAB awards payment of a sum of money, that money shall be immediately due and payable after the payer receives an invoice, without requirement for certification or notice. In the event a party fails to comply with a DAB decision the other party may refer the failure itself to arbitration. An important clarification is issued in terms of challenge in that if no arbitration is commenced within 182 days after the NOD is issued, then that NOD shall be deemed to have lapsed and be no longer valid. Lastly, in the event that no DAB is in place [due to death or lapse of appointment or refusal of a party to appoint a DAB member] parties will be at liberty to proceed directly to arbitration.

- **Amicable Settlement** – the mandatory period for pursuing this has been reduced from 56 to 28 days.

- **Arbitration** – the 2017 Yellow Book expressly permits an arbitral tribunal to take into account any non-cooperation in constituting the DAB in awarding of costs.

CONCLUSION

The 2017 Yellow Book retains the same core structure of the DAB as a mandatory pre-condition to arbitration, including that non-final DAB decisions must be promptly complied with, and it has expanded this concept through the inclusion of a similar mandatory procedure of "binding but not-final" Engineer determinations.

It offers a refurbished dispute resolution mechanism, which includes some helpful and much needed revisions to its predecessor, and introduces some useful new provisions. On the plus side, it offers both parties the ability to obtain fast and inexpensive relief, with three tiers of binding determinations designed to prevent the need for arbitration and also gives clarity as to whether an NOD cancels the binding effect of a DAB decision and whether a non-final DAB decision can be summarily enforced in arbitration. On the other end, it places two-tiers of mandatory determinations in the way before a party can begin to obtain a final binding decision in arbitration and the process of enforcing determinations by the Engineer are unclear.

All in all, parties should think critically as to whether this mechanism, either in whole or in part, is suitable for their particular needs.

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Transport

- **GAUTRAIN**
  Benchmarking The Proposed Nairobi Metropolitan Area Mass Transport System
- **GAUTRAIN**
  Intellectual Property Issues
- **CONNECTING IN THE SKIES**
  Towards Greater Air Transport Connectivity
- **THE RACE FOR THE AFRICAN SKIES**
  Drones in Kenya

IDENTIFY PROJECTS WITH A CLEAR PURPOSE, BASED ON SOCIOECONOMIC PRIORITIES

Infrastructure planning should be rooted in broader socioeconomic objectives set through a political process, and selected projects should address those objectives directly. Some countries are closer to achieving this ideal than others.

Singapore, for instance, has a national goal for dense urban living that has led to the specific aspiration of achieving a 70 percent usage rate for public transit. This aspiration has, in turn, guided the selection of transport projects by the country's Land Transport Authority.

When governments and other players think about infrastructure, they should not focus entirely on major new construction of infrastructure. Instead, they need to focus on the underlying need and find the most efficient solutions to address that need.

Sweden has institutionalized this way of thinking with a four-step principle for transport investment. The first of these steps is considering measures that may affect the need for travel and choice of mode. The second is implementing measures that result in more efficient use of existing infrastructure. The third step, if necessary, is investing in small-scale redevelopment. The fourth, which comes into play only if the first three do not address the infrastructure need, is consideration of new investment or large-scale redevelopment.

Australia's power demand-management regulatory and policy framework follows a similar logic, developing what it refers to as a "neutral" regulatory framework that allows demand-management options to compete with other, more traditional and capital-intensive solutions. These options include, for example, incentive schemes that enable the capture of savings that result from the deferral in investment in new assets.

Source: Report by McKinsey Global Institute, McKinsey Infrastructure Practice, January 2013. Infrastructure productivity: How to save $1 trillion a year

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GAUTRAIN
Benchmarking the Proposed Nairobi Metropolitan Area Mass Transport System

Kenya is set to reduce its carbon footprint notably through the development of a Mass Rapid Transport (MRT) System servicing the counties of Nairobi City, Kiambu, Kajiado, Machakos and Murang'a.

Kenya, can learn from the Republic of South Africa's experiences in developing Gautrain: the first MRT System in Africa, and South Africa's largest public private partnership (PPP) transport infrastructure project at the time of its development.

The 80 Km Gautrain faced various pitfalls and challenges, some of which are set out below:

1. Mobility-related exclusion

Intending to connect the major cities of Pretoria and Johannesburg, South Africa determined that there was a need for a comprehensive and efficient public transit system targeting the majority of the population. The RSA Government decided that this could be achieved by the development of Gautrain. However, runaway project costs, resulted in expensive ticket prices that were outside the means of the majority of Gauteng's residents.

The local majority believes that Gautrain benefits mostly the elite class within the Gauteng region at the expense of the larger poorer majority creating the perception of prioritisation of the wealthy and the corporations over the majority of the population in the allocation of public funds

2. **Escalation of project costs**

Gautrain's initial cost estimate of R7 Billion formed the basis of the feasibility studies and cost-benefit analyses for the project. However, the costs exponentially escalated to over R30 Billion. Gautrain Management Authority blamed the escalation on un-ancipated high levels of inflation and foreign exchange losses. This came at a time when other forms of public transport for the poor were crumbling.

It has been suggested that the significant escalation in costs illustrates at best, inaccurate and poor planning, and at worst a deliberate attempt to have the project approved by the provincial government that could at the time, due to budgetary concerns, afford the R7 Billion estimate. The escalation in costs forced the national government to absorb the added costs, since the financial model adopted for Gautrain project shifted inflation escalation risk to the South African Government. The ultimate winners, of the escalation the theory goes, were the private corporations at the public's expense.

3. **Conceptualisation problems**

Other viable effective and integrated mass transportation options such as an upgrade to the Metro Rail or the bus transport system were overlooked over Gautrain project. An upgrade of the two systems would have greatly alleviated the transportation crisis for a majority of the residents of the Gauteng region and would have served the interests of all. However, these options were barely considered and hence, Gauteng's mobility challenges remained unresolved in the end.

Additionally, there was a paradigm shift in rationale for Gautrain. Initially advertised as an MRT System to benefit the majority of Gauteng residents, it quickly turned into a necessary component to providing a world-class transit experience for World Cup 2010 fans and cementing the legacy for the nation. This was notwithstanding, that there were no legal obligations on South Africa to peg the construction and completion of Gautrain on World Cup 2010. As a consequence, the integrity of the feasibility studies and the implementation of the project was compromised.

4. **Post-completion recurrent costs**

One contributor to the escalating cost of Gautrain is the ongoing payment of a public subsidy provided by Gauteng province to operationalise Gautrain. Details of this post-completion patronage arrangement with Bombela Concession Company were not revealed to the public at the project planning stage. As at 2012, it was estimated that Gauteng residents foot more than R70 million a month to keep Gautrain on its tracks in the name of "patronage fees".

5. **Environmental concerns**

Gautrain boasts of reducing the carbon footprint of vehicular emissions by half, which is true within the Gauteng region. This is not the case in Mpumalanga region, home to the coal-operated power stations that provide the electricity Gautrain uses to run. Evidently, Gautrain overlooked its pollution burden in the form of emissions from the power stations that was exported to the Mpumalanga region, an area that is already facing severe strain from air pollution.

6. **Stakeholder and public participation**

South Africa's National Assembly Portfolio Committee on Transport was of the view that Gautrain Project did not adequately involve the public and other stakeholders in

the project, that it lacked transparency and accountability, particularly when it came to project costs, resulting in costly legal battles and demonstrations by local communities and stakeholders that caused delays to the implementation project.

CONCLUSION

When conceptualising and implementing Nairobi's MRT, a cautious and experiential approach is advisable. The pitfalls Gautrain project faced before, during, and after its implementation and launch, detail the risks that Kenya should assess and look out for in its bid to provide innovative public transport solutions for its citizens.

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GAUTRAIN
Intellectual Property Issues

Gautrain is a mass rapid railway system in Gauteng, South Africa[1], the first of its kind in Africa serving an average of 40,000 passengers per day as of February 2013.

The train is a variant of Bombardier's award-winning Electrostar train and is powered by ABB traction transformers and traction motors. The Electrostar trains were designed for commuter rail service and are capable of speeds of up to 160 km/h[2]. ABB modified the transformer design to meet specific requirements of Gautrain for high acceleration, low noise emissions and adaptability to the African climate[3].

EVOLUTION OF PATENTABLE INVENTIONS IN THE RAIL INDUSTRY

The predecessor of Gautrain and all other contemporary rapid railway systems is the steam engine developed by James Watt in 1769. Watt, while repairing an 'atmospheric engine', found a way to redesign the engine to improve efficiency[4]. He noticed

1 Gautrain, <https://en.wikipedia.org/wiki/Gautrain>
2 Lectrostar& Intercity Systems – Gauteng Province, South Africa , Bombadier, <http://www.bombardier.com/en/transportation/projects/project.electrostar-south-africa.html?f-region=all&show-by-page=50&page=1&f-country=au&f-segment=all&f-type=all&f-name=all>
3 Powering South Africa's first high-speed rail link, ABB communications <http://www.abb.com/cawp/seitp202/8dd91e08ab9eb912c125770700402b14.aspx >
4 Watt Steam Engine, 2017 <https://en.wikipedia.org/wiki/Watt_steam_engine>

that the existing engine designs wasted a lot of energy by repeatedly cooling and reheating the cylinder and so introduced a design improvement known as the separate condenser which prevented the wastage of energy and drastically improved the power, efficiency, and cost-effectiveness of steam engines. With this, Watt had invented the first economically viable steam engine.

For almost ten years after inventing and patenting his design, Watt could not get his invention to work. Matthew Boulton, an "angel" investor, persuaded Watt to extend his patent life from 14 to 30 years, and only after the patent extension was Boulton ready to fund the invention which soon initiated the steam age. Few know the central role that Watt's patent played in triggering the Industrial Revolution[5]. Without the patent, Boulton would almost certainly not have been prepared to continue funding what had, until then, been a failure.

WHY PATENT INVENTIONS

Patents are critical to the railway industry's progress as a whole, be it in the new design of the steam engine, the efficiency of the Electrostar or the intricate shape of the 'bullet train'. These designs and innovations are intellectual property rights that may be registered.

Patents, like other registered intellectual property rights are not worldwide and only exist in the countries in which the right is registered. Few patents are ever registered in more than a dozen industrialised countries. Only a minority of countries have a developed railway industry where patent protection would be economically worthwhile.

Protecting patentable inventions should therefore be deliberated on in developing new and innovative ways of evolving rail transport. This, in the recent past, has been especially crucial in China, which is the country with the largest mass rapid rail transit system in the world. For years, China has been accused of infringing on patent rights around the world. The patent system in China is robust but the administrative organs tasked with upholding these rights are weak.

Remarkably, from the early 1980s, the Chinese government has been keen on creating an economy in which Intellectual Property (IP) plays a fundamental role. Former Chinese Premier Wen Jiabao said, "Competition in the future is competition in IP"[6].

We are living in times when more creative inventions will be required to progress the rail industry. This opens doors for open innovators who may have the mind of patentees like George Westinghouse who invented and patented the railway airbrake. In coming up with his inventions, he looked for innovation inside and outside his own group of scientists. He bought Tesla's patent, employed him and then scoured the world for complementary technologies and patents so that he could develop a complete Alternative Current system of generators, transformers and motors. This was very expensive and despite his wealth, he ran out of money. But using his portfolio of patents as collateral, he raised finance in Pittsburgh, Boston and New York to complete the work.

Looking at the world's technological advancement today, including that within the rail industry, only about half the inventions with high profitable potential are commercialised and perhaps a tenth of them are successful. Development is expensive, and the success rate is low. Innovation is a high cost, high risk business. In light of this, protection of these innovative designs and information cannot be underrated.

Ian Harvey, a former CEO of BTG plc, which is the company responsible for the MRI machines, said "it

5 James Watt and the steam engine patent, http://ianharvey-ip.com/james-watt-and-the-steam-engine-patent/

6 Do Intellectual Property Rights Stimulate or Threaten Innovation?, Ian Harvey, 2014, <http://ianharvey-ip.com/intellectualproperty/do-intellectual-property-rights-stimulate-or-threaten-innovation

is futile to invest heavily in innovation if anyone is free to copy those few results which happen to be successful. Strong IP, in the form of patent protection is essential to funding the innovation process.[7]" IP indisputably stimulates innovation and it is crucial that innovators are supported by a strong system of IP rights.

Patent protection and exploitation has been at the heart of this rapid and ever growing industry and should always be the key consideration before embarking on projects such as Gautrain.

WHAT TO CONSIDER WHEN PROTECTING YOUR INVENTION

Intellectual property rights are essentially negative rights that merely give the holder the right to take action to prevent the unauthorised use of the invention by others.

In determining the intellectual property rights to be protected, priority must first be given to the commercial value of exploiting the invention rather than its ownership. Secondly, an inventor must establish countries in which it is economically sensible to obtain intellectual property protection because the cost of registering the rights in numerous countries can be quite high.

Also, as was stated in the Graham v. John Deere, 383 U.S. 1 (1966) case and KSR v. Teleflex, 550 U.S. 398 (2007) case, a potential patentee should confirm that the invention passes the test for protection. The aforementioned cases describe the tests for determining whether a patent claim is invalid as obvious.

In Graham, the Supreme Court of the U.S. held that in considering whether a patent claim is obvious, courts must consider the following factors:

- The scope and content of the prior art;
- The differences between the claimed invention and the prior art; and
- The level of ordinary skill in the prior art.

In KSR, the Supreme Court held that there is no rigid test for obviousness and that a patent claim is invalid as obvious if a person of ordinary skill in the art would have found it obvious to try the claimed solution when choosing from a finite number of identified, predictable solutions, with a reasonable expectation of success[8]

HOW TO PROTECT YOUR INVENTION

The journey to protecting an inventor's rights begins when you file an application for registration of a patent with the local intellectual property office. In Kenya, this is the Kenya Industrial Property Institute (KIPI), which is established under the Industrial Property Act, Number 3 of 2001, Laws of Kenya.

For a patent application to be successful, the invention must meet the requirements set by the Act. The invention should be a new and useful art, process, machine, manufacture or composition which is non-obvious and is industrially applicable. If successful, the patent holder will be granted patent protection over the invention for a period of 20 years.

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7 Do Patents Truly Promote Innovation?, Klein David, 2014 <http://www.ipwatchdog.com/2014/04/15/do-patents-truly-promote-innovation/id=48768/>
8 The Ten Most Important Patent Cases, Scott Stephen, 2014, <https://www.linkedin.com/pulse/20140320202611-35602357-the-ten-most-important-patent-cases>

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TOWARDS GREATER AIR TRANSPORT CONNECTIVITY

Effective 5th September, 2017 Kenya Airways Plc has been granted approval to operate direct flights to and from the United States of America through a foreign air carrier permit issued by the US Department of Transport. The permit marks the latest development in open skies arrangements involving Kenya's air transport services. Commencement of these direct flights is expected in 2018.

The Convention on International Civil Aviation of 1944 (Chicago Convention) is the foundation of international air transport services. At its inception, it provided a complete modernisation of the basic public international law of the air and birthed the International Civil Aviation Organisation (ICAO) [1]. The Convention is a source of law in Kenya pursuant to the Constitution. As a consequence of the Chicago Convention, the state parties further formulated certain agreements [2] which led to the Nine Freedoms of the Air [3]. These Freedoms are multilateral in nature, however their application (due to the general rule that every state has complete and exclusive sovereignty

1 Prof. Dr. Paul Dempsey, 'The Chicago Convention as a Source of International Air Law', 2015. One function of ICAO -planning and development of international air transport to ensure the safe and orderly growth of international civil aviation throughout the world

2 International Air Transport Agreement and International Air Services Agreement

3 Also known as air traffic rights

over the airspace above its territory) is accomplished bilaterally between states. It is well established customary international law that the possession of these Freedoms by a foreign airline depends either on a unilateral grant by a state, or on a bilateral agreement between the state of the airline and the other state.

This article will briefly look at the implementation of the main commercial Freedoms (3rd, 4th and 5th) towards facilitating or barring air transport connections between countries. One aspect will be to look at connections between Kenya and African countries while the other will look at Kenya and outside Africa.

THREE FREEDOMS: Brief Outline

3rd Freedom - Passengers and cargo may be flown from the airline's country to another signatory state.

4th Freedom - Passengers and cargo may be picked up in another signatory state and transported to the airline's own country.

5th Freedom - Airlines may transport passenger and cargo between one signatory state and a third state; however, the flight must originate or terminate in the airline's own country.

KENYA AND AFRICA: The Yamoussoukro Decision[4]

Kenya has signed bilateral air services agreements with countries including Ghana, Liberia, South Africa, amongst others. The application of the multilateral Yamoussoukro Decision (the Decision) is intended to make it easy for Africa-based airlines to operate freely within the continent without the need for bilateral air service agreements.

The liberalisation of the African air space and increase in connections in Africa is meant to be actualised by the full implementation of the Decision. The World Bank has noted that many African countries still restrict their air services markets to protect the share held by state-owned air carriers. These restrictions have been argued to negatively impact air fares, safety records and air traffic growth. The Decision advocates for the free exercise of the Three Freedoms for passenger and freight air services by eligible airlines.

The application of the Decision in Kenya has been arguably lackluster. Going by a short comparison, it is still cheaper to fly to Dubai than to an African country such as Uganda next door. If fully applied, fare savings of up to 35% are expected for passengers flying within Africa.[5]

The African Airlines Association, on its part has expressed its concerns about the lack of progress in the liberalisation of market access within Africa [6]. It has stated that procrastination in the implementation of the Decision is inhibiting the growth and competitiveness of African carriers. This view has been reiterated at its 48th Annual General Assembly (2016). In essence, air transport connections within Africa are arguably still being hampered by the delayed implementation of the Decision which intends to ensure free exercise of the Freedoms by airlines.

As a follow-up initiative to the Yamoussoukro Declaration, the African Union Summit[7] has launched the Single African Air Transport Market[8]. Its implementation is supported by 23 African countries, including Kenya, and is expected to increase the number of routes, reduce the cost of air travel and contribute to the expansion of intra-African trade and tourism.[9]

4 Economic Commission for Africa ,The Decision Relating to Liberalization of Access to Air Transport Markets in Africa, November 1999 adopted in July2000 by the Assembly of Heads of State and Government of the African Union

5 InterVISTAS Consulting, Transforming Intra African Air Connectivity: The Economic Benefits of Implementing the Yamoussoukro Decision, 2014

6 at its 38th Annual General Assembly(2006)

7 Held in Addis Ababa, Ethiopia on 28th -29th January 2018

8 An 'Agenda 2063' flagship project of the African Union

9 2018 New Year Message of the Chairperson of the African Union Commission, Moussa Faki Mahamat

KENYA AND OUTSIDE AFRICA: Open Skies[10]

Kenya, and Africa at large has entered into open skies arrangements; the most prominent being with the USA. The approach here is to expand and remove restrictions to the Freedoms through a

market-oriented approach. Ideally, airlines will decide which cities to serve, the frequency of flights, the equipment used, and the prices charged [11]. Such arrangements, in our view, would have the effect of ensuring complete implementation of the Freedoms with minimum restrictions thereby enhancing liberalisation of air transport.

Though executed in May 2008, the implementation of this arrangement between Kenya and the USA has arguably not taken place as fast as it should have to ensure the full benefits of the Freedoms between the countries. It is only in 2017 that direct flights between the USA and Kenya received the go ahead to proceed by the US Federal Aviation Authority. The benefits that would have accrued such as greater connectivity and lower prices are yet to be achieved despite execution of this far reaching arrangement.

To that extent, it can be argued that the open skies arrangement, though not hampering connections, has also not aided in increasing air connections due to other factors such as regulatory concerns that have delayed the ability of the countries to conduct direct flights.

CONCLUSION

It is important to note that although air transport is directly facilitated or hampered by the aforementioned agreements between states, the agreements are also affected by parallel concerns such as regulations, political will etc. However, the overarching point is that implementation of the agreements (bilateral or multilateral) will go a long way towards ensuring greater connectivity as initially intended by the Chicago Convention.

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10 refers to a bilateral or multilateral Air Transport Agreement, which liberalizes the rules for international aviation markets and minimizes (or eliminates) Government intervention: the provisions apply to passenger, cargo and combination air transportation on scheduled and charter services

11 https://2001-2009.state.gov/r/pa/prs/ps/2008/may/105463.htm (US State department media note)

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COMMERCIAL DRONES IN KENYA

The race for the African Skies

On 13th October 2017 the government published the Civil Aviation (Remotely Piloted Systems) Regulations, 2017 (the "Regulations") which provide the legal framework for the use of Remotely Piloted Systems or drones in Kenya. Entrepreneurs and investors therefore have the opportunity to tap into a market with a global market value estimated at USD 127[1] Billion in sectors such as infrastructure, agriculture, transport, mining, security, media and entertainment amongst others. Already, African countries such as South Africa, Morocco, Cameroon, Rwanda and Malawi are exploring drone enterprises in these sectors.

Under the Regulations, drones are categorised either as commercial, private or sports and recreational drones, and can fall into one of three classes - Class 1 (weighs between 0 – 5 kgs), Class 2 (weighs between 5 – 25 kgs) and Class 3 (weighs 25kgs and above). Provided a drone meets certain specifications (weighs 2kgs or less, not powered by a fuel system, incapable of carrying a payload, not fitted with a camera etc.) it shall be considered a toy and shall be excluded from the scope of the Regulations.

1 See, Clarity from above: PriceWaterhouseCoopers global report on the commercial applications of drone technology, https://www.pwc.pl/en/publikacje/2016/clarity-from-above.html.

DRONE OWNERSHIP IN KENYA

Irrespective of the category or classification, in order to be eligible to own a drone, the ownership requirements must be met - a person has to be:

- 18 years old;
- a Kenyan citizen;
- a resident of Kenya;
- a Kenyan company; or
- the Government of Kenya.

There are no restrictions on the size of shareholding by a foreigner in a Kenyan company; a foreigner can own 100% of the shares of a Kenyan company. Nonetheless, the approval of the Ministry of Defence will be required before Kenya Civil Aviation Authority (KCAA) can register a drone. A temporary permit can be obtained from KCAA to operate an unregistered drone for a period of 30 days but it will only be renewable once.

What is a commercial drone operation? Any operation for "hire, profit, gain, remuneration or earnings" including utilising a drone for research is a commercial drone operation. In order to pursue commercial drone operations, an operator will be required to meet the ownership requirements as stated above, and demonstrate that they have the necessary personnel, systems, programmes and facilities to operate, supervise and maintain their drones in accordance to the Civil Aviation Act and the Regulations. Furthermore, third party liability cover is to be procured before KCAA can grant its authorisation. As of this date, KCAA is yet to provide any guidance on the minimum insurance cover a drone operator should maintain.

The Regulations require that both commercial and private piloting of drones be certified by KCAA. A pilot will, amongst other things, be required to complete a course of training approved by KCAA. The certificate issued thereafter will reflect the type of drone(s) a pilot can operate. Presently, KCAA is yet to approve any training course.

PROHIBITIONS AND LIMITATIONS

Due to drones being relatively cheap, easy to use and versatile in their applications, certain prohibitions and limitations have been placed on operators. Under the Regulations, a drone will not:

- operate over certain restricted areas, installations or government buildings amongst others, without the approval of KCAA;
- operate above 400 feet above ground level or within 50 meters of a person, vehicle or structure, which is not under the control of the person in charge of the drone;
- carry dangerous goods e.g. chemicals, explosives, volatile liquids etc.;
- operate in unfavourable weather conditions or at night, unless cleared by KCAA;
- operate with a fitted camera (and similar devices) beyond the approved KCAA parameters; or
- operate within the vicinity of an aerodrome (between 7 to 10 kilometres of an aerodrome), except, with the consent of the owner or operator of the aerodrome, the air navigation service provider and KCAA.

RISKS AND CONCERNS OF OPERATING DRONES

Safety Concerns for Third Parties

Despite the prohibitions (including consumption of alcohol and psychoactive substances by a drone pilot) and limitations placed by the Regulations, safety concerns for third parties and property remains. Jurisdictions such as US, Canada, Germany and South Africa have already reported incidents involving drones such as an accident and numerous near misses with aircraft, damage to property and injury to persons. Regardless of the cause of damage or injury, whether mechanical or because of negligence, the person with operational control of the drone will be held liable under the Regulations.

Consequently, insurance cover is paramount to drone operations. The minimum amount of liability cover for a drone is yet to be set by KCAA, however, other jurisdictions can offer guidance on the levels that may be set in the near future. Presently, Canada requires a minimum third party liability cover of USD 100,000 per drone while drone insurance providers advise that, for commercial drone operations, a third party liability cover of USD 500,000 – USD 1 Million is obtained.

Privacy

High-resolution cameras are now capable of being mounted on drones and used to easily trespass on property. The unwanted intrusions and data collected in such instances have already resulted in legal proceedings in other jurisdictions. With no privacy specific sanctions under the Regulations, it is inevitable that the courts will have to address such incidents. The Regulations, however, do explicitly provide monetary penalties and prison sentences for several offences such as, for the illegal importation, assembly, testing or operation of drones, unlawful interference of drone operations, non-compliance with the Regulations, amongst others. If convicted, a person can be fined (up-to KShs. 5 Million) , imprisoned for a term not exceeding 6 months or both.

Drone owners who have already imported their drone(s) should note that they now have six (6) months from the date the Regulations were published to apply for registration. Non-compliance with the Regulations means an owner shall be liable upon conviction, to a fine not exceeding 1 million shillings or imprisonment for up-to 6 months or both. Therefore, drone operators whether commercial or private need to seek legal advice to comply with the Regulations and to minimise their risk exposure.

Notwithstanding the above issues, Kenyan government entities, entrepreneurs and investors are already actively engaged in seizing the benefits of drone technology. Presently, the Nairobi County through its service provider is seeking to operationalize drones to monitor and collect data on motor vehicle parking, to countercheck the revenue collected in certain areas. The National Transport and Safety Authority is also exploring ways to use drones to manage traffic and to augment its role in road safety. And earlier in the year, a local firm was awarded by the International Air Transport Association (IATA), for its concept of managing drone traffic in Africa.

WHY IS KENYA SET TO LEAD?

After extensive consultation with stakeholders, the Regulations are one of several that KCAA has proposed to overhaul the existing aviation legislative framework to make Kenya the premier regional aviation hub. The purpose is to surmount the traditional barriers faced in investing in African aviation such as, poor safety and security records and unfavourable regulations and policies.

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Like the internet and GPS before them, drones are evolving beyond their military origin to become powerful business tools. They've already made the leap to the consumer market, and now they're being put to work in commercial and civil government applications from firefighting to farming. That's creating a market opportunity that's too large to ignore.

Source: Drones Reporting to Work, Goldman Sachs, 2016

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DISRUPTIVE INNOVATION

Rethinking Competition Law in Kenya

Part I: The Market

That change is the only constant is undeniable. Innovation ensures the wheels of various market sectors stay in motion. Disruptive innovation (**DI**) involves new processes, products, services or new technologies that radically transform the operations of existing businesses and industries. DI profoundly affects the functioning of existing industries by forcing traditional market players (**the "Incumbents"**) to alter their business operations lest they lose their respective market shares. The entities that introduce the DI (**the "Disruptors**") can be either existing market players or new market entrants.

The unique role played by DI in economic growth and liberalisation of markets is undisputed. To consumers, products and services based on DI are cheaper, simpler and more convenient to use. Some of the most notable disruptors in the Kenyan market include M-Pesa disrupting the banking industry, Uber disrupting the taxi industry, and OLX disrupting the retail industry.

One of the major concerns players have – be they Incumbents, Disruptors or potential market entrants – is how will the regulatory framework and the Competition Authority of Kenya (**the "Authority"**) react to the existence of DI.

A COMPETITION NIGHTMARE?

At the outset, the conduct of the Incumbents and the Disruptors vis-à-vis the DI may affect competition. The Incumbents could react in several ways.

First, they may compete with the Disruptors at an innovative level resulting in great benefits to the relevant market. The Authority need not intervene in this scenario.

Second, the Incumbents may decide to co-operate with the Disruptor(s), and the Authority may need to assess any resulting competition implications.

Third, the Incumbents may take a defensive approach in a bid to stifle the Disruptor including (a) insisting on stiff enforcement of existing regulations against the Disruptor and (b) engaging in anti-competitive practices in the market. The anti-competitive practices may include forceful acquisition of the DI by the Incumbents, predatory pricing, restrictive agreements, abuse of dominance, and refusal of access to market.

In entrenching its foothold in the new market, a Disruptor, if unchecked, could similarly engage in exclusive dealings, predatory pricing and the bundling of products and services through horizontal or vertical integration.

More often than not, Disruptors will claim the existing regulatory framework does not apply to them; Incumbents citing 'unfair' exclusion from the regulations, often raise complaints with the Authority.

Part II: The Law

Disruptive innovation has a role to play in any given market in Kenya. Competition is engendered in the relevant market for which the Kenyan economy and the consumers stand to benefit. However, in the face of the anti-competitive risks that DI raises, regulation is necessary.

The regulatory approach to disruptive innovations should offer enough room for market dynamism to run its course.

CHALLENGES

However, several competition and regulatory enforcement challenges hamper the process. First, determining the relevant product or geographical market of the DI for purposes of regulation may prove a problematic academic exercise. Secondly, ascertaining whether innovation will occur in a given market segment to pre-empt regulation is not practicable. In addition, the present regulatory framework places emphasis on the interplay between price and marginal costs, and this approach does not augur well with DI which offers very low or zero prices. Lastly, the present regulatory framework is not flexible enough to accommodate new frontiers of regulation.

TOWARDS REGULATION

Evidently, a paradigm shift is required in the regulatory approach to avoid knee-jerk regulations. In coming up with regulations, the Authority should envisage a framework flexible enough to allow for new avenues of regulations but at the same time factoring in the prevailing public policy considerations.

What then are the options available to the Authority in dealing with DI?

As a starting point, the Authority can adopt new regulations to accommodate the particular DI

or, based on the existing framework, put in place appropriate standards aimed at mitigating the disruption in question.

In our view, whatever regulatory approach is taken, be it prescriptive, permissive or a calibrated combination of both, needs to strike a clear balance between protecting the Incumbents and encouraging innovation through the DI.

A sandbox is a supervised space within which untested innovative ideas incubate and blossom before regulation kicks in.

The Authority can create regulatory sandboxes suitable for the unregulated DI that do not easily fit into the existing regulatory framework.

Appropriate regulatory framework follows thereafter having carefully assessed the ramifications of the DI from a practical perspective. Singapore has successfully utilised sandboxes in dealing with DI.

Given the novel nature of DI, the Authority could also allow for a collaborative approach to the formulation of regulation. The Disruptors and Incumbent best understand the market and space within which they operate. With certain DI cutting across various industry regulators, it would be for all regulators to develop a suitable regulatory framework that works in tandem. Hopefully, this will promote innovation and the Disruptors will have a reasonable fighting chance to succeed, the incumbents will have a say in the matter and the various regulators stay at par with the prevailing circumstances.

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CONSUMER PROTECTION IN THE DIGITAL SPACE

A Diagnostic Analysis Of Online Retail Platforms

The tide of digitalisation has swept into Kenya's retail industry with online retailers such as Jumia, Kilimall entering the market. Further, online retail markets including eBay, Amazon, and OLX are accessible to consumers in Kenya. Tied to this is the automation of customer interaction, financial transactions and the handling of complaints etc. This inevitably complicates the application of consumer protection laws mainly because products and services in the digital space are not static and their operations depend on a technical environment.

CONSUMER PROTECTION ISSUES

Digitalised retailing comes with the exposure to vices such as digital profiling[1], social engineering scams[2], phishing schemes[3], identity theft and fraud, lack of or untimely full disclosure, inaccessibility of terms and conditions[4], unclear disclosure of data handling practices, data theft, hacking attacks etc. Additionally, there are data protection and usage concerns that are associated with the online platforms. This often results

1 Digital profiling refers to the process of gathering and analysing information about an individual that exists online for purposes such as marketing, criminal intelligence services among others.

2 Social engineering involves deliberately manipulating people so they give up confidential information.

3 Phishing is the attempt to obtain sensitive information such as usernames, passwords, and credit card details (and money), often for malicious reasons, by disguising as a trustworthy entity in an electronic communication.

4 This is especially since may vendors offer products through a web link with no direct access to the source of manufacturers

in the erosion of consumer trust in online retail platforms.

Further, where a complaint arises out of an online retail transaction, it is difficult for the consumer to access the available remedies. The available return of goods policy and customer complaints policy may be complicated and unhelpful to the consumer in Kenya. In addition, for retailers registered outside Kenya, handling the dispute through a court of law may pose challenges regarding the applicable jurisdiction and choice of law. Enforcing a resulting court order may also be time consuming and expensive to the consumer.

The online retail sector is largely evolving in an unregulated space.

There are also concerns on unfair treatment of consumers. First, there is the risk of technical or deliberate exclusion of some potential consumers such as the elderly, handicapped and first time users of the technology. Second, online retailers may collect data without the (informed) consent of consumers. The collected data is then shared with third parties who use it to digitally profile the consumers through targeted online marketing of other products. Third, there are increasing cases of deceptive advertising and breach of client confidentiality when operating through the online retailers or on online market platforms. In any case, the current fair treatment legislative regime in Kenya does not provide for instances of online transactions.

PROTECTION MECHANISMS

The legislative framework on consumer protection in Kenya is diverse. Article 46 of the Constitution of Kenya enshrines the rights of consumers. Further, the Consumer Protection Act [5] addresses the enforcement and protection of the consumer as well as preventing unfair trade practices in consumer transactions. Further to this, consumer protection mechanisms are contained in various regimes for designated industries that include the Competition Act [6], the Kenya Information Communication Act[7], the Foods, Drugs and Chemical Substances Act[8], the Pharmacy and Poisons Act [9], self-regulatory frameworks among others.

A cursory look at all the foregoing will reveal the following. First, consumer protection regime in Kenya does not specifically provide for the digital space. Second, there is lack of coherence in consumer protection as well as market oversight. As seen above, various legislation and regulations are charged with specific obligations in relation to consumer protection. Having several regulators address a single product or service to a consumer may result in divergent decision-making.

The online retail sector is largely evolving in an unregulated space.

Data protection for consumers is not well provided for in Kenya. Although the right to privacy is enshrined under the Constitution[10], Kenya is yet to enact enabling legislation to protect personal information. A Bill[11] has been pending for several years in parliament. Experts have criticised it for: lacking provisions on

5 Consumer Protection Act No. 46 of 2012.
6 Competition Act No. 12 of 2010.
7 Kenya Information and Communication Act, Chapter 411A of Laws of Kenya.
8 Foods, Drugs and Chemical Substances Act, Chapter 254 of Laws of Kenya.
9 Pharmacy and Poisons Act, Chapter 244 of Laws of Kenya.
10 The Constitution of Kenya 2010, Article 31.
11 The Data Protection Bill, 2013

extraterritorial application; not catering for targeted marketing/digital profiling; and not controlling the transfer of data to third parties.

What is the way forward?

An adaptive legislative and regulatory regime is required to address challenges posed by online transactions in the retail sector. Kenya needs to adopt specific legislation addressing key areas in the digital space concerning consumer protection. Alternatively, Kenya could extend or amend the prevailing consumer protection law to address consumer concerns in the digital space.

There is also need to have in place elaborate law on data protection that is alive to the concerns raised by digital innovation to commercial transactions. This law, however, should appreciate that retailers and various other parties inevitably require data for legitimate purposes.

Finally, the legislative and regulatory regime should be revised to appreciate the extraterritorial implications of online commercial transactions. Regulators should also vet the complaint channels of both product and service providers for efficacy to the consumer as well as guarding against potential abuse.

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IP ISSUES SURROUNDING BUSINESS MODELS

OVERVIEW

A business model is the strategy that a company uses to generate revenue from its product or service its offering e.g. an international franchise or a local distributorship or a regional manufacturer etc. Many a times the business model will involve intellectual property e.g. the Coca Cola brand which is a well known world wide.

Kenya has been streamlining its intellectual property (IP) laws to make it easier for doing business by creating a more robust legal system. This has however not prevented the constant stream of cases involving IP rights. The high incidence of litigation surrounding IP reflects the difficulties parties face in trying to establish legal certainty in this area. Some of the IP issues surrounding business models include:

1. **Commercialization of intellectual property**

   Commercialization is the process of bringing IP to the market in order to be exploited. IP value can be measured and traded therefore it needs to be considered when conducting due diligence of a business. With that in mind, registration of IP is a vital process for any business model since it forms part of its assets.

When transferring a business, most parties overlook the business IP which has led to undervaluation. IP commercialization can take different forms with the most common being assignment, licencing and franchising to other companies or natural persons.

2. Trademark vs company parallel registration

In Kenya, the registries in charge of company registration and IP registration operate as distinct registries. This is unlike Rwanda where one state office is in charge of both registrations.

It is therefore possible for a third party to obtain registration of a company under a certain name even where the name was already registered as a trade mark in favour of a different party.

There is no law stipulating that during examination of trade mark applications, the examiner must cross-check the register of company names. However, the registrar of companies has the discretion not to register a company if the name applied for reservation is a registered trademark unless a document signed by the owner of the trade mark and indicating consent to its use is provided .

The courts of Kenya have on various occasions considered the question of trade mark versus company name registration. In Agility Logistics Limited & 2 Others vs. Agility Logistics Kenya Limited [2012] eKLR, the court found that protection provided to the name “Agility” by the trademark registered in favour of the Plaintiffs overrides the protection of the name “Agility Logistics” secured through registration of the name as a company.

With the Companies’ Act Regulations now in force, it will be interesting to observe how the courts will determine claims by registered trade mark owners against infringing company names.

The high incidence of litigation surrounding IP reflects the difficulties parties face in trying to establish legal certainty in this area.

3. IP rights infringement

IP infringement is where a person deals with IP in a manner that is contrary to the interest of the owner of the IP without the owner’s authority, consent, license or permission. The person that is alleging their IP is infringed must prove directly or indirectly that the alleged infringement is taken from the work or subject matter in which they claim ownership. It is important to identify who owns the rights and then to secure them. Proving infringement is a hard task as seen in the case of Webtribe Limited T/A Jambopay v Jambo Express Limited [2014] eKLR where both parties are claiming ownership to the IP rights and have been arguing this matter for 3 years now. In consultancy work, IP rights will belong to the consultant unless there is a contractual agreement to the contrary.

4. Proving originality

The question of originality has been a difficult case to prove. If viewed in terms of their integral parts, many works have nothing original. It is possible for two persons to produce identical works, and each will be considered to be the author of his work for copyright purposes. For example two people may photograph the Maasai Mara wilderbeast migration at the same time and spot using similar cameras. The two photographs may be

indistinguishable from each other but copyright will, nonetheless, subsist in both the photographs separately.

With respect to work reduced to material form, it would be prudent for purposes of proof in court of ownership of the copyright and the day it commenced it would be wise to affix the authors name and the day that the work commenced as a copyright work.

5. Protection of IP rights

If you have ever developed a new product you`ve mostly grappled with the question of whether you should protect it legally in some way. Parties seeking court protection need to take action promptly to restrain any misuse of their IP rights. They can do so by having key provisions when drafting their employment contracts or consultancy agreements dealing with existing and future IP rights and restrictive covenants.

It is also essential that the employer is not in material breach of the employment contract. Where this is the case, the former employee can rescind the contract and all its clauses, including the restrictive covenants.

6. Implied protection of employees

In employment, confidential information once learned, remains in the employee's head and becomes part of the employee's own skill and knowledge applied in the course of employment. The courts will stop an existing employee from mis-using or disclosing this information but will not impose any implied restrictions on the employee's ability to use or disclose it, even to a subsequent competing employer, after the employment ends.

7. Global considerations

If a business model is entering a global market, one should consider where they would generate the best returns and whether they have the resources to successfully commercialize it. Before entering a foreign market, it`s important to ensure your IP is protected in the relevant country. It`s also important to understand IP protection in the country you would like to establish your market position to ensure you do not infringe on existing IP in that country.

CONCLUSION

The IP issues surrounding business models cannot be avoided and must be confronted head on and as expeditiously as possible. It will be important to consider the aforementioned IP issues before engaging in business. Without IP protection, businesses would not reap the full benefits of their inventions and artists would not be fully compensated for their creations.

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MMAN ADVOCATES

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SHARE SCHEMES
How Employee Share Schemes Work

Share schemes, also known as employee share ownership plans, enable employees to own shares in the company. The shares being offered can also be in the parent company if it is a subsidiary. Standard Chartered Bank Kenya and Barclays Bank run share schemes that allow its executives to buy shares in the parent companies; Standard Chartered PLC and Barclays PLC.

What is the purpose of share schemes?

These schemes provide a form of compensation for employees and enable them to play a part in the ownership and the decision making of the company. Offering shares to employees is a form of incentive and the idea of being rewarded is likely to foster competitiveness within the company.

How can employees purchase shares in a Share Scheme?

Share purchase plans offer employees the chance to purchase shares, sometimes through a loan from the employer. The shares can be paid for through deductions from the employer's salary, or by using the dividends received on the shares. Some share purchase plans also allow employees to pay for the shares in full, up front or at a later date. The shares can also be issued, frequently to high level employees, as a form of reward or compensation.

SETTING UP SHARE SCHEMES

Share schemes are set up as trusts with trustees who hold the shares in trust for the beneficiaries who are in this case the employees. The employer contributes into the fund the shares or sometimes the money to buy the shares from the company. The fund can also take a loan from a financial institution to buy the shares with the company paying back the same.

Vesting of Shares in Employees

The vesting of the shares in an employee is done in three stages;

1. The employee is granted the right to acquire the share by the employer.
2. The rights then vest in the employer and they can exercise their right and purchase the shares
3. The member acquires the shares vested in them at the share price they were offered when the right was initially granted to them.

It should be noted that the vesting of the shares is dependent on the status of employment of the employee.

Establishing An ESOP Plan: Listed Companies

An ESOP by a company that is not listed does not require approval from any regulatory agency. However, prior to an ESOP being established by a listed company, approval must be obtained from the CMA. The setting up of ESOPs is governed by the Capital Markets (Collective Investment Schemes) Regulations, 2001.

ESOP plans should be registered with the Capital Markets Authority (Authority) . In Kenya, the plans that are registered with the Authority make up about 10%. Examples of listed companies with registered ESOPs include Equity Bank, Safaricom, Kenya Commercial Bank, East African Breweries Limited, I&M Bank, Housing Finance, KenolKobil, Access Kenya, BRITAM, Kenya Airways and Scan Group.

On applying for the registration, the incorporation documents such as the proposed trust deed and rules of the scheme and the board of directors' resolution approving the establishment of the trust must be submitted to the Authority.

An ESOP plan should also be registered with the commissioner of the Kenya Revenue Authority.

Share schemes are managed by trustees appointed under the Trust Deed. An ESOP should have at least three trustees but a corporate trustee can act as a sole trustee.

THE BENEFITS

Employee share schemes attract and motivate employees as their interests and those of the shareholders are now aligned. They therefore stand to benefit financially where the company makes profits. Awarding employees schemes is also a form of incentive that will in turn foster competitiveness amongst the employers.

The shares in these schemes are also offered to the employees at a price lower than the actual subscription fee.

THE DISADVANTAGES

The idea of receiving benefits in the form of shares may be an attractive option to the youth but not to the elderly. The latter would be more preferable to receiving a more certain form of compensation such as a pension plan or lump sums.

Another issue arises with the vesting of the rights to the shares in the employee. Sometimes, there is no limit to the period within which the right must vest and can at times take very long. The company should therefore set up conditions that must be met before the shares actually vest in the member. For example a company can require an employee to either meet certain performance targets or remain working for the company for a number of years. During the

vesting period or if the employee is paying for the shares over a period of time, the employees are unable to sell or transfer the stock to another party. Since the law does not expressly provide for a period within which the benefits must vest, the trust deed should come in and attempt to fill this gap left by the law. A clause on the conditions of the vesting of the benefits must be provided for, must be clear and must be notified to the members. In the case of Patrick Wabwile Pamba & 7 others versus Equity Bank Limited & 5 others, Equity Bank was being accused by its ex-employees of purposely not notifying them of the vesting period within which the full value of the shares will vest in the employees set out in a Deed of Variation.

Where the employee leaves the company before the vesting period is over, they lose the right to cash in on the shares. The company can also insist that the shares be given back to the company or sold at the current market price even if it may be less than what they paid for the shares. The trust deed should also expressly provide for leaving of service before and after the vesting of their benefits. This will ensure fairness to employees and not result in instances where an employee feels short changed when they leave.

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ESOP plans should be registered with both the Capital Markets Authority (Authority) and the commissioner of the Kenya Revenue Authority

A clause on the conditions of the vesting of the benefits must be provided for, must be clear and must be notified to the other party. In the case of Patrick Wabwile Pamba & 7 others versus Equity Bank Limited & 5 others, Equity Bank was being accused by its ex-employees of purposely not notifying them of the vesting period within which the full value of the shares will vest in the employees set out in the Deed of Variation.

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EMPLOYMENT RELATED ISSUES SURROUNDING MERGERS AND ACQUISITIONS

What to Look Out For

THE MARKET

STATE OF M&A IN KENYA

Mergers and acquisitions are playing a greater role in steering Kenya's economic growth now more than ever before.

Examples of recent merger and acquisition deals include the International Finance Corporation (IFC) acquisition of a stake in Britam for Ksh3.6 Billion in early 2017 and most recently the acquisition of Coca Cola Beverages Africa by Coca Cola Company for a yet to be disclosed amount. Data compiled by I&M Burbidge Capital on market deals done in East Africa shows that Kenya accounted for Ksh98.4 billion out of the Ksh218 billion disclosed value of deals in 2016.

Analysts see this as a great sign of investor confidence in the Kenyan economy and expect to see such deals growing over the coming years. Whenever such transactions take place, employment issues are almost always certain to arise.

EMPLOYMENT DUE DILIGENCE IN M&A

The mergers and acquisitions process calls for a disciplined approach by the decision makers at the company. To identify any risks, a rigorous due diligence process should ensure that the companies are fully aware of any potential and existing risks or liabilities and also to ensure that the transaction in question complies with all the applicable laws. The due diligence exercise should inter alia comprehensively review the company's policies, procedures, pending employment claims, share incentive schemes, pension schemes, statutory deductions, collective bargaining agreements, benefit plans, housing and any outstanding loans.

THE LAW

KEY CONSIDERATIONS OF EMPLOYMENT DUE DILIGENCE

M&A transactions where original legal entity is retained

When conducting the due diligence exercise, the first key consideration should be establishing whether the transaction will result in the formation of a new legal entity. When a merger or acquisition occurs, the ownership of companies, other business organisations or their operating units are usually transferred or combined and this does not always result in the formation of a new legal entity.

This is because a company is a body corporate that exists separately from its owners, members and directors. The company has its own rights and obligations and the change in shareholders does not affect its separate legal status. All the rights and obligations held under previously signed contracts, including those with employees, remain as they are and still apply even when there is a change in the company's shareholding structure.

CHANGE IN CONTROL CLAUSE IN EMPLOYMENT CONTRACTS

However, if the employment contracts in such a transaction contain 'change in control' provisions, the employees may benefit from additional rights. Such provisions provide for additional rights such as the right to notification, consent, payment or termination in connection with a change in the ownership or management of the other party to the agreement.

These provisions vary from contract to contract and may expressly define what this change in control amounts to. The change could be in the shareholding structure or a change in the decision making/ management of the company. Therefore, parties involved in a potential merger or acquisition should always look out for these provisions.

M&A transaction with change in the legal entity

Where the transaction in question results in the formation of a new legal entity it is important to establish whether or not employees are going to be transferred. This is the second key consideration because many mergers and acquisitions usually result in job losses as a result of restructuring, duplication of roles or a desire to down-size.

A legal entity is not required to retain the employees but may still offer them a chance to be employed by the new entity. If the employees choose to take up such an offer, they must be employed on terms that are on a whole not less favourable than their terms of employment under the previous entity.

STATUTORY PROVISIONS ON M & A

1. **Competition Act**

   If the employees of the organisation that has been merged with or acquired decline the offer then their employment will be terminated on account of redundancy and this termination, occurring as a result of a merger or acquisition, is regulated by the Competition Act, Act No. 12 of 2010 (CA). The CA established the Competition Authority which is mandated with promoting and protecting effective competition in the Kenyan market.

   Section 46 (2) (e) of Part IV of the CA states that one of the criteria that the Competition Authority may rely on when making a determination in relation to a proposed merger is the extent to which the proposed merger is likely to affect employment.

   Further to this provision, the Competition Authority has published the Consolidated Guidelines on the Substantive Assessment of Mergers under the CA. It contains general information intended for the convenient use and guide on how the provisions such as the one provided above are to be applied.

   Paragraphs 221 and 222 of the Guidelines state that when determining whether to approve a merger, the Competition Authority will examine the job losses that may result from the merger and will require the entities in question to clearly demonstrate how the proposed number of job loss figures were calculated and whether or how, in spite of this, the merger will still be for the greater public good.

   These Guidelines were applied recently in the acquisition of Coca Cola Beverages Africa Proprietary Ltd by Coca Cola Company. The Competition Authority approved the merger on condition that the merged entity retains employees of one of the target groups bottling plants for a minimum period of two years after the completion of the transaction.

   If the termination is considered to be in accordance with these guidelines, the termination must still be in accordance with the provisions of the Employment Act, 2007 (EA) which is the primary statute on employment related matters.

2. **Employment Act**

   The Employment Act sets out the procedure and requirements for termination because of redundancy under Section 40 (1). The first is the requirement for notice which varies depending on whether the employee in question is a member of a trade union or not. If the employee is a member of a trade union the employer must give notice to the union not less than a month prior to the date of the intended date of termination.

   - Where the affected employee is not a member of a trade union, the employer is required to notify both the employee and the labour officer in charge of the area where the affected employee is employed, personally in writing.

- The second requirement is for the employer to ensure that there have been consultations between themselves and the affected employees as early as possible to discuss the reasons for termination and seek to measure to mitigate or avert the termination.
- The third requirement is for the reasons for the termination to be valid and fair.
- The fourth requirement is for the employer to ensure that where there is a collective bargaining agreement in existence; they have not placed any employee at a disadvantage for being or not being a member of the trade union.

The employer must ensure that in selecting employees to be declared redundant, they have given due regard to seniority in time and skill, ability and reliability of each employee to be affected by the redundancy. The employer is also obligated to pay severance pay to an employee who is declared redundant at the rate of not less than fifteen days' pay for each completed year of service.

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The importance of this notice and consultations was emphasised in the case of Kenya Airways v Aviation Allied Workers Union Kenya & 3 others where the Court of Appeal stated, "***The purpose of section 40 (1) of the Employment Act with regard to notice is to give the parties an opportunity to consider measures to be taken to avert or to minimize the effect of the measures concerned such as finding alternative employment.***"

For consultation to be acknowledged as valid, the consultations need to be genuine rather than pre-textual, that is, going through the motions merely to comply with the law. An effort to come to a mutually agreeable position must be evident.

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ELECTRONIC PAYMENTS
Market Dominance of Mobile Network Operators

OVERVIEW

An electronic payment system (E-payment system) is a way of making transactions or paying for goods and services through an electronic medium, without the use of cheques or cash. These E-payment systems includes debit and credit cards, electronic fund transfer, mobile payments platforms and internet banking which are already in use in the Kenya market.

Throughout the years the ICT sector in Kenya has transformed to allow for E-payment systems to be used widely in the Kenyan Market. Examples include Pesa Pal, Equitel, Mpesa, Eazzy Pay, Airtel Money, mobile applications developed by respective financial institutions among others.

It is noteworthy that whilst all the forms of E-payments are used in Kenya the mobile payment system platforms seem to have large share of the market as compared to other E-payment systems. The mobile payments have changed the way financial services are delivered by bringing the unbanked and underbanked people into the financial real.

MOBILE NETWORK OPERATORS (MNO)

MNOs have taken large systems and infrastructural investments to enhance the services being provided to its customers with regards to E-payment systems. A MNO is the telecommunications operator that provides and extends the wireless network messaging functionality to provide payment services that enable customers to remit funds to each other that can be settled through its own established agent network. The MNOs provide mobile payment systems as opposed to bank led payment systems. It is argued that MNOs do not require the level of regulatory oversight needed for deposits held in banks. This is because the MNOs only execute client payment instructions and do not perform credit evaluation and risk management function unlike banks.

Since the inception of E-payment systems by MNOs, there has been increased competition between banks and MNOs. In some instance MNOs, banks and other third parties have partnered to offer mobile financial services that combine mobile banking services and mobile money transfer services.

FACTORS THAT HAVE LED TO THE MARKET DOMINANCE OF MNOS

1. **Early Entry**

   Early entry into the market has contributed to a larger extent to MNOs gaining a dominance in the E-payment systems platforms in Kenya. The concept of E-payments in Kenya was limited to credit and debit cards until the inception of E-payment mobile payment platform. Safaricom Limited being the largest MNO in Kenya was the pioneer of mobile e-payment platform in Kenya known as M-pesa. M-pesa has grown in leaps and bounds to include M-Kopa and M-Shwari that offer borrowing and saving facilities to the Safaricom consumer. The M-pesa platform is also able to provide person to business services, business to business services, credit and savings services, buying and transferring of airtime among other services. It can be said that Safaricom enjoys a bigger market share than other MNOs.

2. **Infrastructural Investment**

   Investment in the infrastructure that facilitates the electronic platform required to facilitate E-payments. Safaricom begun first by providing mobile service to its customers. It embarked on acquiring national coverage and on the basis of this M-pesa was able to kick off country wide and have nation-wide usage faster than having piece meal implementation of the system. This allowed for customer loyalty to take effect faster than having customers turned away or turn to a competitor due to lack of adequate infrastructure.

3. **Third Party Partners**

   The above factors give the MNO a greater advantage in terms of institutions that want to partner with it. It can be seen through Safaricom that they have managed to partner with numerous key stakeholders in the E-payment system chain such as banks, supermarkets, the Government and large and small scale businesses.

4. **Corporate social Responsibility**

   Lastly good will to your general customer base helps propel the E-payment systems provider to increase market share. Community services activities to the general public irrespective of whether they are customers demonstrates that the service provider is after more than just gaining a larger market share but also is geared towards to betterment of the community at large.

CONCLUSION

In conclusion the demand for efficient cost effective E-payment systems has already been created, therefore suppliers need to work within the Kenyan market and factors that can lead to greater market share acquisition to ensure that electronic payments becomes a reality.

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REAL ESTATE INVESTMENT TRUSTS IN KENYA
Are We Ready?

Traditionally, land ownership was based on two maxims. The first maxim states that an owner of land owns everything up to the sky and down to the centre of the earth. The second maxim states that anything attached to land becomes part of the land and becomes part of real estate. Land ownership has evolved throughout the years to challenge these two maxims. One such evolution and innovation in land ownership is through the Real Estate Investments Trust (REIT). This mode of ownership and investments in real estate through REITS has been in existence for many years.

How does REITS innovate land ownership and investments in Kenya?

A REIT is an investment vehicle that owns or invests in property to earn income by leasing or sale of developments. This investment vehicle allows the members to collectively own, invest and develop commercial and residential real estate units such as malls, office spaces, hostels, hotels and apartments among others.

It may be argued that ownership of property through a trustee is an innovation that has existed for a long time. However, for REITS, one's ownership is denoted by a unit. Each subscriber to REIT acquires rights or interest in a trust. Each interest is then divided into a unit that enables the unitholders to earn an income depending on the number of units owned in that REIT.

Unlike ownership in conventional real estate, raising of capital in REITS is through floating the REIT offer on the Nairobi Securities Exchange. This allows the real estate investors to tap in terms of funding from the prospective unitholders.

A REIT departs from the conventional real estate on the issue of ownership of land as owning the soil and everything attached to it. In REITS model, investors only own a unit in the REIT's scheme. The REIT scheme in turn owns the land and other properties on the land.

Another innovation is that it allows foreigners to invest in real estate in Kenya without limitation as to the tenure of ownership. It is important to note that non-citizens and companies not wholly owned by citizens are only allowed to hold land on the basis of leasehold tenure not exceeding 99 years. In addition they cannot undertake transactions that relate to agricultural land.

Under the REIT framework, eligible investments include property where the form of tenure is either freehold or leasehold or under the Sectional Properties Act. This effectively means that non-citizens are free to invest in freehold properties.

Capital Markets Authority enacted the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations in 2013 allowing for the regulation of REITs in Kenya.

WHAT ARE THE ADVANTAGES OF REITS?

1. **Raising Capital**

   Investors both local and foreign can take advantage of property ownership through REITS. This is because availability of capital to finance acquisition of land and its development may prove to be challenging if undertaken by a sole individual.

   However, if a project is collectively undertaken, capital and financing may not be an impediment. As it is common knowledge, pooled resources are sometimes efficient and if maximised in investments can yield better returns.

2. **Tax Exemptions**

   Ownership of properties through trustees allows REITS schemes to enjoy various tax exemptions. These exemptions include exemptions are in the Stamp Duty Act and the Income Tax Act.

   Under the Stamp Duty Act, instruments transferring or conveying an interest from one trustee to another and instruments conveying a beneficial interest from a person for the transfer of units are exempt from stamp duty. However, exemption for instruments conveying an interest on transfer of the units is applicable to documents executed before 31st December 2022.

   The Income Tax Act exempts tax of income from REITS except for withholding tax.

3. **Professional Management**

   The Regulations mandate the Capital Markets Authority to license various professional in REITS related developments. This is beneficial to unitholders and investors as they get professional management of their investments in REITS projects.

WHAT ARE THE DISADVANTAGES OF INVESTING IN REITS?

1. **High Management Costs**

   The costs involved in managing a REIT are high thus the initial investment required is substantial and denies investors, who are not deep pocketed, a chance to establish such REITS. They also incur high operational costs which may not be recouped from the investments.

   For example, the minimum capital required before floating a Development REIT is Ksh.5 000,000. This is only favourable to professional investors locking out the normal investors. Also, the costs of managing the project such as trustee fees, licensing fees, marketing and public relations fees are not conducive to many investors.

2. **Competition**

   The other disadvantage is that REITS face an intense competition from other alternative sources of funding such as bonds and loans. This competition could be due to lack of awareness in operation of REITS.

HOW DID THE TWO REITS LAUNCHED IN KENYA PERFORM?

Capital Markets Authority enacted the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations in 2013 allowing for the regulation of REITs in Kenya.

The first REIT was launched in 2015. This was the Stanlib Fahari I-REIT (popularly known as Fahari), where it derives its income from cash generated from real estate developments. The properties that are fully owned by Fahari are located in Nairobi and are the Greenspan Mall, Highway House and Bay Holdings.

The Fahari REIT did not penetrate the market as expected. This was perhaps due to lack of awareness and limited understanding of the REIT system of investments. As noted, the Fahari I-REIT unitholders receive income from cash generated from the real estate developments. This, however, did not convince potential investors probably due to the traditional view that income from rental properties should only be treated as rent.

Another REIT was the Fusion Development REIT, popularly known as FRED, that was floated at the Nairobi Securities Exchange in 2016. The funds raised were used to develop the Meru Greenwood City Mall in Meru County.

The floating of the FRED-Commercial was postponed several times perhaps due to the limited marketing understanding of how this investment tool operates. Furthermore, the uptake of FRED was not satisfactory forcing Fusion Capital Limited to seek alternative funding to fund the development.

The performance of these two REITS has not attracted many investors. This is largely attributed to the lack of awareness and information on operations of REITs as an investment tool.

CONCLUSION

Judging from the performance of the two REITS, it appears that there is lack of awareness and information on investment through REITs. The stakeholders ought to engage more in marketing and public relations. This will enable investors, especially local, have a better perception of REITS as an innovation in Real Estate.

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CORPORATE INSOLVENCY
Rights of Creditors During Liquidation

The current problems facing Nakumatt Holdings Limited are not a new phenomenon in Kenya. In the recent past, several companies, private and public alike, have fallen into tough financial times and have had to undergo reorganisation to enable them stay afloat. In the case of public entities, in addition to reorganisation, they often apply to the Government, as one of the shareholders, for financial bailout.

Creditors of a distressed company can enter into voluntary arrangements with the company for the settlements of their debts, apply to court for the recovery of the debt by execution or attachment of the assets of the company, or file a petition in court for the liquidation of the company.

Under the **Insolvency Act, Act No. 18 of 2015 ['the Act']**, a company is insolvent in three scenarios. One, if a creditor to whom the company is indebted for Kshs.100,000.00 or more has served on the company a written demand for the company to pay the debt and the company failed to pay the debt or secure it to the reasonable satisfaction of the debtor within 21 days on receipt of the demand. Secondly, if it is proved to a court that the value of the company's assets is less than the amount of its liabilities. Finally, if execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part.

It is a fact that not every company can avert its complete collapse by reorganising and when all else fails, can be forced to sell its assets to meet its liabilities. This process in law is referred to as liquidation.

Liquidation involves bringing a company's operations to an end and dividing its assets up between the creditors and shareholders. In the process of liquidation, creditors' rights are held paramount to those of the shareholders and directors of a company in several jurisdictions.

Under the Act, some of the rights available to creditors during liquidation are as follows:

To initiate liquidation: The creditors can compulsorily liquidate a company by way of petition to the court. The process officially commences with court appointment of a liquidator who manages the affairs of the company during liquidation. They can also agree to voluntarily appoint a liquidator for the company following a meeting of the creditors convened by the company.

To receive notice and attend creditors meetings: A creditor of a company, having proved their debt, has a right to attend every single creditors' meeting convened by the company before the appointment of a liquidator and after appointment of the liquidator. The Act also provides that if the liquidation process takes more than one year, the liquidator must convene a creditors meeting every 12 months until completion of the process.

To appoint a liquidator: A liquidator is an insolvency practitioner appointed by the company's members, creditors or a court to manage the affairs of an insolvent company. If the creditors fail to appoint a liquidator and the members or directors of the company nominate a different insolvency practitioner to be the liquidator- the creditors have a right to apply to court for orders. In such a scenario, the court may order the two appointees to act jointly or that the company's appointee acts as the sole liquidator. The court in its own discretion may also appoint a liquidator.

To appoint a liquidation committee: The Act provides that the creditors may appoint a five-member liquidation committee if they see it fit to do so. The company may also appoint members to the committee, however, only the creditors have a right to disqualify a member of the committee. On application, the court has powers to quash any resolution by the creditors to disqualify any member of the committee.

The functions of the committee include but are not limited to the approval of any transfer of shares or sale of an insolvent company and supervision of the liquidator in the exercise of his or her powers. In liquidation, the directors of the company cease to carry out their roles as directors. The committee, however, has powers to allow the directors to continue working as such.

Consider accounts proffered by the liquidator on the liquidation process: On completion of the liquidation process, the creditors have a right to inspect and consider the accounts and explanation tabled before them by the liquidator showing how the liquidation process has been conducted and the assets of the company disposed. This is the last meeting of the company before dissolution.

Right to apply to court for any matter arising out of liquidation: The creditors can, if they so wish, apply to the court to adjudicate any matter arising out of the liquidation process. This includes the right to seek stay of liquidation proceedings any time before the court grants a liquidation order or to restrain any further proceedings.

The aforementioned rights correspond to rights accessible to creditors in many jurisdictions around the world, including the United Kingdom and South Africa.

Notably, under the Act, any application for attachment, distress or execution filed against the assets of the company after commencement of liquidation is void. For instance, in August 2017, a group of Nakumatt creditors applied to court seeking orders to attach the retailer's assets so as to offset debts owed to them. The court declined to issue the orders stating that there was an ongoing insolvency proceeding against the retailer.

On completion of the liquidation process and as against other creditors, there is an order of priority on payment of debts owed. First to be paid shall be the cost of liquidation, employees' wages and statutory deductions.

CONCLUSION

In conclusion, although the Insolvency Act, 2015 offers solutions for the companies to redeem themselves and maximise returns to the creditors without complete dissolution of the company, liquidation provides the creditors with a greater say in an insolvent company as they are able to participate in the decision making process up to dissolution.

For more information or advice related to this topic please contact Lynnette on lwanyonyi@mman.co.ke

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