Chambers

GLOBAL PRACTICE GUIDE

Definitive global law guides offering
comparative analysis from top ranked lawyers

Project Finance

Kenya
Anjarwalla & Khanna

chambers.com

2019

KENYA

LAW AND PRACTICE: p.3

Contributed by Anjarwalla & Khanna

The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

Contributed by Anjarwalla & Khanna

Contents

1. Project Finance Panorama p.4
- 1.1 Recent History and Expected Developments p.4
- 1.2 Institutions Typically Acting as Sponsors and Lenders p.4
- 1.3 Public-private Partnership Transactions p.5
- 1.4 Main Issues Considered When Structuring the Deal p.6

2. Guarantees and Security p.6
- 2.1 Assets Typically Available as Collateral to Lenders p.6
- 2.2 Charge or Interest over All Present and Future Assets of a Company p.6
- 2.3 Costs Associated with Registering Collateral Security Interests p.7
- 2.4 Granting a Valid Security Interest p.7
- 2.5 Restrictions on the Grant of Security or Guarantees p.7
- 2.6 Absence of Other Liens p.7
- 2.7 Releasing Typical Forms of Security p.7

3. Enforcement p.7
- 3.1 Secured Lender Enforcing its Collateral p.7
- 3.2 Upholding Foreign Law p.8
- 3.3 Judgment Without Retrial p.9
- 3.4 Other Matters Impacting a Foreign Lender's Ability p.9

4. Foreign Investment p.9
- 4.1 Restrictions on Foreign Lenders Granting Loans p.9
- 4.2 Restrictions on Foreign Lenders on Granting of Security or Guarantees p.9
- 4.3 Foreign Investment Regime p.9
- 4.4 Restrictions on Payments Abroad or Repatriation of Capital by Foreign Investors p.9
- 4.5 Maintenance of Offshore Foreign Currency Accounts p.10

5. Structuring and Documentation Considerations p.10
- 5.1 Registering or Filing Financing or Project Agreements p.10
- 5.2 Licence Required for Owning Land or Natural Resources p.10
- 5.3 Recognition of Agent and Trust Concepts p.10
- 5.4 Rules Governing the Priority of Competing Security Interests p.10
- 5.5 Requirements of Local Law p.10

6. Bankruptcy and Insolvency p.11
- 6.1 Availability and Practice of Company Reorganisation Procedures p.11
- 6.2 Commencement of Insolvency Processes Impacting Lender's Rights p.11
- 6.3 Payment Order to Creditors on a Company's Insolvency p.11
- 6.4 Risk Areas for Lenders p.11
- 6.5 Entities Excluded from Bankruptcy Proceedings p.11

7. Insurances p.11
- 7.1 Restrictions, Controls, Fees and/or Taxes on Insurance Policies p.11
- 7.2 Payable Insurance Policies over Project Assets to Foreign Creditors p.11

8. Tax p.11
- 8.1 Payments to Lenders Subject to Withholding Tax p.11
- 8.2 Taxes, Duties, Charges or Tax Considerations Relevant to Lenders p.12
- 8.3 Usury Laws or Other Rules Limiting the Amount of Interest Charged p.12

9. Applicable Law p.13
- 9.1 Law Typically Governing Project Agreements p.13
- 9.2 Law Typically Governing Financing Agreements p.13
- 9.3 Matters Typically Governed by Domestic Law p.13

10. Islamic Finance p.13
- 10.1 Development of Islamic Finance p.13
- 10.2 Regulatory and Tax Framework p.14
- 10.3 Business Requirements for Islamic Banks to be Authorised/Admitted p.14
- 10.4 Framework for Ensuring Shari'a-compliant Products p.14

Anjarwalla & Khanna is noted for its expertise in handling large projects and infrastructure matters in Kenya, with a dedicated team of five partners and four associates in offices in Nairobi and Mombasa. The firm's dynamic energy and projects practice handles project finance and is regularly engaged in the financing of the most significant power and infrastructure projects in Kenya and Africa. The power practice covers various sectors, including solar, hydro, wind, geothermal, heavy fuel oil, gas and coal, while the infrastructure practice covers road, rail, waste management, construction and telecommunications. A&K is the founder and key driver of ALN, an alliance of leading law firms which is currently in 16 key African jurisdictions, including the continent's gateway economies.

Authors

Aleem Tharani is a partner in Anjarwalla & Khanna's Projects and Infrastructure department. He focuses on all aspects of project development and project finance, including advising sponsors and governments on some of the largest private sector power and infrastructure projects undertaken in Kenya, negotiating various project agreements across the energy supply chain, including long-term concession agreements, power purchase agreements, EPC construction contracts, operations and maintenance agreements, fuel supply agreements and steam supply agreements.

Edwin Mbaru is a principal associate in Anjarwalla & Khanna's Projects and Infrastructure department. He has experience in public procurement and PPPs, legal compliance and regulatory advice, drafting, negotiating and reviewing power purchase agreements, concession agreements, project agreements, EPC contracts, O&M agreements and equity documents, and debt and equity closing processes

Karim M. Lalji is a senior associate in Anjarwalla & Khanna's Projects and Infrastructure department. He handles all aspects of project finance transactions, with an emphasis on PPP, infrastructure, project sponsors and energy.

Juliana Apopo is an associate who has experience in public procurement and PPPs, drafting and reviewing project agreements, EPC contracts, O&M agreements and finance agreements, and debt closing processes.

1. Project Finance Panorama

1.1 Recent History and Expected Developments

There is a long history of power projects being undertaken by independent power producers (IPPs) in Kenya using traditional project finance structures (eg, Tsavo Power and Rabai, which date back more than a decade). Following the recent enactment of various pieces of legislation such as the Public Private Partnerships Act 2013 and unbundling policies in the energy sector, several PPP projects are currently being developed, most of which will be completed using traditional project finance structures. Project finance structures are expected to be used in other sectors, particularly in infrastructure projects, due to the fact that, as the debt of the Government of Kenya (GOK) increases, the GOK is under increasing pressure to move from EPC and EPC-F structures to project financing structures. Therefore, it is expected that the GOK will use project financing and public private partnerships to develop roads, water facilities and other infrastructure projects in the future.

1.2 Institutions Typically Acting as Sponsors and Lenders

International companies typically act as sponsors (eg, Globleq, Actis, AIIM, Mota-Engil, Ormat, Elicio, Engie, responsAbility and Frontier). Local sponsors are also present (eg, Centum, Gulf Energy, Craftskills Wind Energy and Triumph Power).

With regard to lenders, European DFIs primarily act as senior lenders in Kenya (eg, Proparco, FMO, EIB, DEG, etc).

Other DFIs, such as OPIC and AfDB, also act as senior lenders in Kenya, as do South African commercial banks (Standard Bank, Ned Bank and Absa) and Chinese commercial banks (ICBC).

1.3 Public-private Partnership Transactions

In Kenya, the governing statute is the Public Private Partnerships Act 2013 (the Kenya PPP Act), which has been in force since February 2013; the Public Private Partnerships Regulations, 2014 (the Kenya Regulations), which operationalise the Kenya PPP Act, were brought into force on 17 October, 2014. Other applicable regulations worth noting are the Public Private Partnerships (County Government's) Regulations, 2014 (which apply to PPP projects undertaken by county governments) and the Public Private Partnerships Act, Petition Committee Guidelines, 2014 (which regulate petitions made by private parties during the process of tendering and entering into a project agreement under the Kenya PPP Act).

One of the main pieces of relevant legislation is the Energy Act 2006 (revised in 2015). The GOK has overhauled the energy sector through reconstruction and reforms, including the unbundling of the previously vertically integrated monopoly in power production, promulgation of the feed-in tariffs policy allowing for a clearer framework for the implementation of IPPs, the commercialisation of power distribution, and the establishment of the Energy Regulatory Commission (ERC) as the single regulatory agency with responsibility for the economic and technical regulation of the energy sector, as well as the Kenya Electricity Transmission Company Limited (KETRACO), a wholly state-owned company tasked with developing the national transmission grid network and facilitating trade in electric power through its transmission network.

The main challenges with respect to public private partnership transactions are as follows:

1. The time it takes to reach financial close:

- In previous years, most of the project risk was allocated to the government or government agencies (eg, by way of sovereign guarantees, which would cover payment and performance obligations). At present, the risk allocation process is more nuanced. For instance, the government is currently usually willing to assume certain political risks along with the risks related to changes in tax rates, laws and regulations. Developers, on the other hand, are usually willing to take on construction risk, technology risk, operational performance risk, funding risk, human resources risk and socio-environmental risk. The allocations of other risks, such as economic risk (inflation, interest rates and exchange rates), fuel supply risk, inter-connection risk and certain political risk (eg, terrorism) are highly negotiated issues that can cause delays in the conclusion of a transaction.
- PPPs usually involve heavy planning and logistics that may take at least three years before implementation commences. The planning includes the initial PPP project proposal, feasibility studies, the submission of tender documents, the pre-qualification of bidders, proposal preparation, bid evaluation (both financial and technical) and contractual negotiations. Most stakeholders are unaware of the time required for matters such as the mobilisation of capital, multiple approvals such as environmental impact assessments, and the appointment of technical, legal and financial professionals, etc.
- Out of necessity, a single PPP project will require the involvement and collaboration of many government agencies and departments. Consultations between these various departments are therefore central during the structuring and implementation stages of a project.
- There is inadequate institutional capacity in the public sector to be able to advise and deliver on multiple PPP projects at a time. Where projects are being developed solely by local private developers, similar issues around capacity can arise:
  - (a) *Government expertise* – there is limited expertise to judge whether projects should be prepared on a PPP basis or a public-only basis, and, if on a PPP basis, the type and extent of private partnership needed. The risk allocation process is also not entirely clear (as mentioned previously).
  - (b) *Limited private sector experience* – some private sector players often have limited experience as developers or investors, and have inadequate access to technical staff with regard to structuring, planning and executing a PPP project.

2. Inadequate funding:

- There are significant financial constraints due to the high funding costs. The contributing factors that result in high funding costs are:
  - (a) *The credit rating of the GOK and government institutions* – as sovereign debt levels increase, the stability of the GOK's current credit rating remains uncertain. Furthermore, state corporations and parastatals do not have international credit ratings.
  - (b) *Assessing credit risk* – the lack of a clear mechanism for effectively assessing credit risk in PPP transactions dampens lenders' interest, making it difficult for the project sponsors to access banks and capital markets for funding.

- It has recently been reported that Kenya will only undertake a few PPP projects out of more than 100 projects identified as being important by the GOK, due to inadequate finances. This is exacerbated by the lack of local players in the long-term lending market, which is currently dominated by DFIs. The government hopes that the Kenya PPP Act will help to create an appetite for long-term lending, which will persuade local banks and financial institutions to enter the market.

1.4 Main Issues Considered When Structuring the Deal

The main issues that need to be considered are the identification of risk and the allocation of risk between the public and private sectors. With regard to funding techniques, projects are mostly funded through debt, with the typical debt to equity ratio being in the range of 70-80% debt and 20-30% equity.

Debt is usually provided by DFIs; for projects funded using an A/B structure, DFIs and commercial banks act as senior lenders, whilst a handful of DFIs act as mezzanine lenders (eg, DEG, Finnfund).

The equity is usually provided by the project sponsor through share capital and/or shareholder loans, subject to the applicable tax implications and deal structure.

2. Guarantees and Security

2.1 Assets Typically Available as Collateral to Lenders

A wide range of assets can be taken as security in Kenya, including land, shares, receivables, bank deposits, aircraft, ships, tangible and intangible assets, whether present or future. Below is a brief summary of the typical security that can be created over such assets:

- A charge may be taken over land (including buildings). The form of instrument and the execution requirements of security over land must conform with the mandatory requirements of the land laws. Under the Constitution of Kenya, a person who is not a citizen of Kenya may only own land on the basis of a leasehold tenure of a period not exceeding 99 years.
- A charge or a security right may be created over specific assets, such as plant and machinery and motor vehicles.
- A company may create debenture security over all its present and future assets. However, land must be separately charged, in order to conform with land law requirements.
- Intellectual property rights and rights under contract (including a contract of insurance) may be assigned by way of security to a lender.
- A security interest in shares may be created by way of a charge over shares or a memorandum of deposit of shares. In addition, it is recommended that the chargor executes blank share (stock) transfer forms and surrenders the transfer forms and the original share certificates in respect of the shares to the chargee. Appropriate authority to undertake the transfer should be included in the security documents, or the chargor should execute an irrevocable power of attorney granting the security holder rights to sell the shares. This will assist in the event of enforcement.

General perfection formalities

Stamp Duty

Subject to certain limited exemptions (eg, instruments executed in respect of transactions relating to loans from foreign sources received by investors in the energy, roads, port, water or railways sectors, which are exempt from stamp duty), stamp duty is payable on the majority of security documents. The stamping process must be completed within 30 days of executing the document (or, if the security is executed outside Kenya, within 30 days of the security document being brought into Kenya). The person taking security bears the stamp duty cost. However, the borrower is typically required to pay these and all other costs relating to the security. The failure to stamp a security document can result in a fine, the inability to register the security document, and the security document being declared inadmissible as evidence in any court proceedings.

Stamp duty is typically payable at the rate of 0.1% of the amount secured by the principal security document. Supplemental security documents attract stamp duty at the nominal rate of KES200 (approximately USD2). The rate of stamp duty on collateral security is 0.05% of the amount secured under the collateral security. For purposes of assessing stamp duty, a principal security is the security identified by the parties as the main security, a supplemental security is an additional security provided by the security provider who is providing the principal security, and a collateral security is an additional security created by a different security provider other than the one providing the principal security. Instruments creating security rights over movable assets which require registration at the Collateral Registry (recently established in respect of movable assets) only are exempt from the payment of stamp duty.

Registration

Registration is required in order to provide priority to the lender in the event of enforcement, and to achieve third-party effectiveness. For land, the security has to be registered at the relevant land registry (if the land owner is a company, registration of the security at the Companies Registry is also required). Registration at the Companies Registry must be made within 30 days of the creation of the security in order for the security to be valid against creditors and a liquidator of the relevant company. Registration at the Collateral Registry is not mandatory but it is prudent, since it achieves third-party effectiveness. A security right over movable assets of a company that is not registered at the Collateral Registry is void against the liquidator of the company.

2.2 Charge or Interest over All Present and Future Assets of a Company

Floating charges or other similar security interests over all present and future assets of a company are permitted, and would be achieved by creation of an all-assets debenture.

2.3 Costs Associated with Registering Collateral Security Interests

The costs are as follows:

- Lands Registry – KES500 (approximately USD5) for each security document;
- Companies Registry – the registration fees depend on the value of the secured amount and will be between KES2000 (approximately USD20) and KES14000 (approximately USD140); and
- Collateral Registry – no registration costs are payable.

2.4 Granting a Valid Security Interest

A general description of the types of collateral covered is sufficient. Please note, however, that in relation to security over land, specific description of the land is required. A security agreement creating a security right over specific movable assets must describe such assets in a manner that reasonably allows their description by way of specific listing, category, type of collateral and quantity. It is sufficient if the description in the security agreement describes all the movable assets or all assets within a generic category of the security provider. The general description should not be so vague as to make it impossible to reasonably identify the collateral item.

2.5 Restrictions on the Grant of Security or Guarantees

The restrictions depend on various factors, such as the type of lending or borrowing institution and whether it belongs to a regulated industry such as banking or insurance. Below are some of the factors for consideration:

- Insurance: Pursuant to section 51 of the Insurance Act (cap 487), an insurance company is limited with regard to issuing charges over its assets, the value of which should not exceed 10% of its total assets.
- Authority: Companies must have due authority under their constitutional documents in order to create security.
- Consent: Some securities require consent from third parties, such as the Commissioner of Lands in the case of certain leased property, or the Kenya Ports Authority for land at the port.
- Commercial benefit: A company providing third-party security or guarantee must show that it is deriving some commercial benefit from the guarantee arrangement. Directors of a company incorporated in Kenya have a fiduciary duty to act in the best interest of the company. The directors of a corporate guarantor would be in breach of their fiduciary duty to the company if they resolved that the company provides the third-party security or guarantee in circumstances where there is no commercial benefit.
- Financial assistance: The Companies Act No 17 of 2015 prohibits the giving of financial assistance, whether directly or indirectly, and in any form (including issuance of a guarantee) in the following circumstances:
  (a) if a person is acquiring or proposing to acquire shares in a private company, a public company that is a subsidiary of that company is prohibited from providing financial assistance for acquisition of shares in the private company; and
  (b) if a person is acquiring or proposing to acquire shares in a public company, the public company or a subsidiary of that public company is prohibited from providing financial assistance for the acquisition of shares in the public company before or at the same time as the acquisition takes place.

2.6 Absence of Other Liens

Lenders can satisfy themselves with respect to the absence of other liens on their collateral by undertaking due diligence, which should include searches at the relevant registries.

2.7 Releasing Typical Forms of Security

In Kenya, the release of a security interest over an asset typically involves the signing, stamping and registration of a discharge of the security at the relevant registry in which the security has been registered. In relation to security rights created over movable assets, where the secured creditor has filed an initial notice in respect of those security rights at the Collateral Registry, the secured creditor is required to file a cancellation notice where the security provider has been released from all obligations, or an amendment notice where the security provider has been released from some of the secured obligations.

3. Enforcement

3.1 Secured Lender Enforcing its Collateral

The circumstances under which a secured lender can enforce their security are largely dependent on the terms of the security agreement. Typically, the agreement will contain covenants to be observed by the borrower, and if these are breached then the lender has the right to terminate the agreement and enforce the security. Furthermore, it is also typical for security agreements to contain certain events, the occurrence of which gives the lender the right to enforce the security (commonly referred to as events of default). These events of default include issues such as the insolvency of the borrower, a change of control in the borrower without lender consent, and the cessation of business by the borrower.

Charge Over Land

In the case of immovable property, the steps are set out under statute (ie, the Land Act No 6 of 2012 and the Land Registration Act No 3 of 2012). The procedure also depends on whether the charge is informal or formal. A formal charge is perfected and duly registered at the relevant Lands Registry.

Formal charges

The chargee may exercise the following enforcement remedies for formal charges:

- sue the chargor for any money due and owing under the charge;
- appoint a receiver to demand and recover income derived from the charged land;
- lease the charged land or, if the charge is of a lease, sublease the land;
- take possession of the charged land; or
- sell the charged land via statutory power of sale (the chargee may purchase the charged property with leave of the court).

Enforcement of the above remedies is subject to the provisions provided in the Land Registration Act.

Statutory power of sale

The steps that would be taken by the chargee wishing to exercise its power of sale are as follows:

- the issuance of a three-month statutory notice to the chargor. The statutory notices must be in the form and manner prescribed under the Land Act and served on the persons prescribed;
- the issuance of a 40-day notice to sell the property to the chargor;
- the issuance of 45 days' notice by the auctioneer to the chargor, as required under the Auctioneers Act, 1996;
- the undertaking of a forced sale valuation by the chargee prior to exercising its right of sale; and
- if the sale is by way of public auction and not a private contract, the chargee shall ensure that the sale is publicly advertised in the prescribed form and manner, and that the laws applicable to public auctions are complied with.

Appointment of a receiver

The steps that would need to be taken by the chargee are as follows:

- the issuance of a three-month statutory notice to the chargor; and
- the issuance of a 30-day notice to appoint a receiver to the chargor.

Following the issue of the statutory notices set out above, the receiver may be appointed by the chargee.

Debenture

Typically, the debenture would provide for the enforcement of the security interest through the appointment of an administrator, whose conduct is governed by the Insolvency Act, 2015. Administration involves the running of the insolvent company by an administrator as a going concern. However, the debenture has to be a qualifying floating charge. The requirements that have to be met in order for the lender to have the right to appoint an administrator without court approval are as follows:

- the debenture has to be over the whole or substantially the whole of the company's assets;
- the debenture has to expressly state that section 534 of the Insolvency Act applies to it; and
- the debenture has to expressly give the lender power to appoint an administrator.

However, where the borrower is placed under liquidation or administration by way of a court order, the lender cannot exercise its right to appoint an administrator, but does retain the contractual right contained in the debenture (if it is a fixed debenture) to appoint a receiver. However, the receiver's power is restricted to the fixed assets covered by the debenture, and the receiver does not have any right to operate the company or act as agent of the company in the manner of an administrator. The steps that are to be followed prior to the appointment of a receiver and the process of receivership (including the receiver's powers) are also derived from the debenture.

Restrictions and Consents

Certain approvals and consents need to be procured before the lender can enforce its security and effect the transfer of the secured assets. Failure to procure these consents and approvals may restrict the lender's ability to enforce its security. The nature of the approval or consent required depends on the nature of the security, as discussed below:

In the case of security over land:

- Spousal consent is required to be obtained from a chargor's spouse if the chargor is married. If the chargor is not married, it is typical for a lender to require that the chargor issues a sworn affidavit declaring his marital status.
- Land Control Board consent is required if the security being created is a charge over 'agricultural land'. Accordingly, a lender should establish in advance whether land being secured is in fact 'agricultural land' as provided for under the Land Control Act (Chapter 302, Laws of Kenya).
- If land is held under a grant from the Government of Kenya, it is likely that the grant will require consent to charge, to be obtained from the Commissioner of Lands.
- In the case of other leasehold land, it would be necessary to establish from the lease if any consents are required to be obtained, for example from the head-lessor.

In the case of charge over shares:

- The requisite approvals may need to be obtained from the relevant competent authorities, such as the Competition Authority (if shares are transferred following an enforcement) and the Energy Regulatory Commission.

3.2 Upholding Foreign Law

Where the parties to a contract expressly stipulate that the contract shall be governed by a particular law, that law will be the law of the contract. The courts of Kenya will therefore observe the choice of said foreign law (for example, English law or New York law) as the governing law of the contract, provided that the choice of law was made in good faith and not for extraneous purposes or to perpetuate fraud or any other illegal purpose and that there is no objection on the grounds of public policy. Where there are strong reasons or exceptional circumstances warranting a departure from the terms of a clause subjecting a contract to foreign law, Kenyan courts retain right to assume jurisdiction at their discretion. However, the burden of proving the existence of such exceptional circumstances lies on the person seeking to avoid the choice of governing law.

The choice of law or legal system is construed as referring to the substantive law of that state and not to its conflict of laws rules or procedural rules. Therefore, if a contract stipulates, for example, that English law is to apply, the court would uphold English law but apply Kenyan conflict of laws and procedural rules.

3.3 Judgment Without Retrial

Enforcement of a foreign arbitral award in Kenya is mainly governed by the Foreign Judgments (Reciprocal Enforcement) Act (the Foreign Judgment Act), the Arbitration Act 1995 (the Arbitration Act) and the New York Convention on the Recognition and Enforcement of Foreign Arbitral awards, New York, 10 June 1958 (the New York Convention).

The Foreign Judgment Act is applicable to the enforcement of arbitral awards given in countries outside Kenya which accord reciprocal treatment to judgments given in Kenya. Australia, Malawi, Seychelles, Tanzania, Uganda, Zambia, the United Kingdom and the Republic of Rwanda are the current designated countries. Section 13 of the Foreign Judgment Act empowers the Minister to declare a country to be a reciprocating country if the Minister is satisfied that said country has made or will make provisions for the enforcement in that country of judgments given by superior courts in Kenya.

The Arbitration Act and the New York Convention are applicable to the enforcement of arbitral awards rendered in countries which are signatories to the New York Convention. In order for an arbitral award rendered outside Kenya to be recognised and enforced in Kenya, the country in which the Arbitration Award is rendered has to be either a signatory of the New York Convention or a designated country under the Foreign Judgment Act.

If the arbitration award is rendered in a country which is neither a designated country under the Foreign Judgment Act nor a signatory to the New York Convention, the suit between the parties has to proceed to full trial in a Kenyan Court.

3.4 Other Matters Impacting a Foreign Lender's Ability

For a charge over land, the lender has to ensure that if the land is freehold or designated for agricultural use, the security provider obtains consent to charge the land from the relevant Land Control Board. It should also be noted that in the event of enforcement of a charge over freehold or agricultural land, the lender can only dispose of the land to a Kenyan citizen. Please note that a company is deemed to be a Kenyan citizen if all the shareholders of the company are Kenyan citizens. If the insolvent company in Kenya has assets in another jurisdiction that are secured, the provisions of cross-border insolvency will apply, particularly the provisions of the Model Law on Cross-Border Insolvency adopted by the United Nations Commission on International Trade Law of 30 May, 1997. The secured creditor will need to familiarise itself with the insolvency legislation of the country where the assets are located and determine whether, for example, court approval in that jurisdiction is required. In Kenya, leave of court will be required where a company in a foreign jurisdiction is being liquidated to realise an asset in Kenya.

4. Foreign Investment

4.1 Restrictions on Foreign Lenders Granting Loans

Foreign lenders are not restricted from granting loans in any currency in Kenya.

4.2 Restrictions on Foreign Lenders on Granting of Security or Guarantees

The granting of security to foreign lenders is not restricted or impeded in any way under Kenyan law.

4.3 Foreign Investment Regime

There are no laws that deal with foreign investment specifically. However, Kenya does have an Investment Promotion Authority. An investor who has a minimum investment of USD100,000 qualifies to apply for an investment certificate from the Investment Promotion Authority. Registration assists with the procurement of other applicable licences.

4.4 Restrictions on Payments Abroad or Repatriation of Capital by Foreign Investors

There has been no formal exchange control regime in force in Kenya since the repeal of the Exchange Control Act in 1995. However, certain limited conditions and procedural requirements that apply in connection with the repatriation of foreign currency from Kenya should be noted.

Pursuant to the Central Bank of Kenya Act, the Central Bank of Kenya has issued a number of Prudential Guidelines, including the 'Guidelines on Foreign Exchange' dated 1 September, 2002 (the 2002 Guidelines), which are binding on all licensed banks in Kenya. The 2002 Guidelines provide that banks are to play a monitoring role in relation to foreign currency transactions, and require each bank to submit returns to the Central Bank of Kenya on a regular basis in relation to, inter alia, foreign currency transactions.

In general terms, foreign currency may be freely repatriated from Kenya, provided there is evidence of a bona fide transaction and the bank undertaking the repatriation is satisfied that the transaction is genuine. However, for any amount equivalent to USD10,000 or higher, the Central Bank of Kenya has required that the relevant commercial bank in Kenya remitting the funds from Kenya notifies the Central Bank of Kenya as to the amount and purpose of the remittance. It should be noted that the obligation is merely to notify, and that there is no need to obtain any prior consent or approval from the Central Bank of Kenya. For any amount equal to or above USD10,000, remitting banks are required to obtain a confirmation of source of funds and, where applicable, documentary evidence to support the transaction.

4.5 Maintenance of Offshore Foreign Currency Accounts

There are no restrictions under law on a project company maintaining an offshore currency account.

5. Structuring and Documentation Considerations

5.1 Registering or Filing Financing or Project Agreements

Please see **2.1 Assets Typically Available as Collateral to Lenders**.

5.2 Licence Required for Owning Land or Natural Resources

In general, natural resources are owned by the Government of Kenya and held in trust on behalf of all Kenyans, whether situated on public or private land, according to the Constitution of Kenya, 2010. Any person wishing to deal with natural resources requires a licence.

With respect to land, foreigners can own land in Kenya subject to certain limitations: they can only hold land through leasehold tenures for a term not exceeding 99 years, and they cannot own agricultural land. A company is deemed to be Kenyan if it is owned 100% by Kenyan citizens.

5.3 Recognition of Agent and Trust Concepts

The principles of agency and trust are recognised in Kenya.

5.4 Rules Governing the Priority of Competing Security Interests

Schedule 2 of the Insolvency Act sets out the priority for preferential creditors as follows:

- First priority claims:
  - (a) costs of the liquidator's/administrator's remuneration, and operational costs for the administration or liquidation; and
  - (b) reasonable costs incurred during the court proceedings, and costs incurred by a creditor to preserve an insolvent company's assets.

- Second priority claims:
  - (a) wages and salaries payable to employees up to a maximum of KES200,000;
  - (b) statutory deductions from employees (eg, PAYE, NSSF (retirement benefits contribution) and NHIF (statutory health insurance contributions)); and
  - (c) other amounts required by other written law.

- Third priority claims: unpaid taxes such as customs duty and excise duty.
- Fourth priority claims: holders of floating charges (non-crystallised).
- Fifth priority claims: unsecured creditors – these claims have the same priority among themselves and are payable on a pari passu basis.

Secured assets do not form part of the insolvent's estate, and the secured creditor has priority with respect to the secured assets so has the right to realise the security and set off debts due to them but must account for any excess funds from the realisation, which must then be remitted to the liquidator for distribution, in accordance with the waterfall described above. In the event that the secured creditor has a deficit upon realisation of the security, they will be treated as an unsecured creditor for the shortfall.

Contractual subordination of competing interests is possible, and is usually required in instances where lenders with competing interests enter into intercreditor agreements to determine how their respective rights will be addressed in the event of enforcement. These intercreditor agreements differ depending on the parties' mutual understanding, and they can be, for example, pari passu or prorated. They survive the insolvency of the borrower, and the liquidator or administrator will respect such agreements if they conform with the provisions of the Insolvency Act and are subject to Schedule 2, which lists the preferred creditors.

5.5 Requirements of Local Law

The only legal requirement relating to the organisation of project companies is set out under the Public Private Partnerships Act, 2013, which requires a project company to be registered as a limited liability company in Kenya. However, project companies are generally Kenyan registered companies.

6. Bankruptcy and Insolvency

6.1 Availability and Practice of Company Reorganisation Procedures

Under the Insolvency Act, the directors of an insolvent company can make a proposal to the company and to its creditors for a voluntary arrangement, under which the company enters into a composition in satisfaction of its debts or a scheme for arranging its financial affairs. The composition may include a consensual restructuring and/or reorganisation of the insolvent company. The courts will generally observe and respect these consensual arrangements. Once a proposal has been made and an arrangement entered into, a supervisor is appointed to oversee the arrangement, and has to prepare a report within 30 days of appointment and submit it to the court with recommendations as to whether the proposal has reasonable prospects of benefiting the company.

A liquidator or administrator can also propose the reorganisation of the company, as their role includes the power to set up subsidiaries and transfer assets of the company.

6.2 Commencement of Insolvency Processes Impacting Lender's Rights

Commencement of an insolvency process has an overall negative effect on lenders, but the degree of the effect depends on whether the lender is a secured lender or an unsecured lender.

For unsecured lenders, the insolvency process effectively diminishes their rights to realise the loan and they are usually left at the mercy of the liquidator or administrator and the outcome of the insolvency process. Unsecured creditors rank in last place in the list of creditors.

For secured creditors, the insolvency process only limits their rights to a certain extent insofar as enforcement of the security is concerned. The lender cannot enforce the security without leave of the court or consent/approval of the relevant insolvency practitioner (ie, administrator or liquidator).

6.3 Payment Order to Creditors on a Company's Insolvency

Please see **5.4 Rules Governing the Priority of Competing Security Interests**.

6.4 Risk Areas for Lenders

Risk areas primarily concern enforcement and ranking. Please see **6.2 Commencement of Insolvency Processes Impacting Lender's Rights**.

6.5 Entities Excluded from Bankruptcy Proceedings

Section 3 (2) of the Insolvency Act provides that the Insolvency Act applies to natural persons, partnerships, limited liability partnerships, companies and other corporate bodies established by any written law. It should be noted that the Insolvency Act is relatively new and has not been applied extensively, so jurisprudence on this issue and whether it is all-encompassing is lacking. It remains to be seen whether courts will invoke provisions on the Insolvency Act even on government corporate bodies established by statute, noting that such institutions typically have their own dissolution mechanisms in the establishing statute.

7. Insurances

7.1 Restrictions, Controls, Fees and/or Taxes on Insurance Policies

There are generally no restrictions or controls on insurance policies over project assets. However, the Insurance Act provides that only a person registered under the Insurance Act can carry out insurance business in Kenya, meaning the business of undertaking liability by way of insurance and including the effecting and carrying on of contracts of guarantee – ie, contracts effected by way of business in return for a payment of one or more premiums.

7.2 Payable Insurance Policies over Project Assets to Foreign Creditors

Insurance policies over project assets are payable to foreign creditors, but consent from the Commissioner of Insurance may need to be sought as the Insurance Act provides that prior written approval of the Commissioner of Insurance is required where there is a transfer of any sum of money or securities out of Kenya whether in respect of or by way of premium, reserve value, claim, management expense, profit surplus, investment income, or other payment or sum of money that arises directly or indirectly out of insurance business.

8. Tax

8.1 Payments to Lenders Subject to Withholding Tax

Pursuant to section 35 of the Income Tax Act, chapter 470 of the Laws of Kenya (ITA), the payment of interest to lenders (both resident and non-resident) is subject to withholding tax at the rate of 15%. However, interest payments to licensed banks in Kenya are not subject to withholding tax. The due date for payment of withholding tax to the Kenya Revenue Authority (KRA) is the 20th day of the month after the payment has been made.

There are some sector-specific exemptions. By virtue of Legal Notice 91 of 2015, interest paid on loans advanced from foreign sources used to invest in the energy or water sectors, or in roads, railways or aerodromes, is exempt from withholding tax.

Further, Legal Notice 165 of 2015 provides that payments made to a non-resident person on account of services rendered under a Power Purchase Agreement shall be exempt from withholding tax.

Where a double tax treaty exists between Kenya and a foreign country, lower withholding tax rates for interest may apply. Kenya has double tax treaties in force with a number of countries, including the UK, Germany, Sweden, France, India, Zambia, Canada, Denmark, Norway, Iran, South Korea, Qatar, the United Arab Emirates and South Africa.

8.2 Taxes, Duties, Charges or Tax Considerations Relevant to Lenders

Pursuant to the provisions of the Stamp Duty Act, duty is charged at a nominal rate on certain financial instruments and transactions, including charges, debentures and guarantees relating to loans. However, pursuant to Legal Notice 106 of 2015, instruments executed in respect of transactions relating to loans from foreign sources received by investors in the energy sector, roads, ports, the water sector, railways and aerodromes are exempt from stamp duty.

Interest on loans is tax deductible as long as it is incurred on a debt obligation that has been incurred by a person in the production of its income.

Where a company is a foreign-controlled company, a ratio of 3:1 (debt to equity) must be maintained at all times to avoid a thin capitalisation position. This will be important from a foreign shareholder investment perspective.

A company is considered to be 'controlled' by a non-resident person where the non-resident person holds 25% or more of the issued share capital in the company. 'Debt' is deemed to comprise all types of financial indebtedness, while 'equity' is deemed to comprise all classes of share capital (including redeemable preference shares).

When a company is thinly capitalised:

- Interest expense above the thin capitalisation ratio of a thinly capitalised company is restricted as a tax deductible expense; and
- Realised foreign exchange losses in respect of the loans advanced are not tax deductible until the thin capitalisation position is reversed.

During the construction phase, if the loan is used for capital expenditure, the interest payable will be deemed to be capital in nature and therefore not tax deductible, but may be capitalised into the cost of the asset and capital allowance claimed accordingly. When normal operations commence, the interest will qualify as a tax deductible expense.

Kenya is in the process of reviewing its income tax regime through the Income Tax Bill, 2018 (ITB) with the aim of simplifying compliance and aligning it to international best practice within the Kenyan business context. The ITB is currently undergoing public participation, as part of the legislative process before the National Assembly, and it is expected to be enacted in the course of 2019.

The ITB proposes to reduce the thin capitalisation ratio to 2:1 and proposes to expand the definition of 'control' so that a person is said to be in control of a company when they hold more than 20% of the voting rights of the company, have power to appoint more than 50% of the board of directors/members of a company, indebtedness, intellectual property rights and influence on supply of goods, prices or markets. The reduction in the ratio will lead to a higher interest expense restriction and result in a higher taxable income for companies that exceed the debt-to-equity ratio.

8.3 Usury Laws or Other Rules Limiting the Amount of Interest Charged

Transfer pricing rules and rules on deemed interest are applicable where a non-resident lender and the Kenyan entity are related parties.

Transfer Pricing

Where the non-resident lender is related to the Kenyan entity (by virtue of common management or control), the interest rate charged on the loan ought to comply with the Income Tax (Transfer Pricing) Rules, 2006 (Transfer Pricing Rules), which are applied in determining the arm's-length price of goods and services. Based on the Transfer Pricing Rules, any interest charged on loans extended to a Kenyan entity by a related non-resident lender should comply with the arm's-length principle.

There are no specific transfer pricing penalties in Kenya. However, pursuant to section 18(3) of the ITA, the Commissioner of Domestic Taxes can conduct an audit and make adjustments on the taxable profit and demand tax where applicable. Any tax due and unpaid in a transfer pricing arrangement is deemed to be a tax shortfall under the provisions of the Tax Procedures Act, 2015. A tax shortfall penalty of 20% of the tax due would be payable, in addition to interest at a rate of 2% per month as long as the tax due remains outstanding.

The ITB proposes to introduce a penalty of 2% of the value of the transaction where a company fails to provide transfer pricing documentation. The ITB further provides that the imposition of the penalty does not prevent the Commissioner from assessing and recovering any taxes due.

Additionally, the ITB proposes to extend transfer pricing to transactions between resident companies and non-resident companies (including unrelated entities) situated in preferential tax regimes (defined as regimes that have tax rates of less than 16%, and which do not have effective exchange of information arrangements, do not allow access to banking information, or lack transparency on the details of its application, including details of corporate structure, ownership of the legal entities located in the country, beneficial owners of income or capital, or financial disclosure).

Deemed Interest
Deemed interest applies with respect to interest-free loans from a non-resident shareholder. Section 2(1) of the ITA defines deemed interest to mean an amount of interest equal to the average 91-day Treasury Bill rate, deemed to be payable by a resident person in respect of any outstanding loan provided or secured by the non-resident, where such loans have been provided free of interest. Where the lender is also a shareholder of the Kenyan entity and extends a loan on an interest-free basis, the Kenyan entity is required to calculate a deemed interest charge based on the prevailing Treasury Bill rates and the withholding tax of 15% on interest remitted to the KRA on a monthly basis.

The ITA does not provide a separate deemed interest rate for dollar or sterling-denominated loans, and therefore the prevailing Kenya Shilling Treasury Bill rates will apply. These rates are determined by the Central Bank of Kenya on a quarterly basis.

The ITB proposes to amend the definition of deemed interest to provide that deemed interest is triggered where a loan has been provided by a non-resident person who exercises control over the resident person, and the loan has been provided to the resident person at an interest rate that is lower than the market interest rate in the country of the non-resident. This in effect removes the possibility of providing notional interest rates for loans.

In Duplum Rule
Section 44A of the Banking Act (which applies to banks licensed by the Central Bank of Kenya) provides that a lender shall be limited in what it may recover from a debtor with respect to a non-performing loan to the maximum amount of the outstanding capital debt. In simple terms, the rule means that interest ought to stop running once it equals the unpaid principal amount.

9. Applicable Law

9.1 Law Typically Governing Project Agreements
Project agreements with government or governmental agencies are typically governed by Kenyan law. Furthermore, all project agreements entered into pursuant to the Public Private Partnerships Act, 2013 must be subject to the laws of Kenya.

9.2 Law Typically Governing Financing Agreements
Financing agreements are governed by the preferred law of the lender, which has typically been English law or New York law.

9.3 Matters Typically Governed by Domestic Law
All project agreements are subject to the laws of Kenya, including the following:

- the Power Purchase Agreement;
- the GOK Support Letter;
- the Land Lease Agreements; and
- the Key Permits.

10. Islamic Finance

10.1 Development of Islamic Finance
Kenya's Islamic finance industry has been in existence for more than a decade, but is not yet fully developed. Islamic finance institutions in the country operate under the same regulatory framework as their conventional counterparts.

The banking sector is the most developed, comprising three fully-fledged Islamic Banks and another 11 conventional banks offering Islamic banking products and services. The Islamic finance industry also includes one Takaful company and a Takaful reinsurance company. The first Islamic Bank to operate in the country was licensed in 2006, and Kenya has seen a steady growth of Islamic finance since then, including the products on offer. Whereas Islamic financial institutions continue to compete with conventional institutions, customers of Islamic Banks view the industry much more favourably on the basis of the social and ethical goals that it serves, rather than the mechanics of its operability and functions. However, a widespread lack of information has inhibited the development of Islamic finance in Kenya, with many of the eligible banking population still not aware that Shari'a-compliant financing is available to both Muslims and non-Muslims. Considering the fact that there is still low access to formal savings and borrowing among the Kenyan population, coupled with Kenya's position as a hub for Islamic finance, the demand for Islamic finance products is expected to remain strong.

With respect to project finance, while there have been no major developments and/or infrastructure projects financed through Islamic finance, investors and the government have made concerted efforts to tap into Islamic finance to finance developments and infrastructure projects in the country. The government has amended key pieces of legislation to provide Islamic finance institutions with a level playing ground with conventional institutions, and to enable the issuance of an Islamic bond to finance infrastructure projects, among other things. Once the requisite regulatory framework and regulations are in place, Islamic finance will provide an alternative source of funding for capital intensive projects and developments, to investors and the government.

10.2 Regulatory and Tax Framework

Kenya has laws and regulations in place that explicitly recognise Islamic banking practices, products and institutions, but some gaps remain. The Banking Act was amended in 2008 to include provisions for banks to provide non-interest financial products, and to allow banks to offer Islamic banking products through full-fledged Islamic banking. The amendment entailed the inclusion of a clause to recognise 'returns' as consideration for money lent/borrowed, as opposed to 'interest'.

The Central Bank of Kenya has also accommodated Islamic Banks by exempting them from provisions of the Banking Act that prohibit trading or investment in consideration of the nature of their business. However, the law does not provide adequate guidance on the Islamic contracts that are acceptable in Kenya.

The Capital Markets Authority also has powers to supervise and regulate Islamic banking investment activities. Corporate governance structures for Shari'a compliance are in place, but important gaps remain.

It is important to note that there is no Shari'a National Board in Kenya, unlike in other countries with a developed Islamic finance practice, and as such there is no governing body that oversees the manner in which Shari'a scholars perform their professional obligations. However, Islamic Banks are required to set up Shari'a supervisory boards as a subsidiary organ of their boards of directors. These supervisory boards have powers to rule on the compliance of products and contracts with a Shari'a element, and are required by law to evaluate and determine the Shari'a compliance of the Islamic Banks.

There are no provisions specific to Islamic Banks relating to audit requirements and, as such, there is currently no difference between Islamic Banks and conventional banks when it comes to disclosure requirements, except that Islamic Banks are required to publish a statement issued by their Shari'a board regarding the bank's state of Shari'a compliance. The consumer protection framework covers misrepresentation to the general public by someone or an entity holding itself out as conducting its banking business on a Shari'a-compliant basis, with consequences including cautionary warnings, fines and other administrative penalties.

There is no separate supervisory framework in respect of Islamic finance, as all banks in Kenya are regulated by the Central Bank of Kenya. With respect to Sukuk, the government issued a raft of amendments in 2017 to enable Kenya to issue its debut Sukuk in the near future, including amendments to the law to include a Sukuk as one of the modes through which government and county governments can raise finance, and amendments to Kenya's tax laws exempting structures used in the issuance of a Sukuk from the payment of stamp duty.

The Insurance Regulatory Authority opened the Takaful market to conventional insurers in 2015, enabling firms to offer Shari'a-compliant and conventional products side by side. The rules were effected in June 2015, with firms required to adhere to the requirements by December 2015. The Islamic insurance industry in Kenya includes one Takaful company and a Takaful reinsurance company. The Islamic insurance industry has not developed with the same zeal as its banking counterpart, largely due to the lack of an Islamic regulatory framework in the Kenyan insurance market.

10.3 Business Requirements for Islamic Banks to be Authorised/Admitted

A bank will be issued a standard bank licence, irrespective of whether it is an Islamic Bank or a conventional bank. There is also no difference between Islamic banking and conventional banks in terms of the framework that applies to management and shareholders; Islamic Banks are subject to the same prudential framework as conventional banks. The regulations relating to minimum capital requirements, fit and proper internal controls, liquidity, asset classification, provisioning, and related parties apply equally to conventional and Islamic Banks.

The only major distinction is that, upon application by an Islamic Bank, the Cabinet Secretary for Finance may issue an exemption to such bank from certain provisions of the Banking Act that prohibit banks from engaging in trade. These exemptions allow the Islamic Banks to offer their Islamic finance products under different financing structures without falling foul of the provisions of the Banking Act, usually for a period of five years. Takaful operators, on the other hand, have to meet the same requirements as other conventional insurance companies operating in the market.

10.4 Framework for Ensuring Shari'a-compliant Products

The main supervisory bodies for Islamic finance players are the Central Bank of Kenya, the Capital Markets Authority and the Insurance Regulatory Authority. In addition to these, each bank is required to have a Shari'a supervisory board, which approves all the products being offered by the particular Islamic Bank and ensures that they are Shari'a-compliant.

The Central Bank of Kenya is the regulator of all financial institutions and regulates both Islamic Banks and their conventional counterparts. Before a new product can be offered to the market by a banking institution, it needs to be approved by the Central Bank of Kenya.

The Capital Markets Authority also licenses fund managers and collective investment schemes, among others. To date, the Capital Markets Authority has licensed one Islamic fund manager and approved one Islamic Collective Investment Scheme. Furthermore, when investors want to raise money from the public through either conventional bonds or Islamic bonds, they have to seek the approval of the Capital Markets Authority before they can issue their prospectus to the public.

The Insurance Regulatory Authority, on the other hand, regulates all insurance companies, including the ones offering Takaful. Its key mandate is to ensure that insurance players comply with the provisions of the Insurance Act, and to approve the products of all insurance companies before they can be allowed into the market.

Anjarwalla & Khanna
The Oval, 3rd Floor
Junction of Ring Rd.
Parklands & Jalaram Rd.
Westlands
Nairobi

A&K ALN
ANJARWALLA & KHANNA

Tel: +254 20 364 0000
Email: bidsandsubmissions@africalegalnetwork.com
Web: www.africalegalnetwork.com/kenya