



REPUBLIC OF KENYA

OFFICE OF THE ATTORNEY-GENERAL
&
DEPARTMENT OF JUSTICE

AG/CONF/6/D/109 VOL II

8th April 2014

Your Ref: NT/DMD/SEC/GN/A

Mr. Henry Rotich
Cabinet Secretary
The National Treasury
Harambee Avenue
NAIROBI

Dear *Henry Rotich*

RE: LEGAL OPINION ON FOREIGN JUDGEMENTS - FIRST MERCANTILE
SECURITIES CORPORATION (FMSC) VS. REPUBLIC OF KENYA AND
UNIVERSAL SATSPACE (USS) VS. REPUBLIC OF KENYA

Reference is made to our letter dated 3rd April 2014 giving our final legal opinion and advice in the two cases currently pending with the execution proceedings to attach the assets of the Republic of Kenya before the High Court of Justice in England. We have given several opinions in the two cases and there have been several Cabinet resolutions directing that these matters be settled in the best interests of the Republic in accordance with the recommendations of the Public Accounts Report of May 2006

Brief summary of the cases

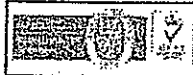
The two cases arose from two contracts signed by the Ministry of Information and Transport on 11th July 2002 for the purchase and supply of equipments and VSAT communication network for Postal Corporation of Kenya (PCK), at a contract price of USD\$ 11,787,000.00. The purchase was to be financed through a Financing Agreement with FMSC which authorised FMSC to pay the suppliers on behalf of the Republic of Kenya in order to discharge its obligations under the purchase contract. The Contract provided a penalty annual interest rate of 8.75% for any delayed payment.

The Contracts were implemented until August 2004 when the Government suspended further payments in all security related contracts following the Anglo Leasing saga.

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After the suspension of the payments FMSC demanded the balance of payments from the Government under the terms of the contract. No payments were made and in January 2006 FMSC filed a claim against GOK in the Geneva Tribunal of First Instance claiming USD\$12,716,250 plus penalty interest at an annual rate of 8.75% for breach of contract.

The Republic was represented by the firm of Lalive Advocats of Geneva. In 2008 the Geneva Court of First Instance disallowed the Republic's plea to include the PWC report which had the allegations of corruption in the procurement of the contracts and awarded summary judgment in favour of FMSC. The Republic appealed against the decision. The Republic's appeal was allowed and the case was sent back to the Court of First Instance for full hearing. The Geneva lawyers obtained an opinion on English law on the question on the allegations of corrupt practices and bribery in the procurement of the contract from one Collin Nichols QC.

The case was heard fully with the claimant and the Republic presenting their respective evidence and witnesses. Mr. Henry Mwithia of the former KACC gave evidence on behalf of the Republic and referred to the PWC Report's findings. On 6th December 2012 the Court delivered its judgement in favour of the claimant and made the following findings: -

- a) FMSC had proved its claim for breach of contract as there was no dispute that all the goods and equipments purchased under the contract were supplied.
- b) There was no dispute that FMSC had performed its part of the contract and paid the supplier USD\$11,787,573.30, but the Republic had only repaid USD\$6,872,750 leaving a balance of USD\$ 5,936,910.10.
- c) The Republic did not discharge its burden of proving the allegations of corruption and dishonesty or that the contract was unduly influenced by the former PS Mr. Sammy Kyungu through payment of school fees for his children by the claimant's managing director.
- d) On the issue of overpricing as alleged in the PWC report the Court ruled under English Law, the same would not be a consideration for the Court but a matter between the Supplier and even if overpricing were to be proved it would not affect the validity or a defence to the claim.
- e) The Court awarded the annual interest rate of 8.75% pursuant to clause 7.1 of the deferred payment agreement.

After the judgement, our office and the external legal team having consulted and noted the earlier legal opinion by the QC took the view that any further appeal would be futile as it would only increase costs since there were no sufficient grounds in law for a successful Appeal. The Court had determined the case in favour of FMSC on two occasions. The judgement of the Court was correct in law, as the Republic could only have voided the contract if it had discharged the burden of proof on any acts of corruption or dishonesty, with cogent evidence.

We therefore advised the Treasury to settle the award and drew their attention to the escalation of costs and accrual of interests.

The second case was filed in the High Court of Justice in England in July 2006 by USS claiming US\$12,366,816 in respect of the contract for the supply of the PCK

Bandwidth for 980 VSAT communication systems in Post Offices throughout Kenya for 10 years. The claim was for balance of payments due under the contract plus interest. The Claimant applied for summary judgement on 22nd March 2007. The Republic filed a defence on 8th August 2008 denying liability on the basis of PWC's report claiming overpricing on the cost of the bandwidth and public policy bar due to allegation of corruption and bribery.

The case was referred to mediation pursuant to the English civil rules of procedure which requires all civil claims to be referred to mediation. The Republic proposed a reputable international mediator Mr. William Wood Q.C as the mediator of the dispute on advice of PWC, who was accepted by FMSC.

Mediation sessions were held in Nairobi on 19th and 20th February 2013 where we had the input and advice of the Treasury's technical consultants from PWC led by Mr. Jack Ward and MR. Andy Middleton, an expert on bandwidth, from the UK advising the Government on the fair value of the costs of bandwidth. Through the guidance and disclosure of the allegations of corruption in the contract to the Mediator in private sessions, it became clear that the defence could only succeed if there was cogent evidence to place before the English High Court other than the PWC report alone. The issue of over pricing in English law was a matter between the buyer and seller.

After protracted negotiations with the guidance of the Mediator, the claimant was willing to accept a settlement for USD\$7.6 million as opposed to its claim for USD\$28,106,40. During the mediation sessions in private with the mediator, the issues of allegations of corrupt practices in the procurement and public policy bar were discussed and the chances of successfully defending the claim. The proposed settlement was forwarded to the PS Treasury for approval.

Upon failure to agree on the proposed mediated amount, the claimant filed an application seeking to strike GOK defence and counter-claim and a second application seeking summary judgement for the entire amount claimed. The matter came up for hearing on 20th December 2013 when the Court in England rejected the Republic's application for extension of time to approve the mediated agreement on the grounds that the case was an old matter and the Republic had delayed resolving the matter.

The Court entered judgement for \$7.6million the amount proposed in the mediation. The costs were reduced from £75,000 to £60,000. The amount due as at 10th January 2014 was \$8,007,496 which is incurring interest at the rate of \$1,665 per day and the deadline for payment was 17th January 2014.

Way Forward

These two litigations have affected the Sovereign Bond issue process. Upon disclosure of the two cases to the Lead Counsel and the Joint Lead Managers (JLMs) in the transaction the Republic has been advised that the judgements must be resolved before the transaction is launched and the JLMs have indicated that they would not initiate the Road Shows for the Bond if the litigations remains unresolved due to the risks of attachment against the proceeds of the Bond posed by the judgement creditors.

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Our office sought advice from English Solicitors on the chances of appeal and stay of execution before the English Courts where the cases are pending. The advice from the English Solicitors, which is consistent with the advice of the firm of Arnold & Potter, who are the Lead Counsel in the sovereign bond transaction, is that it would be most unusual for litigation to be disclosed in Bond process and that the GOK must resolve the two matters with the judgement creditors for the Bond process to proceed.

Taking into account the legal risk posed by the cases, which will result in the judgement creditors proceeding with their enforcement proceedings for the full amount awarded in the judgements plus interest and in view of the advice that there are no further legal avenues available to the Republic to seek further remedies against the enforcement proceedings, our legal advice is that the Republic should accept the proposed settlement agreement, the negotiated amount is reasonable and favourable to the Republic and will save the Government from further losses.

Further note that the proposed settlement is in respect of civil law claims and not the criminal process relating to these two cases and which is still alive and EACC is handling that process. EACC has been informed of the proposed settlement.

These two cases are not part of the so called Anglo Leasing contracts which GOK has publicly stated were revoked and funds returned to the Treasury. We have received mutual legal assistance from a number of foreign Governments in respect of the other contracts and have forwarded documents and information to the EACC.

Yours


GITHU MUIGAI, EGM, SC
ATTORNEY GENERAL

Copy to:

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Secretary/CEO
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