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Ref: NT/DMD/SEC/GN "D"

11<sup>th</sup> April 2014

Mrs. Agnes Odhiambo  
The Controller of Budget  
Bima House  
NAIROBI

Dear *Agnes,*

**SETTLEMENT OF FOREIGN COURT JUDGEMENTS AGAINST GOK: FIRST  
MERCANTILE AND UNIVERSAL SATSPACE**

**I. Background**

1. The Government is planning to issue the first International Sovereign Bond for approximately US\$1.5 billion (equivalent to Ksh 130 billion) to finance the Fiscal Year 2013/2014 budget. Towards this process, the National Treasury has contracted international Lead Counsel and Joint Lead Managers to assist in the transaction. These advisers are working with a GoK team comprising of officers of the National Treasury, Central Bank of Kenya and the Attorney General's Office.
2. The preparation of the Bond Offering Circular (OC) is well under way and it has been submitted to the Irish Stock Exchange where the Bond will be listed for trading. The OC is currently being reviewed and finalized. However, the next steps in the process cannot be undertaken due to two outstanding litigation issues.

3. As part of the Bond issuance process, GoK is expected to disclose all litigation cases against it and state whether they pose risks to the bond investors. In Kenya's case the following two cases pose a big risk to the bond issuance.

**a) Broadband Network Project (First Mercantile Securities Corporation)**

The facts of this case are as follows:-

- The project involved supply of VSAT equipment by Spacenet to connect all the post offices in Kenya. First Mercantile Securities Corporation (FMSC) guaranteed payments for the supplied equipment.
- On 12<sup>th</sup> August 2004, GOK suspended payments for this project when it was listed among the so-called "Anglo-Leasing" projects.
- Arising from the suspension of payments, in January 2006, First Mercantile Securities Ltd filed a claim of US\$12.7 million plus penalty interest at 8.75 p.a. against the Kenya government in Geneva Court of First instance.
- On 14<sup>th</sup> May 2009, the suit was determined against GoK for \$6.0 million (Ksh516 million).
- The Attorney General lodged an appeal but this was defeated in November 2012 and a Judgement of \$10.1 million (Ksh868 million) was made against GoK.
- This amount continues to attract interest of \$1,413 per day beginning 6<sup>th</sup> December 2012.
- The amount due for payment, including accrued interest and cost as at 24<sup>th</sup> March 2014 is \$10.7 (Ksh920 million) and the claimant has sought Registration of Judgement in the High Court in London to compel Kenya to pay or else proceed with attachment proceedings.
- GOK also received a notice of attachment of GOK Mission assets in Geneva due to non-payment.

- GOK also received a demand letter for payment of the judgement debt giving 24<sup>th</sup> March, 2014 as the final deadline after which the claimant will start enforcement proceedings.

**b) Bandwidth Network Project ( Universal Satspace)**

The litigation on this project is related to (a) above and the facts of the case are as follows:

- Universal Satspace signed an agreement with GoK for provision of bandwidth and network management for 10 years for all the Post Offices under project (a) above.
- As with the case of First Mercantile payments were similarly suspended. After suspension of payments on 12<sup>th</sup> August 2004, a suit against GoK was filed in London in July 2006, seeking US\$12.3 million.
- Protracted suit terminated in the case being referred to mediation pursuant to the English civil rules of procedure to resolve the issue.
- Mediation in Nairobi in February 2013 agreed on payment of \$7.6 million (Ksh653 million) by GoK. After waiting for 10 months to be paid as agreed the claimant went to court in London on 20<sup>th</sup> December 2013 and judgement was upheld and Kenya was expected to pay \$7,874,431. (Ksh 677 million) being principal of \$ 7,600,000 and interest of \$ 274,431) by 17<sup>th</sup> January 2014 inclusive of costs of £60,000.
- This amount continues to attract interest at 8.75% per annum which translates to \$1,665 per day beginning 21<sup>st</sup> December 2013.

In both cases, the claimant's legal counsel, Travers Smith LLP, of London on 21<sup>st</sup> March 2014 wrote to Arnold & Porter, the National Treasury's Lead Counsel for the Sovereign Bond, making a clear link to the two cases to the sovereign bond issuance and their intention to interfere with the bond process by disclosing to prospective investors Kenya's continued breach of judgement orders is a demonstration of failure to comply with its contractual obligations and to adhere to the rule of law.

## **II. Risks posed by the judgements**

These litigations pose various risks to the Republic, which include:-

### **a) Stoppage of the Bond process**

These litigations have complicated the Government's plan to issue the first International Sovereign Bond amounting to at least US\$1.5 billion (equivalent to Ksh 130 billion) to finance the Fiscal Year 2013/2014 budget. In both cases, the claimant's legal counsel, Travers Smith LLP, of London on 21<sup>st</sup> March 2014 has written to Arnold & Porter, the National Treasury's Lead Counsel for the Sovereign Bond, making a clear link between the two cases and the sovereign bond issuance. Specifically, their intention is to interfere with the bond process by disclosing to prospective investors that Kenya's continued breach of judgement orders is a demonstration of failure to comply with its contractual obligations and to adhere to the rule of law. This development in effect means that the bond issuance process is stalled unless GoK settles the litigation cases.

Arnold & Porter, the Republic's Lead Counsel for the Bond and SNR Dentons, counsel instructed to represent the Republic in the enforcement proceedings in the UK have both advised the Republic to resolve the judgements before the Bond transaction is launched. The Joint Lead Managers (JLMs) for the Bond transaction, aware of the litigations, have indicated their reluctance to support the bond issuance if the payments are not made.

### **b) Enforcement of judgements/attachment of GoK assets**

The claimant has also applied to international courts seeking to enforce the judgement in both cases and attach GoK assets.

### **c) Fiscal risk**

The stalled bond process means that the proceeds of the bond, which are already factored in the 2013/2014 budget, will not be available and the budget cannot therefore be implemented including the repayment of the syndicated loan of US\$600 million contracted in 2012 falling due in May 2014. Such a scenario would result in serious macro-economic dislocations with a likely sharp increase in interest rates, which would have a serious adverse effect on the growth of the economy.

d) **Interest charges on the judgements**

It is also noted that whether GoK proceeds with the bond or not, interest charges on the judgement debts continue to accrue as follows.

- For the First Mercantile case @ US\$ 1,413 (Ksh 122,931) per day since 6<sup>th</sup> December 2012.
- For the Satspace case @ US\$ 1,665 (Ksh 144,855) per day since 20<sup>th</sup> December 2013.

The judgement debts therefore need to be paid to avoid further loss to GoK.

e) **Consultations with Parliament**

The National Treasury sought and received audience with the parliamentary committee on budget and appropriations on 18<sup>th</sup> February 2014 and the joint Budget and Appropriations and Finance, Planning and Trade Committees on 19<sup>th</sup> February 2014.

Both committees were of the opinion that the debts should be settled on condition that the National Treasury provides to them the Legal Opinion of the Attorney General and evidence of approval by the executive.

III. **Cabinet approval to negotiate**

A committee of the cabinet was formed to look at the issue. The National Security Council (NSC) meeting held on 25<sup>th</sup> April 2013 directed the Chief of Staff and Head of Public Service, the Cabinet Secretary National Treasury, the Attorney General, Cabinet Secretary Foreign Affairs and Cabinet Secretary for Defence to explore whether there were any other avenues that could be used to settle the matter, and to proceed on the basis of what they agree after briefing the President.

The Attorney General hired Dentons of UK, an International Law firm to advice on whether any other avenue exists that could be used. Dentons advised that there was no legal avenue left for GoK apart from settling the payments.

IV. **Negotiations to resolve the issue**

Following these complications and risks to the sovereign bond, threats to Kenyan assets, the fiscal risk involved, the continued loss to the Republic on account of accrued interest on the judgements as well as the Attorney General's advice to

reach a negotiated position, the Government, represented by the office of the Attorney General and the National Treasury held negotiation meetings with the claimant's counsel on 28<sup>th</sup> March 2014 and on 1<sup>st</sup> April 2014 in an attempt to resolve the issue. *(Minutes of the meetings are attached as Annex I & II).*

The following is a summary of the Republic's and claimant's positions during the negotiations:

Judgement debts (as at 28 <sup>th</sup> February 2014)		GoKs offer	Claimant's counter offer
Satspace	<ul style="list-style-type: none"> <li>• \$7.6 mn (mediation)</li> <li>• \$393,321 (Interest)</li> <li>• \$98,100 (costs)</li> </ul>	\$7.6 mn	<ul style="list-style-type: none"> <li>• \$7.6 mn (mediation)</li> <li>• \$393,321 (Interest)</li> <li>• \$98,100 (costs)</li> </ul>
<b>Sub-Total</b>	<b>\$8.09 mn</b>	<b>\$7.6 mn</b>	<b>\$8.09 mn</b>
First Mercantile	<ul style="list-style-type: none"> <li>• \$5.89 mn (Principal)</li> <li>• \$4.69 mn (Interest)</li> <li>• \$87,280 (costs)</li> </ul>	\$5.9 million	<ul style="list-style-type: none"> <li>• \$5.89mn (Principal)</li> <li>• \$2.34 mn (Interest)</li> <li>• \$87,280 (costs)</li> </ul>
<b>Sub-Total</b>	<b>\$10.67mn</b>	<b>\$5.9 mn</b>	<b>\$8.33 mn</b>
<b>Total</b>	<b>\$18.76mn</b>	<b>\$13.5 million</b>	<b>\$16.42</b>

Following the second negotiation meeting held on 1<sup>st</sup> April, 2014 the Republic requested the claimant to reduce the interest further to US\$1,174,731 in the First Mercantile case, on the Republic's pledge to pay the Agreed Amount in one installment on or before 28<sup>th</sup> April, 2014. However, they came back to indicate that their position remains at US\$16.4 million as the final Agreed Amount. The Treasury is agreeable to this amount given that the Republic has negotiated a reduction of US\$2,349,461 from the initial claim of US\$18,771,106 to US\$16,421,662 translating to a discount of 13 percent.

#### V. Attorney General's legal opinion request

The Attorney General was requested to give his final opinion on the issue and this was done vide his letter reference AG/CONF/6/D/109 VOL II dated 3<sup>rd</sup> April 2014. *(Attached as Annex III)*

**VI. Consultation with Ethics and Anticorruption Commission**

The Secretary and Chief Executive Officer of Ethics and Anti corruption Commission has been briefed and he has given his opinion vide letter reference EACC.6/2/3/1 dated 3<sup>rd</sup> April 2014. *(Attached as Annex IV)*

**VII. Payment approval by the Cabinet Secretary and the Principal Secretary**

After the consultations detailed above, the payment of the judgement debts has been approved by both the Cabinet Secretary and the Principal Secretary in flagged folio 33. *(Attached as Annex V)*

**VIII. Special Authorization**

From the foregoing consultations and approvals, and in accordance with the Settlement Agreement Letters *(attached as Annex VI)*, the National Treasury has prepared the attached PAs no. 101199 and 101200 for a total of \$16,421,662 to settle the judgement debts. I have signed the PAs under delegated authority by the Principal Secretary vide the letters dated 7<sup>th</sup> April, 2014. *(Attached as Annex VII)*

**IX. Request**

The purpose of this letter is to request the Office of the Controller of Budget to consider and approve grant of credit to pay the judgement debts.

Yours

*Sincerely*

*Mutua Kilaka*

**MUTUA KILAKA, CBS, SS.  
FINANCIAL SECRETARY  
FOR: PRINCIPAL SECRETARY, NATIONAL TREASURY**