

# DELIBERATE LOOPHOLES

Transparency Lessons from the Privatisation of Telkom and Safaricom

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AFRICA CENTRE FOR OPEN GOVERNANCE  
(AfricOG)

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## Disclaimer

All attempts have been made to verify information provided in this publication and to ensure the validity and factual accuracy of all assertions in this report. However, in the event that some information may have been superseded by events AfriCOG welcomes feedback to enable updates of future editions of this publication.

## ABBREVIATIONS AND ACRONYMS

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<b>AfriCOG</b>	Africa Centre for Open Governance
<b>AG</b>	Attorney General
<b>AGM</b>	Annual General Meeting
<b>ASIC</b>	Australian Securities and Investment Commissions
<b>CAG</b>	Controller and Auditor- General
<b>CBN</b>	Central Bank of Nigeria
<b>CCK</b>	Communications Commission of Kenya
<b>CDMA</b>	Code Division Multiple Access
<b>CMA</b>	Capital Markets Authority
<b>IEA</b>	Institute of Economic Affairs
<b>IFC</b>	International Finance Corporation
<b>IPO</b>	Initial Public Offer
<b>KACC</b>	Kenya Anti-Corruption Commission
<b>KANU</b>	Kenya African National Union
<b>KCC</b>	Kenya Co-operative Creameries
<b>KENAO</b>	Kenya National Audit Office
<b>KENEXTEL</b>	Kenya External Telecommunications
<b>KENGEN</b>	Kenya Electricity Generating Company Limited
<b>KMC</b>	Kenya Meat Commission
<b>KP&amp;TC</b>	Kenya Post and Telecommunications
<b>KRA</b>	Kenya Revenue Authority
<b>KWAL</b>	Kenya Wine Agencies Limited
<b>KYC</b>	Know Your Customer
<b>NASD</b>	National Association of Securities Dealers
<b>NBK</b>	National Bank of Kenya
<b>NSE</b>	Nairobi Stock Exchange
<b>NYSE</b>	New York Stock Exchange
<b>PAC</b>	Public Accounts Committee
<b>PIC</b>	Public Investments Committee
<b>PIM</b>	Preliminary Information Memorandum
<b>PPP</b>	Public Private Partnership
<b>SFO</b>	Serious Fraud Office
<b>SGM</b>	Special General Meeting
<b>SNO</b>	Second National Operator
<b>SOE</b>	State-Owned Enterprise
<b>VKL</b>	Vodafone Kenya Limited

# FOREWORD

In this report, AfriCOG documents the privatisation/divestiture of Telkom and Safaricom. *“Deliberate Loopholes”* describes some of the lapses that occurred in the privatisation of Telkom Kenya and Safaricom: the title refers to the deliberate evasions and subterfuges that created a fertile climate for asset stripping and corruption by senior officials whose identity continues to remain shrouded behind the veil of secrecy provided by international tax havens and off-shore financial centres. The preliminary findings of this study were presented to Parliament’s Public Accounts Committee (PAC), which took the matter to the floor of the House.

AfriCOG’s interest in this area stems from its mandate to build and entrench an anti-corruption culture through informed and determined public action, both in the public and private sectors. Effective privatisation requires a robust regulatory environment. Regulators need to be independent in delivering on their mandate and achieving outcomes that protect the public interest and advance Kenya’s development. However, these bodies face the constant reality or threat of capture by special interests.

Kenya is currently engaged in an extensive series of privatisation exercises, with around 23 major public enterprises slated for or engaged in some sort of privatisation. The unanswered questions surrounding the sale of the Laico Grand Regency Hotel are still fresh in the public’s memory. By providing objective information on the privatisation of Telkom Kenya and Safaricom, AfriCOG aims to promote public knowledge and vigilance on other public divestment ventures. Furthermore, the general public has a huge stake in privatisation considering the significant investments that citizens have made in building these institutions in the first place and the gains that ordinary investors hope to make from their divestiture.

Given the market dominance of the entities involved and the endemic corruption that plagues Kenya, it is perhaps inevitable that many of these exercises have been shrouded in political controversy. From experience, large scale privatisation is a process that can be particularly prone to political corruption, or the theft of public resources to fund elections. Since 2012 portends a particularly hard-fought and conflictual election, heightened scrutiny against possible abuse of privatisation of state-owned enterprises with the aim of financing politics would be prudent.

The probity issues arising from the privatisation of Telkom Kenya and Safaricom will certainly impact on public confidence in upcoming Initial Public Offers (IPOs); the process brought to light the unknown risks that investors were exposed to due to the lack of background knowledge and irregularities in the exercise. Telkom Kenya’s privatisation remains clouded by dissension and lack of access to information. Following the conclusion of the deal, there was further dispute between France Telecom and the government of Kenya.

AfriCOG acknowledges the contribution of the Civil Society Task Force on Grand Corruption to the origins of this work (see appendices). We also thank our dedicated team and Board members for their commitment.

We hope this report will contribute to strengthening public vigilance over this important area of politics and the economy so that the fruits of privatisation are employed towards improving the welfare of ordinary Kenyans, rather than risking fattening the bank accounts of a few greedy and unaccountable individuals.

Gladwell Otieno  
Executive Director

# EXECUTIVE SUMMARY

## INTRODUCTION

**T**he Kenya Government is preparing to sell its stake, partial or total, in over 26 corporations by inviting strategic partners (Public-Private Partnerships) or by offering shares on the Nairobi Stock Exchange (Privatisation). The State-Owned Enterprises (SOEs) targeted for divestiture include:

- Consolidated Bank
- Development Bank
- National Bank of Kenya (NBK)
- Kenya Ports Authority
- Kenya Pipeline Company
- Kenya Wine Agencies Limited (KWAL)
- Kenya Meat Commission (KMC)
- New Kenya Cooperative Creameries (New KCC)
- the Agrochemical and Food Corporation
- East African Portland Cement Company
- Numerical Machining Complex

Five sugar companies and eight hotels are also up for sale. Before these sales take place, the country urgently needs to take stock of and learn from recent attempts at privatisation.

Although there have been some successes - for example the government's partial divestiture of Kenya Airways and the Kenya Electricity Generating Company Limited (KenGen) — the privatisation of other companies such as Telkom and Safaricom raise grave issues of transparency and disclosure, which should be examined in the interests of protecting planned similar exercises from suffering the same defects.

## SUMMARY OF KEY FINDINGS

### Key Probity Concerns

Briefly, the privatisation of both Telkom Kenya Ltd and Safaricom Ltd raises troubling probity issues that will inevitably impact on public confidence in upcoming IPOs:-

1. They occurred outside the Privatisation Act, which was passed, and received presidential assent, in 2005. The final steps of the privatisation processes were carried out with astounding speed, outside the law and in complete disregard of the recommendations of parliament's Public Investments Committee (PIC). Even now, the law is yet to be fully operationalised as the Privatisation Appeals Tribunal has not been set up.
2. The then Minister for Finance delayed gazetting the Privatisation Commission until December 20, 2007. Even then, he only did so because of a pending case in court seeking orders to compel him to do so.
3. The sale of Safaricom shares was carried out against the express recommendation of the parliamentary Public Investments Committee (PIC). The Committee's inquiries into the ownership transactions surrounding the mobile telephone company had found these dealings to be fraught with irregularities. Specifically, the PIC found that the 10% shareholding of Telkom Kenya Limited that was transferred to Mobitelea Ventures Limited was done irregularly, without the consent of Treasury and that of the parent ministry. The PIC recommended that further investigations

be made, locally and abroad, including investigations by Britain's Serious Fraud Office (SFO), and that the Initial Public Offer (IPO) of Safaricom Limited be suspended until such time when the investigations into the transfer of Safaricom's shares to Vodafone PLC and Mobitelea were completed.<sup>1</sup>

4. The Privatisation Commission became effective on January 1, 2008, when the sale of Telkom Kenya had already been concluded, and the privatisation of Safaricom Limited was at an irreversibly advanced stage. The Privatisation Appeals Tribunal, the statutory disputes resolution mechanism that deals with complaints over government divestiture, is still not in place.
5. The final stages of the sale of Telkom Kenya and the privatisation of Safaricom Limited occurred in great haste and under circumstances that were less than transparent.
6. The privatisation of the two companies changed the design of ownership of the telecommunications sector in Kenya. The sale placed the two largest companies in the sector out of the reach of parliamentary oversight and scrutiny at a time when there were grave concerns about how their ownership changed hands over a nine-year period.

## KEY DISCLOSURE FAILURES

### 1. The consortium that never was

Among the key failures are the partial disclosures made by Telkom's purchaser, France Telecom

in December 2007. On the face of it, the Kenya Government sold 51 per cent of its stake in the country's only fixed line telecommunications company to a consortium of foreign companies for KES 26 billion. As part of the sale agreement, the government took up Telkom's debts and its shareholding of Safaricom before the sale. However, it turned out upon sale that France Telecom was not representing a consortium and that its only partner is Alcazar Capital, a Dubai-based company.<sup>2</sup>

### 2. Lack of clarity about market valuation of Telkom Kenya Limited

The government further transferred Telkom's 60 per cent shareholding in Safaricom Ltd to the Treasury. The sale effectively put the market value of Telkom Kenya, without counting the value of its ownership of Safaricom, at KES 50.98 billion. Although an International Finance Corporation (IFC)<sup>3</sup> valuation of Telkom Kenya is believed to have been used as the basis of this transaction, it has not been made public.

### 3. Shadowy shareholders in Safaricom

Safaricom is 40 per cent owned by Vodafone Kenya Ltd, who until recently was 87.5 per cent owned by Vodafone UK and 12.5 per cent by the Mobitelea Ventures. Mobitelea's real owners are undisclosed and were hidden behind two nominee firms Guernsey-registered Mercator Nominees Ltd and Mercator Trustees Ltd. The directors are named as Anson Ltd and Cabot Ltd, based in Anguilla and Antigua. This has been a lingering query: the stake was acquired at the beginning of 2000, during Daniel arap Moi's presidency. Although the nature of the shareholding was never resolved,

the government of Kenya went ahead to sell 25 per cent of its 60 per cent shareholding through an IPO. Documents obtained by the Guardian Newspaper show that Mobitelea was registered in Guernsey on June 18, 1999 - several months after Vodafone had struck a preliminary deal with the Kenyan government.<sup>4</sup> Safaricom is now 35 per cent owned by the Government of Kenya following the IPO. The company issued 10 billion new shares and offered them for sale to the public at KES 5 each.

## KEY RECOMMENDATIONS

In order to pre-empt systemic failures observed in the privatisation of Telkom Kenya and Safaricom, the following steps need to be urgently taken:

### 1. Take action on the recommendations of the Public Investments Committee

There is need to create a mechanism that triggers action and sanctions against those who defy the recommendations of parliamentary committees such as the Public Accounts and Public Investments Committees. The parliamentary Public Investments Committee's (PIC) recommendation that the Safaricom IPO be put on hold until the ownership of the company had been resolved, was egregiously ignored. For future transactions the provisions of the Fiscal Management Act relating to imposition of personal sanctions on officials should be exercised in the event of non-compliance<sup>5</sup>.

### 2. Hold to account those responsible for implementing recommendations of the PIC

Parliament needs to strengthen its own internal mechanism for holding to account those who bear responsibility for implementing its recommendations. The PIC Report recommended

that certain individuals be barred from holding public office because of their conduct with regard to the transfer of Safaricom's shareholding. No action has been taken on this recommendation to date. Also, a very pointed recommendation was made to the Kenya Anti-Corruption Commission (KACC) to investigate the loss of the 10 per cent public shareholding in Safaricom and report back to Parliament in a specified time frame. The KACC's Annual Reports of 2007, 2008, 2009 and 2010 are silent on this PIC recommendation. It is not clear whether an investigation was undertaken by the KACC or a report made.

### 3. Fully operationalise the Privatisation Act

The Privatisation Act should be brought into full operation, complete with the installation of a Privatisation Appeals Tribunal to oversee all government divestiture and ensure it is always above board.

### 4. Strengthen the transparency provisions of the Privatisation Act

The opacity surrounding the privatisation of these two corporations indicates that the transparency provisions of the Act are weak. It is clear that there is too much room for executive discretion in the privatisation process.

### 5. Strengthen the regulatory capacity of the Capital Markets Authority<sup>6</sup>

The Capital Markets Authority Act needs to be revised to strengthen the institutional capacities of the Authority to function as an efficient and effective regulator of capital markets. In particular, disclosure rules and regulations must compel the disclosure of both nominal and

1 See AfriCOG's statement "Cause for Public Concern on the Telkom Privatization and Safaricom IPO" [www.africog.org/reports/cause\\_for\\_concern\\_over\\_safaricom\\_IPO.pdf](http://www.africog.org/reports/cause_for_concern_over_safaricom_IPO.pdf)

2 Currently, France Telecom-led consortium's total share-holding of 51 per cent is split between France Telecom and Dubai based Alcazar Capital, with the former owning a 78 per cent share while Alcazar has 21 per cent. See "Lights dim on Telkom's NSE Listing" Daily Nation, April 15, 2010. <http://www.nation.co.ke/magazines/smartcompany/Lights%20dim%20on%20listing%20as%20Telkom%20misses%20targets%20-/1226/906392/-/item/0/-/mx7li4/-/index.html>

3 IFC is a member of the World Bank Group. IFC provides investments and advisory services to build the private sector in developing countries. See [www.ifc.org](http://www.ifc.org)

4 "Kenyan inquiry into Vodafone's mystery partner". The Guardian. 2007-02-16. <http://www.guardian.co.uk/kenya/story/0,,2014579,00.html>. Retrieved on 2007-10-09.

5 In addition to the provisions of the FMA on withholding of approval, the New Standing Orders provide the Implementation Committee this withholding mechanism as well as the power to propose sanctions for government officials who fail to implement House resolutions.

6 See AfriCOG's comments on the Capital Markets Authority regulations at [www.africog.org/reports/AfriCOG\\_comments\\_on\\_the\\_Capital\\_Markets\\_Authority\\_regulations.pdf](http://www.africog.org/reports/AfriCOG_comments_on_the_Capital_Markets_Authority_regulations.pdf)

beneficial owners of shares even though such names may be in a register closed to public scrutiny. The current disclosure requirements are minimal and are limited to financial information only. Information about directors and management is merely perfunctory. It is a key objective of securities regulation in general to ensure that market participants have sufficient information in order to participate in the market on an informed basis. Consistent with emerging best practice, those making IPOs or listing on the stock market should disclose full information about all transaction advisers.

#### **6. Enact laws to regulate borrowing for investment in securities**

Poorly regulated capital markets pose a danger to the public. The lack of investor education, as well as the absence of legislation and regulations saw many first-time investors taking loans to buy shares. Laws to regulate borrowing for investment in securities are urgently required. Laws modelled on those in Australia and the USA on margin lending would help to ensure greater investor protection.

#### **7. Strengthen the Registrar of Companies**

The office of the Registrar of Companies should be strengthened to carry out its mandate under the

Companies Act. It is unacceptable that companies should flout reporting rules and not face any legal consequences. In addition, greater transparency is needed on ownership of companies, including beneficiaries.

#### **8. Amend the Companies Act**

The Companies Act needs to be amended to provide sufficient protection for minority shareholders' rights.

#### **9. Simplify investment codes and clarify definitions in the Privatisation Act**

Investment codes should be simplified and the definition of a foreign investor clarified in our legislations to ensure that unscrupulous individuals do not use it as a cloak for hiding corrupt and unethical practices.

#### **10. Ensure that laws that have been passed by Parliament and assented to by the President are brought into effect within a specific timeframe**

The Privatisation Act was, inexcusably, held in abeyance for over two years after it was passed by Parliament and received Presidential assent, thereby allowing the privatisation of Telkom/Safaricom to take place in a legal vacuum.

## 1. SELLING OFF TELECOMS

### **Historical background**

The structural adjustment reforms of the mid-1980s ushered in an era of limited government, trade liberalisation and privatisation of state-owned enterprises. The critique was that government had run business inefficiently, incurred huge budget deficits in the process and crowded out the private sector. The remedy proposed was that governments, including Kenya's, needed to divest from business, strengthen their regulatory function and create an environment conducive to the private sector.

In implementing privatisation policies, however, governments routinely made a distinction — often driven by political considerations — between 'strategic' and 'non-strategic' investments, readily privatising the former while restructuring the latter and continuing to operate them — and only agreeing to sell them off as a last resort. As with many developing countries grappling with the economic crisis of the late 1970s and 1980s, the Kenya Government did not readily embrace economic liberalisation and privatisation. State-Owned Enterprises (SOEs) had long been cash cows for the politically-connected and central to the country's patronage politics.

In the case of the telecommunications sector, the reluctance to privatise was buttressed by national security and strategic arguments. These seemed plausible, given the fact that in the execution of many of the continent's coup-d'etats, telecommunications infrastructure was often a key target. Indeed, the capture of the Kenya External Telecommunications (KENEXTEL) was one of the prime goals of the insurgents of the 1982 coup attempt in Kenya.

### **A sector in transition**

The Kenya Posts and Telecommunications Corporation [KP&TC] — incorporating KENEXTEL after 1982 — was one such strategic company the government originally retained after the early privatisations.

In 1999, the KP&TC was split into three wholly government-owned corporations; the Communications Commission of Kenya (CCK, the regulator), Telkom Kenya (telecommunications) and the Postal Corporation of Kenya<sup>7</sup>. Telkom Kenya launched the monopolist Safaricom Limited mobile telephone service in 1993. Competition for Safaricom arrived in the form of the privately-owned Kencell Communications (later Celtel Kenya and then Zain<sup>8</sup>) in 1999. Persistence by development partners, from whom aid was solicited to cover the financing shortfalls of an inefficient public sector, including loss-making state corporations, pushed the privatisation agenda into these strategic interests. The inefficiency of the state-owned Telkom Kenya eventually forced the argument for the proponents of privatisation. Very much in concert, the increased privatisation of the seemingly highly profitable Safaricom Limited was not far behind.

### **Haphazard restructuring**

But the haphazard manner in which state corporations were being privatised or restructured for improved efficiency raised concerns in civil society. Most privatisations were opaque and asset-stripping, benefiting a minority — i.e. taking company funds or assets of value while leaving behind its debts — was rife. In 1998/1999 the Institute of Economic Affairs (IEA-Kenya) called for the creation of a bona fide privatisation framework. These efforts

<sup>7</sup> In theory, separating regulation of telecommunications from telephony and postal services would increase efficiency and reduce conflicts of interest in a free market environment.

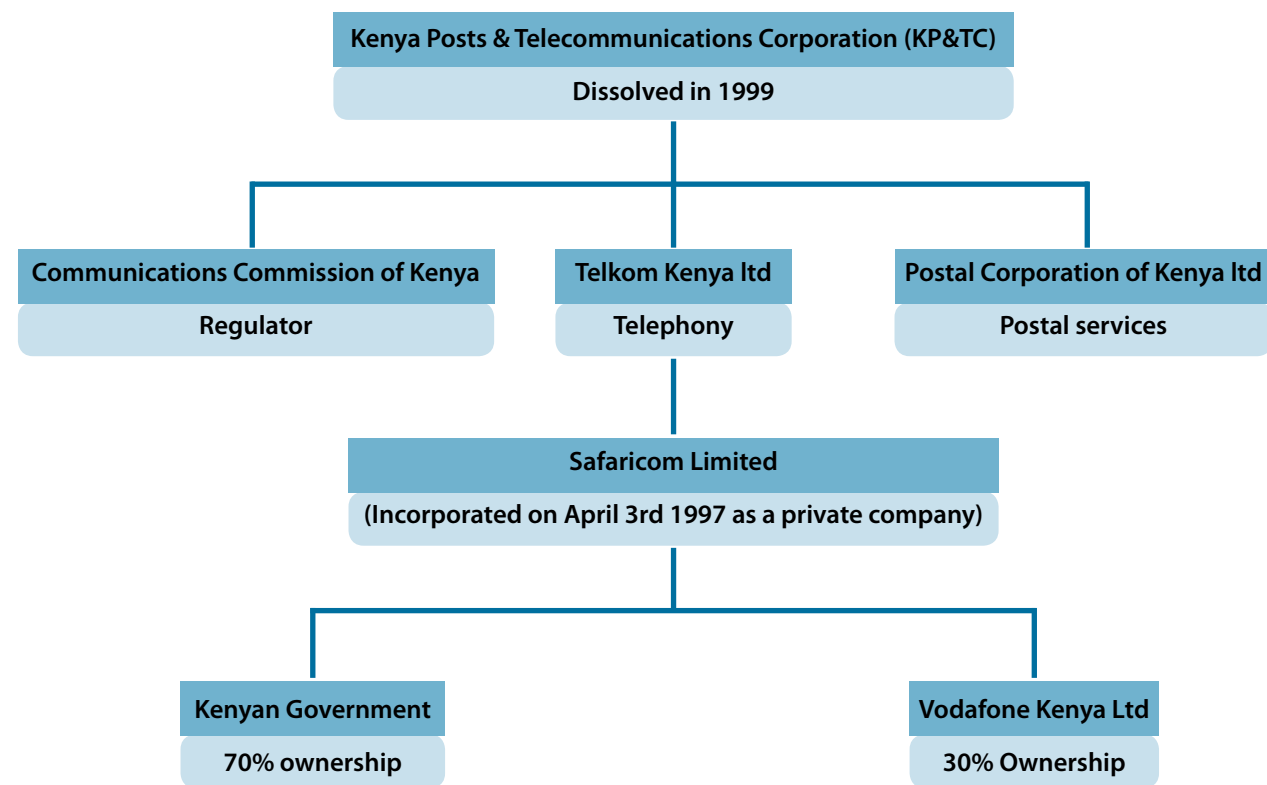
<sup>8</sup> Re-branded to Airtel in November 2010



culminated in the drafting of the Privatisation Bill in 2000. It was introduced in Parliament as a Private Member's Bill, clearly reflecting the government's reluctance to champion such a law. Indeed, while the Privatisation Act was passed and assented to by the President in 2005, the Finance Minister did

not gazette the Privatisation Commission — which triggers the law into effect — until threatened by a court case on the matter in December 2007, on the eve of the sale of both Telkom Kenya and Safaricom Limited.

### Kenya Telecommunications Sector after July 1999



## 2. LEGAL FRAMEWORK FOR PRIVATISATION

The Privatisation Act 2005 was enacted after nearly a decade of botched privatisations in which the public lost billions of shillings through asset-stripping and undervaluation by politically-connected businessmen. The Privatisation Act states that public assets can only be transferred to the private sector through public offering of shares, concessions, leases, management contracts and other forms of public-private partnerships or negotiated sales resulting from the exercise of pre-emptive rights<sup>9</sup> and the sale of assets, including liquidation. The law also gives leeway for any other mode authorised by the cabinet in the approval of a specific privatisation proposal.

Since Telkom Kenya and Safaricom Ltd were established under the Companies Act, with the government holding controlling shares in both, they should have been privatised in accordance with the provisions of the Privatisation Act, 2005. In 2007, the government sold 51 per cent of Telkom Kenya to a private foreign consortium. The announcement of plans to sell 25 per cent of the total shares in Safaricom through an IPO followed soon after.

The Minister for Finance appointed members of the Privatisation Commission and gazetted their names on December 20, 2007. The Commission however, began operations on January 1, 2008, essentially missing out on its role as mandated by law.

The privatisation of Telkom Kenya and Safaricom took place outside the legal framework of the Privatisation Act. The Minister for Finance's refusal to gazette it and set up the Privatisation Commission kept the Act, though duly passed by Parliament and signed into law by the President, in abeyance.

<sup>9</sup> Pre-emptive rights are rights given to existing shareholders that entitle them to buy additional shares in a new issue before it is offered to other potential investors.

## OVERVIEW OF THE PRIVATISATION ACT

The operationalisation of the Privatisation Act depends on the existence of the Privatisation Commission, which must “formulate, manage and implement a privatisation programme to be approved by the Cabinet and published in the *Kenya Gazette*.”

### Composition of the Privatisation Commission

The Privatisation Act, 2005, requires the Minister for Finance to propose seven members of a Privatisation Commission to the relevant committee of Parliament, which ‘approves’ their appointment. Other members of the Commission are the Attorney General (AG), the Permanent Secretary (Ministry of Finance), Treasury and a Chairman appointed by the President. The Finance Minister appoints the Chief Executive through a competitive process.

### Privatisation Procedure

The Commission formulates a privatisation programme for each divestiture, which must be published in the *Kenya Gazette*. The Minister is then expected to give a report on the privatisation proposals approved by the Cabinet to the relevant Committee of Parliament. Each proposal must:

- a) Explain why the SOE being privatised was established, whether the purpose for establishing it has been met and detail the financial position of the corporation;
- b) Indicate the recommended method of privatisation;
- c) Provide an estimate of the costs of the privatisation;
- d) Set out recommendations for dealing with the employees affected by the proposed privatisation;
- e) Indicate the benefits expected of the proposed privatisation;
- f) Set out a work plan for the proposed privatisation;
- g) Indicate whether any written law should be repealed, amended or enacted for privatisation to take place and
- h) Provide proposals on how Kenyans will participate in the transaction.

In addition, the law requires that a valuation be carried out to assist the Commission in implementing the privatisation proposal and to ensure that the public gets good value for its investments.

### The Privatisation Appeals Tribunal

The Act establishes the Privatisation Appeals Tribunal, consisting of a chairman, appointed by the President, and two members appointed by the Minister of Finance from persons ‘with knowledge or experience in privatisation management’. The Tribunal should review the decisions of the Privatisation Commission in case of a complaint.

## 3. THE TELKOM PRIVATISATION

### Background

The first attempt at restructuring began in 1999 when the company was hived off from KP&TC. Kenya Posts & Telecommunications Corporation had been mismanaged for years. From Telkom Kenya’s inception, it was evident that the Government intended to restructure and privatise the company. In fact, the Telecommunications and Postal Sector Policy of 2001 stated categorically that Telkom Kenya Limited would be privatised through the sale of 49 per cent of its equity to a strategic investor.<sup>10</sup> The 2001 attempt to privatise failed when the government declined all prospective strategic partners’ bids for allegedly being too low.

Although the precise figures of Telkom Kenya’s assets at the time remain uncertain, the government’s equity in the new company was at least KES 21 billion<sup>11</sup>, that being inclusive of conversion into equity of the loans the corporation owed the Government, less its debts to the Corporation. An indication of the company’s worth is that by 2002, it reportedly had fixed assets including reserves worth at least

KES35 billion.<sup>12</sup> When Telkom Kenya’s monopoly ended in 2003, the government began the search for a Second National Operator (SNO) for fixed telephony services, a fraught process. None of the bidders had been able to comply with the requirement that foreign ownership of telecommunication companies be limited to 30 per cent<sup>13</sup>. Over time, the licence on offer lost value as mobile telephone companies continued to entrench themselves in the Kenyan market.

Efforts to sell Telkom resumed in 2004 when the government commissioned PKF Consulting to undertake a study for restructuring the company. The study, released in 2005, concluded that unless corrective measures were taken, the company would collapse in two years. The recommendations of PKF Consulting to privatise the company were submitted to the Cabinet and approved in February 2006. Four months later, the government hired the private sector arm of the World Bank, the International Finance Corporation (IFC), to act as the transaction advisor in the sale of the majority shareholding in Telkom Kenya.<sup>14</sup>

**The latter stages of the Telkom/Safaricom privatisation were conducted with undue haste. The processes did not benefit from the advice or direction of the Privatisation Commission, which is by law required government to prepare a privatisation proposal, assess the assets of the entity being privatised, and make all this information public.**

<sup>10</sup> Telecommunications and Postal Sector Statement, 1998 released by the Minister for Transport and Communication available at [http://www.cck.go.ke/regulations/downloads/telcom\\_postal\\_guidelines.pdf](http://www.cck.go.ke/regulations/downloads/telcom_postal_guidelines.pdf)

<sup>11</sup> 14th Report of the Public Investment Committee (PIC) on the Accounts of State Corporations; Volume 1; National Assembly of Kenya; pg. 167 and 173

<sup>12</sup> 14th Report of the Public Investment Committee (PIC); Volume 1; National Assembly of Kenya; pg. 168-169 and 179

<sup>13</sup> ‘Kenya: Liberalisation Blues’, Economist Intelligence Unit, March 7, 2007

<sup>14</sup> See IFC, ‘Infrastructure Advisory Success Stories’, <http://www.ifc.org/ifcext/psa.nsf/>

## How Telkom Kenya was privatised

The privatisation process went through several stages over an extended period. They are as follows:<sup>15</sup>

STAGE	TIME TAKEN	PERIOD
Commissioning and completion of a restructuring study	Approximately 1 year	2004 to 2005
Ministerial study of the restructuring; Cabinet approval and hiring of a transaction advisor	At least 6 months	2005 to June 2006
Preparation and formal release of the Preliminary Information Memorandum (PIM) followed by the final PIM detailing the plan and details of the restructuring	1 year	June 2006 to May 2007
Period between formal release of the final PIM and the invitation of bids	2 months	May to July 2007
Preparation and holding of a bidders' conference	1 month	July to August 2007
Period between the bidders' conference and the day of opening the bids	3 months	August to November 12, 2007
Period between the opening of bids, the announcement of technical qualifiers and the opening of financial bids. France Telkom was declared the winner.	4 days	November 12 to 16, 2007
Period between the opening of financial bids to the scheduled finalisation of contract documents.	24 days	November 16, 2007 to December 13, 2007
Scheduled transfer of shares and conclusion of the privatisation process	8 days	December 13 to 21, 2007

### Hasty conclusion to Telkom Kenya's privatisation

The final stages of the Telkom Kenya privatisation took place barely a month to the 2007 General Election. While the 32-day period from the opening of bids (November 12, 2007) to the transfer of shares (December 21, 2007) is, in itself, reasonable, the fact that the process closed just six days before the General Election raised questions on whether the process was above-board.

### Change of policy mid-stream

When the government embarked on privatising Telkom Kenya, the stated policy was to offer a percentage of the company to a strategic partner, and reserve a majority stake for the public through an initial public offer (IPO). In the earliest proposals, the Treasury had planned to sell 26 per cent of the company to a strategic partner and sell another 23 per cent on the Nairobi Stock Exchange (NSE) through an IPO. That would have meant that the

government would retain a majority stake in the firm. When the Corporation began to reduce wastefulness by laying off over 11,000 employees, the stated purpose was to make it lean and efficient, pending its sale on the Nairobi Stock Exchange. Staff were cut from 17,000 to 3,200, thus significantly reducing the Corporation's expenditure on the wage bill from an international high of 49 per cent of revenues.<sup>16</sup>

In fact, the terms of the privatisation were subsequently changed: the strategic partner would now be offered 40 per cent, not 26 per cent, of the company and 11 per cent would be sold through the stock exchange.<sup>17</sup> Ultimately, after discouraging bidders like AT&T from becoming strategic partners in the privatisation process, because the government would not let go of 51 per cent of Telkom's shareholding, it did just that. This contradicts the Privatisation Commission's rule, which states that: "The Commission shall conduct a privatisation in an open and competitive way, subject to any pre-existing legal rights, with a view to ensuring that the compensation received represents the fair value of what is privatised."<sup>18</sup> By selling a majority stake in Telkom Kenya privately, the Government disposed of a huge public asset without making full disclosures about the company.

### Procedural and constitutional misconduct

The most disturbing thing in the privatisation of Telkom Kenya is that it was done outside the framework set out in the Privatisation Act. Tardiness by the then Minister, Amos Kimunya, in operationalising a law that was passed by Parliament and assented to by the President in 2005 must surely count as reckless disregard for the public interest or a deliberate policy of opacity. The Minister of Finance finally gazetted and

established a Privatisation Commission on the day the corporation's ownership changed hands.

But privatisation of Telkom outside the framework of an enacted law raised deeper questions of constitutional import. A law is deemed to be in effect after it has been passed by Parliament and has received presidential assent. Ministerial action to operationalise a law is intended as a practical regulatory or administrative consideration not a veto or new mechanism for thwarting the implementation of a law. This is a serious indictment of the then Finance Minister. The conclusion can only be, therefore, that the Government intentionally avoided operationalising the law to subvert the obligations contained in it. That reasons for this delay were never made public casts serious doubts on the government's forthrightness and of its commitment to an open process of privatisation.

### Value for money?

It is not clear that a transparent valuation of the company was carried out before it was sold. If such valuation existed, it was probably based on a due diligence study that PKF Consulting carried out in 2005, two full years before the sale. In the intervening period, Telkom Kenya had reduced its wage bill by retrenching over 11,000 workers and ventured into wireless telephony.

France Telecom quoted the company's annual revenues, as at 2006, at USD170 million or KES12 billion. Although Telkom Kenya's fixed wire line network had stagnated below 300,000 subscribers over the years, the introduction of fixed wireless systems based on Code Division Multiple Access (CDMA) technology had seen the total number of subscribers grow to 329,358 by the end of June 2007.<sup>19</sup>

<sup>15</sup> Press Statement by the Orange Democratic Movement (ODM); November 15, 2007; Daily Nation and The Standard and a replying Press Statement by the Ministry of Finance; November 16, 2007; Daily Nation and The Standard

<sup>16</sup> 'Kenya: Liberalisation Blues'; Economist Intelligence Unit, March 7, 2007 and 'Kenya: Second Time Lucky?'; Economist Intelligence Unit, July 19, 2007

<sup>17</sup> Press Statement by the Orange Democratic Movement (ODM); November 15, 2007; Daily Nation and The Standard and a replying Press Statement by the Ministry of Finance; November 16, 2007; Daily Nation and The Standard.

<sup>18</sup> Privatisation Act, 2005, Section 28

<sup>19</sup> CCK annual report 2006/07 page 17

On the face of it, the details of the Telkom Kenya privatisation show that, at least in financial terms, the government was, on to a good deal.<sup>20</sup> The known points of the financial terms and considerations of the Telkom Kenya privatisation are that:

- i. A competitive bidding process preceded the sale. Among the bidders who participated were France Telecom, Telkom South Africa, LAP Green, and Reliance Communications. France Telecom won the bid by offering KES 26 billion for 51 per cent stake in the company. The France-Telecom-Alcazar consortium's USD390-million bid was significantly higher than Telkom South Africa's USD282-million and Reliance Communications' USD221-million. Part of the terms of the sale was that the company was to acquire a cellular phone licence, for which France Telecom would pay an additional KES 3.5 billion<sup>21</sup>.
- ii. The 60 per cent Safaricom shares held by Telkom – valued between KES 120 and KES 144 billion<sup>22</sup> – were to be taken over by the Government. The Government-appointed consultancy firm, PKF Consulting, had estimated the stake to be worth between USD471 million and USD790 million (KES 28 billion and KES 47 billion) in 2005.
- iii. Also transferred to the Government was Telkom Kenya's debt estimated at KES 68.8 billion.<sup>23</sup> The debt includes KES 36 billion owed to the Kenya Revenue Authority (KRA) in tax arrears and penalties accruing; KES 10 billion in pension

deficit; and a further KES 10 billion owed to international lenders and a syndicate of local banks and the government.

The known terms of the Telkom sale thus are as follows:

Party	Terms
Kenya Government	Received fee of KES26 billion, 60 per cent shareholding in Safaricom with an approximate value then of KES120 billion. In addition to taking up debts worth 68.8 Billion.
France Telecom	Paid fee of 26 Billion in exchange for a 51 per cent stake in Telkom Kenya.

### Similarities to Mobitelea?

Alcazar Capital, which is registered by the Dubai International Financial Centre, initially wanted 15 per cent of the stake that France Telkom bought in Telkom. On November 16, 2007, Alcazar increased its stake in the consortium to 21.5 per cent. This translates to nearly 11 per cent of Telkom Kenya. Its role in the consortium is ostensibly to provide advice on the Kenyan market situation.<sup>24</sup> It is unclear what its expertise is based on and curious that France Telecom, which has invested in at least 12 African countries, would need to team up with a company registered on October 29, 2007 in Dubai, just in time to bid for the Telkom Kenya sale. The similarities to the Mobitelea case are striking.

20 A dispute emerged, in early 2010, between the government and France Telecom over the value the latter made in the purchase of its 51% shareholding in Telkom. France Telecom was seeking to recover USD385 million from the government, alleging that at the time of Telkom's privatization, there were several large supplier contracts that had not been disclosed. Further, it alleged that there were assets that were missing despite being on Telkom's books at the time of privatization. See <http://www.theeastafrican.co.ke/news/-/2558/874148/-/item/1/-/jexolf/-/index.html>

The dispute was reportedly resolved later in the year, with the government apparently making huge concessions that allowed France Telecom to "exclusively manage and control assets built by the government at a cost of millions of dollars." See <http://www.theeastafrican.co.ke/news/How%20the%20French%20got%20their%20way%20in%20battle%20for%20Telkom%20Kenya/-/2558/942312/-/gktealz/-/index.html>. In a letter to AfriCOG, PS Bitange Ndemo denied reports that France Telecom had been given shares in the TEAMS fibre optic project in compensation.

21 Cf. Business Daily, Nairobi, states that "The Kenyan government has revealed that it will offer a mobile concession to sweeten the sale of a majority stake in fixed line operator Telkom Kenya. (...) Telkom must pay a licence fee of KES3.9 billion (USD55 million) ...".

22 This figure is taken from estimates by Business Daily, front page lead story, November 23, 2007

23 Telkom's debt and its breakdown taken from 'Telkom sale faces delay over talks on 68 billion debt burden' Article by Michael Omondi; Business Daily, 27th October, 2007

24 France Telecom press release, December 21, 2007

## 4. THE SAFARICOM PRIVATISATION

### Convoluting transfer

Two years before the dissolution of the KP&TC, the Corporation had set up a cellular phone department and registered it as a private company under the Companies Act, Safaricom Limited, wholly owned by the government. In effect, the government acted as a private individual and registered Safaricom as a private entity, even though it was wholly government-owned.

In any case, the privatisation of Safaricom began with the invitation of Vodafone Group Plc to join the company as a strategic investor in a public private partnership (PPP) in January 1999. A shareholder's agreement gave the government, through Telkom Kenya, 70 per cent shareholding and Vodafone's local entity, Vodafone Kenya Limited, 30 per cent of Safaricom. Vodafone Kenya Limited (VKL) is a wholly-locally owned holding company for Vodafone Group Plc of the United Kingdom.

Official policy capped foreign investment in any telecommunication company at 30 per cent.<sup>25</sup> The policy would be changed to permit 40 per cent foreign ownership the same year. This policy change was followed by Telkom Kenya allowing Vodafone Kenya Limited to increase its shareholding in Safaricom to 40 per cent, thus reducing the Government's shareholding to 60 per cent. There is no evidence that Telkom Kenya's parent ministry or the Treasury was consulted before the Board of Directors of KP&TC ceded 10 per cent of its shareholding in the cellular phone company. There is also no evidence that Vodafone Group Plc paid for the extra stake in Safaricom. In turn,

Vodafone transferred this 10 per cent shareholding to Mobitelea Ventures Limited in 2002, and then bought back half of it a year later. In 2007, when Telkom Kenya was privatised through the sale of 51 per cent of its stake to France Telecom and Alcazar Capital, its 60 per cent shareholding in Safaricom reverted to Treasury. The Treasury, in turn, offered 25 per cent of the issued share capital of Safaricom Limited through an initial public offer in 2008. As was the case with the Government's divestiture from Telkom Kenya, the privatisation occurred outside the framework of the Privatisation Act. The valuation of the company had been done before the Privatisation Commission came into operation on January 1, 2008. All the preparations for the sale of Safaricom's shares had been completed by the time the Commission was gazetted.

### Mystery investor

One intriguing question in the Safaricom story is who Mobitelea really is. A letter by the Chief Executive Officer (CEO) of Vodafone, Gavin Darby, to the PIC sheds some light on this. His evidence was that Mobitelea Ventures was a company registered in Guernsey and offered an opportunity to acquire 25 per cent of Vodafone Kenya by the Vodafone Group.<sup>26</sup> The justification was that this stake was offered for the advisory role that Mobitelea played as a local partner of Vodafone group. These advisory services purportedly related to advice on local business practices and the challenges of investing in Kenya. It is strange that these advisory services should have been needed at a time when Vodafone was already established in the local market.

25 Postal Telecommunications Sector Policy Statement, 1997

26 By one account, Mobitelea was registered under two nominee companies on 18 June 1999 in Guernsey, shortly after Vodafone's deal with Telkom. See John Maina, 'Scramble for Safaricom: Who's Fooling Who?', The African Executive, 3 October 2007.

This transaction was completed in cash in 2002 and translated to 30 per cent of Safaricom being owned by Vodafone Group and 10 per cent by Mobitelea. In January 2003, Vodafone Plc bought back 12.5 per cent of Vodafone Kenya Ltd. from Mobitelea, translating into 35 per cent of Safaricom being owned by Vodafone Group and five per cent by Mobitelea. Mobitelea's involvement only came to light in November 2006, when the government was preparing an initial public offer of Safaricom's shares. Vodafone has now repurchased all the shares from Mobitelea.

### Public controversy on Mobitelea

In 2007, then opposition politician Raila Odinga demanded that the planned privatisation of Safaricom and its parent company, Telkom Kenya, be stopped because the process was contrary to the Privatisation Act and the owners of Mobitelea were unknown. However, lawyers pointed out that his effort was in vain since the law he was referring to had not been gazetted and thus could not be used as a ground for litigation. This was although Parliament had passed the Act in 2005.

The 15th PIC Report, 2007, had also raised concerns about the ownership transactions in Safaricom's shareholding. Its inquiries had found that 10 per cent of Telkom Kenya's shareholding in Safaricom had been irregularly transferred to Mobitelea Ventures Limited without the consent of Treasury and that of the company's parent ministry. The Committee had wanted the value of the 10 per cent shareholding in Safaricom irregularly ceded to Mobitelea Ventures determined and either Mobitelea and or Vodafone PLC made to pay for it by June 2008.

Alternatively, the PIC recommended that the 10 per cent Safaricom stake irregularly transferred to Vodafone Plc immediately revert to Telkom Kenya and be held in trust for Kenyans. The Controller and Auditor-General (CAG) had based these conclusions on an inquiry into the Company's shareholding following an audit query.<sup>27</sup>

### Heavily oversubscribed IPO

Soon after the sale of the majority stake in Telkom Kenya, the government began the process of privatising Safaricom Limited through an IPO of 25 per cent of the company's shares. The IPO was expected to raise KES 50 billion (10 billion shares were on offer at a price of KES 5 each), thus putting the market value of Safaricom at KES 200 billion. The IPO was heavily oversubscribed, with over 860,000 investors seeking a stake in the company. The government received KES 50 billion for the 10 billion shares on offer.

It is curious that a high number of investors then let their money lie uncollected for more than a year. One plausible explanation is that there were many allocations made to wrong accounts, thus necessitating reversals and complicating the accounting process. Another is that the sums on the refund cheques, most of which were under KES 10,000, were too small a sum for rural investors to collect, given the high cost of travel to and from Nairobi. Yet, the Kenya National Audit Office (KENAO) undertook a special audit which found that the funds used to buy shares in the Safaricom IPO were mostly borrowed from banks and financial institutions. Investors borrowed between KES 10,000 and KES 2 million to finance the purchase of shares<sup>28</sup>. The loans would be secured by the shares allotted, meaning that the borrower needed to pay off the loan for the ownership to vest in him or her.

### Regulatory lapse

But the IPO also revealed a serious regulatory lapse: there were cases of stockbrokers investing in Safaricom under dormant accounts and fictitious names. In the past, stockbrokers had used numbered and nominee accounts, as well as fictitious names to enable their clients put in multiple applications for IPO shares and therefore boost their chances for larger allocations.<sup>29</sup> The stockbrokers sometimes applied for their own IPO shares by disguising their applications as those of customers'.

The "Know Your Customer" (KYC) principle and rules, which are to be strictly observed by commercial banks, are not enforced on the stock-broking business.<sup>30</sup> The decision by the Central Bank of Kenya and the Capital Markets Authority requiring that refund cheques be written in the names of individual investors rather than their stockbrokers unravelled these schemes. Furthermore, Capital Markets Authority regulations are silent on interest earned on money due to be paid as refunds for unallocated shares, in the event of delay in refunds.

### Vodafone's evidence

In a letter to the PIC, Vodafone Group's Chief Executive for Americas, Africa, China and India, Gavin Darby had presented the position of his company in relation to Telkom Kenya and Safaricom. The main points of his evidence were that: Vodafone Kenya Limited acquired 40 per cent of Safaricom from Telkom Kenya in the year 2000 at a price of USD42 million 'following a competitive process'. Vodafone also paid an additional USD22 million as its share of the cellular licence fee for Safaricom.

At the time, it granted Mobitelea an option to buy up 25 per cent of VKL based on the price that

Vodafone had paid. Mobitelea took the option at the end of 2001, paying Vodafone USD10m. Mobitelea retained a 12.5 per cent stake in VKL, giving it a 5 per cent interest in Safaricom. From Vodafone's figures, Mobitelea paid USD10 million for a 25 per cent stake in Vodafone Kenya -- being 25 per cent of the USD20 million that Vodafone paid for its share of Safaricom plus the USD22 million it supposedly paid as part of its contribution to Safaricom's licence fee.

In the words of the CEO to the PIC, the offer was made to Mobitelea 'in return for its valued advice', the explanation being that whenever Vodafone invests in 'new territories', it is not uncommon for the company to work alongside 'a partner who typically gives advice on local business and protocols and the various challenges associated in investing in a new market'. The letter does not say when the 'offer' to Mobitelea was made but goes on to mention that the deal was closed in 2002. A spokesperson said: "Mobitelea has never had representation on the board of Vodafone Kenya or on the board of Safaricom. "We have received guarantees from Mobitelea that no prohibited parties have benefited from this transaction".

In 2003, Vodafone Group Plc bought back 12.5 per cent of Vodafone Kenya shares from Mobitelea Ventures Limited, equivalent to half its stake, just one year after selling them to Mobitelea, leaving Mobitelea, a shell company, with a 5 per cent stake in Safaricom.

### Safaricom's evidence

The PIC took evidence from Michael Joseph, then CEO of Safaricom. The main points that emerged were:

1. That Mr. Joseph was 'unable' to tell the PIC who the direct and indirect owners of the company he headed at the time were.

<sup>27</sup> See Special Audit Report of the Controller and Auditor General on the Sale of 51% GOK Shareholding in Telkom Kenya Limited, July 2009, for details.

<sup>28</sup> Ibid.

<sup>29</sup> "Ghost investors behind Safaricom IPO refunds riddle", The Daily Nation, Saturday May 9 2009 available at <http://www.nation.co.ke/News/-/1056/595508/-/u67ph1/-/index.html>

<sup>30</sup> Know your customer (KYC) is the due diligence and bank regulation that financial institutions and other regulated companies must perform to identify their clients and ascertain relevant information pertinent to doing financial business and the prevention of fraud, and money laundering.

2. Safaricom's cellular licence fee was not, as it were, ever paid by Vodafone<sup>31</sup>. Rather Vodafone, the new 40 per cent owner of Safaricom was supposed to fork out USD22 million for the licence but instead loaned Safaricom the money at zero interest rate and with no repayment schedule. Telkom Kenya reportedly paid in kind with USD33 million worth of equipment and its customer base. In short, Telkom's contribution was converted to equity while Vodafone's was treated as a loan that had to be repaid. The PIC picked this fact from the Controller and Auditor General's Report for the year ending March 2006 and from the evidence given to the Committee by the Safaricom chief executive officer, Mr. Joseph.

3. In another letter dated June 22, 2000, and tabled before the PIC - ostensibly forwarded from Vodafone Kenya Limited - Mr. Joseph presented purported evidence of a banker's cheque showing that Vodafone Kenya had paid USD22 million as its share of the licence costs for Safaricom in 2000. But the letter was found to be fictitious as it gave the address of Vodafone as 8th Floor, Lonrho House, and P.O Box 40034-00100, Nairobi. The 00100 postal coding system was not in existence when the cheque was supposedly drawn or should have been drawn.

### Telkom Kenya's evidence

The company's evidence to the PIC contradicts the position taken by Vodafone. Telkom Kenya's position was presented to the PIC by John Waweru, the former Director General of the Communications Commission of Kenya (CCK) and a Director of Telkom Kenya at the time Vodafone came on board. He was also, at the time, an alternate to Telkom Kenya's Managing Director in the Safaricom board.

The key points of Mr. Waweru's evidence were that:

1. Safaricom applied for, and was granted, a cellular licence in June 1999, at which time it was already owned 60:40 by Telkom and Vodafone Kenya. Specifically, the Board of Telkom Kenya was informed of a verbal request by Vodafone Plc to increase the latter's shareholding in Safaricom from 30 per cent to 40 per cent.<sup>32</sup>
2. The 8th Full Board meeting of Telkom Kenya on September 27, 1999, approved the change in shareholding of Safaricom to 60 per cent for Telkom Kenya and 40 per cent for Vodafone Kenya Limited 'pending an official (written) request from the management of Vodafone'<sup>33</sup>. Alongside Mr. Waweru in that meeting were Directors, W.N. Ayah, A.K. Cheserem, M.P. Manji, K.K. Cherogony, D.A. Oyatsi and G. Mitine.

Besides considerably denting the position presented by Vodafone to the PIC, Mr. Waweru's evidence also marked out the negligence and sheer impunity that prevailed at the time: a 10 per cent shareholding in a massive public utility such as Telkom Kenya changed hands on the strength of a 'verbal request pending official written request'. In fact, the Telkom Board did not even directly receive the so-called 'verbal request' - it merely 'was informed of' such a request.

### The government's evidence

Joseph Kinyua, Permanent Secretary to the Treasury and a representative of the Registrar of Companies, set out the government's position on Telkom Kenya vis-à-vis Safaricom to the PIC. This evidence further contradicted earlier statements by Vodafone and Safaricom. Specifically, the government's evidence was that:

1. Vodafone first acquired 30 per cent, rather than 40 per cent, of Safaricom in January 1999 and not in 2000 as claimed by Vodafone PLC's CEO.
2. According to the Registrar of Companies, Vodafone Kenya Limited was not established in Kenya as a direct subsidiary of Vodafone Group Plc. Rather, it took over an existing local company, Shomoro Limited, which had been established in 1998 and changed its name to Vodafone Kenya Limited.<sup>34</sup>

3. Until 2006, neither Vodafone Kenya Limited nor Safaricom submitted annual reports.
4. The files and records of Vodafone Kenya could not be traced at the Registrar of Companies<sup>35</sup>.

In March 2007, the PIC asked Britain's Serious Fraud Office (SFO) to assist in an inquiry into the ownership of Safaricom. Analyst Robert Shaw said he hoped for more clarity on the case. "The suspicion is that a third party got a slice of the cake", he said, "Until it is proven otherwise, people will continue to believe this."<sup>36</sup>

### Contradictions in Evidence

Vodafone PLC	Telkom Kenya	Permanent Secretary to Treasury	Vodafone Kenya	Safaricom Ltd
Vodafone Kenya Limited acquired 40 per cent of Safaricom from Telkom Kenya in the year 2000 at a price of USD20 million	Safaricom got a cellular licence in June 1999 when Telkom and Vodafone Kenya already owned the company 60:40	Vodafone first acquired 30 per cent, rather than 40 per cent, of Safaricom in January 1999 (and not in 2000).	Vodafone paid an additional USD22 million as its share of the cellular licence fee for Safaricom.	In a letter dated June 22, 2000, and tabled before the PIC (ostensibly forwarded from Vodafone Kenya Limited) Michael Joseph, the CEO of Safaricom, presented supposed evidence of a banker's cheque showing that Vodafone Kenya had paid USD22 million as its share of the licence costs for Safaricom in 2000. The letter was found to be fictitious as it gave the address of Vodafone as 8th Floor, Lonrho House, and P.O Box 40034-00100, Nairobi. The 00100 postal coding systems were not in existence when the cheque was supposedly drawn.

31 PIC Report on Safaricom 2007, National Assembly of Kenya; pgs 172 -173.

32 PIC Report on Safaricom 2007, National Assembly of Kenya; pg 175

33 Ibid

34 PIC Report on Safaricom 2007, National Assembly of Kenya; pg 177

35 Fifteenth Report of The Public Investments Committee on the Accounts of State Corporations 2007, Pg 177 Para (vii)

36 <http://www.reuters.com/article/idUSL1943856320070320>

## 5. ANALYSIS OF THE KEY ISSUES IN THE TELKOM-MOBITELEA-SAFARICOM SAGA

### Emerging evidence on Mobitelea

The sale of 25 per cent shareholding in Safaricom – nearly half of the government’s stake in the company – through the Nairobi Stock Exchange, forced disclosure and confirmation of what the management of Safaricom and the government, had all along denied: their knowledge of Mobitelea Ventures’ interest in Safaricom. The company prospectus stated: “As of the date of this Prospectus, there are two persons with beneficial interests in the shares of Vodafone Kenya Limited. More specifically, Vodafone International Holdings B.V. beneficially holds 350 shares (equivalent to an 87.5 per cent beneficial interest in Vodafone Kenya Limited (“VKL”)) and Mobitelea Ventures Limited beneficially holds 50 shares (equivalent to a 12.5 per cent beneficial interest in VKL).”<sup>37</sup>

### Evidence gathered by the PIC

- 1) Vodafone Kenya acquired a 30 per cent stake in Safaricom in January 1999 but only paid for it in 2000 – and only after requesting and obtaining an additional 10 per cent stake in the company.
- 2) Vodafone’s Plc’s sale of shares to Mobitelea Ventures was concluded in 2002. The deal was completed two years after Vodafone supposedly acquired its share of Safaricom – but actually three years after the fact. This would suggest that Vodafone UK made payment for advice it had received from Mobitelea three years after it clinched the deal that resulted in a shareholder agreement with Telkom Kenya on Safaricom. It is highly unlikely that Mobitelea, a commercial venture, would give a client, Vodafone, advice for this period without receiving any consideration. Moreover, Mobitelea supposedly did not get the Safaricom shares as payment

for services rendered to Vodafone. Rather, Mobitelea bought these shares at near-market value. It is all the more strange that after paying for services rendered, Vodafone would find it necessary to sell its shares to a service provider who was ostensibly needed to ease entry into a new market, in which it had, in fact, already established itself, rather than as a strategic long-term partner.

### Financing politics?

It is striking that the year of Mobitelea’s sale, 2002, also happened to be a watershed year in Kenyan politics. Daniel arap Moi, whose KANU government was facing uncertain elections, was slated to exit politics, having served his last term. As it turned out, KANU lost that election.

It seems that in 2003 Vodafone then bought back half of the shares it had sold to Mobitelea in 2002. The PIC was given no reason why this new transaction was done. But the timing is telling: 2003 was the year NARC swept KANU out of office. It is significant that Mobitelea ceded in 2003 exactly half of what it had obtained from Vodafone in 2002. It seems so uncannily like a sharing of the spoils that suspicions appear justified.

Indeed, the Safaricom prospectus virtually accepts that this deal was illicit. The prospectus noted that one of the risks facing Safaricom was the possibility of being investigated by the KACC regarding the circumstances and manner in which Mobitelea Ventures Limited purchased shares in Vodafone Kenya Limited from Vodafone International Holdings B.V. It added that it was difficult to predict whether any such investigation would result in any action that could directly or indirectly affect Safaricom’s business or results of operations.<sup>38</sup>

Given the broad catalogue of privatisation exercises expected in 2011 – a pre-election period – it is imperative that lessons learned urgently be applied and implemented.

### Irregularity and impunity?

Besides undermining Vodafone’s position to the PIC, Mr. Waweru’s evidence also underlined the cavalier attitude and impunity that characterised the transfer of Safaricom shares from Telkom Kenya.

A number of highly irregular points are worth noting:

1. It is incredible that a 10 per cent stake in Safaricom, changed hands on a reported ‘verbal request pending official written request’.
2. There was further PIC evidence of another similarly casual contract. There was a share transfer contract between Vodafone Kenya Ltd and Telkom Kenya amended in May 2000 to show that Safaricom shareholding still stood at 60 per cent (Telkom Kenya) and 40 per cent (Vodafone Kenya Ltd).  
  
Unusually, and as the PIC noted, some of the amendments to this agreement were handwritten and were not countersigned nor authenticated by way of company seal, a legal requirement.
3. The PIC noted that there were serious discrepancies in the dates provided by the PS to Treasury and the CCK Director General, on when Telkom Ltd shareholding at Safaricom was reduced from 70 per cent to 60 per cent. PS Kinyua gave the date of October 5, 1999 while Eng. Waweru said it was June 30, 1999. As a matter of company law, the transfer of shares is not a casual issue and any divestiture ought to have been sanctioned by the parent ministry and the Treasury.

4. In closed companies, even the transfer of shares by a single shareholder may have implications for the control of the company and often for its management, since a shareholding in such a company may be perceived as giving rise to a formal or informal entitlement to membership of the board of directors and participation in the management of the company. This was not considered in the Telkom-Safaricom case.
5. In private companies, it is common for the articles of association to contain some restrictions on the transferability of the shares, perhaps by making transfers subject to the permission of the board or requiring the shares to be offered initially to the other shareholders before they can be sold outside the existing shareholder body. These are pre-emption rights arising on transfer. Again, this was not considered in the Telkom-Safaricom case.

### Why was Vodafone’s portion of the licence fee treated as a loan?

At the onset of Safaricom operations in Kenya, the shareholders of Telkom Kenya and Vodafone Kenya paid the Communications Commission of Kenya (CCK) KES 4.5 billion in licence fees. The cost of the licence was meant to be shared according to the shareholding structure.

By the accounts of Vodafone Group Plc and Safaricom management, Safaricom’s cellular licence fee was not ever paid by Vodafone.<sup>39</sup> Rather, Vodafone, the new 40 per cent owner of Safaricom, loaned USD22 million to Safaricom, the money being at zero interest rate and with no repayment schedule, while Telkom Kenya paid in kind with USD33 million worth of equipment and customer base. No provision was made for Safaricom to repay Telkom for its contribution, yet Safaricom was clearly committed to repay the loan from Vodafone.

<sup>37</sup> Safaricom Prospectus, 2008, page 80

<sup>38</sup> Safaricom Prospectus, 2008, page 80

<sup>39</sup> PIC Report on Safaricom 2007, National Assembly of Kenya; pgs 172 -173

The net effect is that Telkom was fleeced of USD33 million. This fact emerged from the CAG's report on the accounts of Safaricom Ltd for the year ending 31st March 2006 and from the evidence given to the PIC by the Safaricom CEO at the time.

### Key PIC comments on the Telkom-Safaricom privatisation

1. It would have been more prudent to convert the USD 22 million loan into equity at the very beginning.
2. It was imprudent of Safaricom's directors to accept the loan without a specific repayment period. This, the report notes, would make it difficult for Safaricom to project the risks and exposures associated with the loan. This arrangement was further seen to be exposing the Kenyan public to an unknown risk because of their ignorance of the background, nature and implications of the loan. Also, it was argued that in the absence of a written agreement between the parties on the loan, it was not possible to confirm the terms of the loan.<sup>40</sup>

### Telkom/Safaricom: beyond scrutiny?

The establishment of the Privatisation Commission on January 1, 2008, came too late to impact on the transparency and probity of the Safaricom and Telkom privatisations despite the passage of the Act in 2005.

Further, because the government now only holds 49 per cent of the stake in Telkom Kenya, the company can no longer be classified as a state corporation. These changes mean that:-

1. The Controller and Auditor-General shall no longer examine the company's activities. Consequently, the PIC shall no longer scrutinise the company's record of activities.<sup>41</sup>
2. As a private company, Telkom Kenya will hence only be required to file annual returns with the Registrar of Companies – a requirement that many firms do not adhere to, with no consequences befalling them.
3. Similarly, the privatisation of Safaricom through the NSE reduced the government's shareholding to 35 per cent. Just like Telkom Kenya, Safaricom is no longer subject to the provisions of the State Corporations Act, which requires the CAG to examine its activities and report to Parliament.<sup>42</sup>

### Truth-in-lending reforms?

The use of loans to finance the purchase of Safaricom shares by individuals is a tenuous practice that places a heavy burden on investors. In the event that the share price drops, (indeed, the value of the Safaricom shares halved in the first year of its listing), investors who borrowed from commercial banks to buy shares are saddled with debts. This situation arose because there were no regulations on how much of the money intended to be invested in buying shares could come from loans. Analogies of this practice can be made to margin loans which are a common market practice in more developed economies. Margin buying is buying securities with cash borrowed from a broker, using other securities as collateral. This has the effect of magnifying any profit or loss made on the securities. The securities serve as collateral for

### Margin Loans: A comparative view

Margin loans in the United States have been regulated since the Stock Market crash of 1929. The basic rules are set by the Federal Reserve Board (FRB), the New York Stock Exchange (NYSE), and the National Association of Securities Dealers (NASD). Every broker must apply the minimum rules to customers, but a broker is free to apply more stringent requirements. Australia has introduced the Corporations Legislation Amendment (Financial Services Modernization) Bill 2009 into Parliament which will make margin loans subject to the investor protection regime in the Corporations Act. It requires margin lenders and advisers to obtain a licence and be subject to supervision and enforcement by the Australia Securities and Investment Commission (ASIC). Margin loan lenders will be subject to responsible lending requirements which will only allow them to provide a margin loan if they are reasonably sure that the borrower is able to afford the loan without suffering substantial hardship. A new provision is included which clarifies whether lenders or financial advisers are responsible for notifying borrowers of margin calls. Closer to home, the Governor of the Central Bank of Nigeria (CBN) proposed and pushed for financial sector reforms; one being 100 percent provisioning for margin loans. The CBN Governor was quoted as saying: "It is sad if there are investors who are not happy that the regulator is trying to institute reforms. However, that would not deter me from instituting improved transparency and regulation in the banking system." Thus the use of loan financing in the Safaricom IPO raises wider questions regarding the effectiveness of financial regulation in Kenya.

the loan. The net value, i.e. the difference between the value of the securities and the loan, is initially equal to the amount of one's own cash used. This difference has to stay above a minimum margin requirement. This is to protect the broker against a fall in the value of the securities to the point that they no longer cover the amount loaned.

### Were investors deceived?

Section 50 of the Privatisation Act states that any "person (who) knowingly mislead(s) a person carrying out a duty or function of this Act (shall be) guilty of an offence and is liable... to (a) fine not exceeding two hundred thousand shillings (or) imprisonment for a term not exceeding one year or both." Even if this penalty were to be meted out in full, it would still be inadequate. Faced with the prospect of retaining billions of shillings acquired through the dubious sale of state assets, there

appears to be no deterrent to lying to investigators. Although the law pegs every function of the Privatisation Act on the existence of a Privatisation Commission, which must "formulate, manage and implement (a) (the) privatisation programme"<sup>43</sup>, and has exclusive authority to manage and implement the privatisation programme, the absence of the commission and its programme raised several questions:

- 1) Why was there no programme despite privatisation being topical for government policy?
- 2) If Cabinet consequently raised these matters, what response did it obtain?
- 3) What measures should be taken against an officer who aims to defeat the intentions of a statute?

<sup>40</sup> The company paid off this interest-free loan and cleaned up its books in December 2007, as evidenced by this statement from the auditors in the prospectus. "The shareholder loan comprises a loan of USUSD33 million made by Telkom Kenya Limited and another of USUSD 22 million made by Vodafone Kenya Limited in May 2000. The loans were non-interest bearing. The loans were paid in December 2007."

<sup>41</sup> In 1985, under the Moi regime, the Exchequer and Audit (Amendment) Act No. 12 of 1985 created the office of the Auditor-General (Corporations) responsible for auditing state corporations. This had the effect of removing the auditing of state corporations from the Controller and Auditor General. In 1995, the auditing of the state corporations was made the responsibility of the Controller and Auditor General by the Exchequer Act (CAP 412). Its independence and effectiveness to perform its audit function were, however, hampered by insufficient funding and direct interference by the Executive. The Public Audit Act, of 2003 established the Kenya National Audit Office, (KENAO) with the aim of improving the the independence of the office.

<sup>42</sup> Safaricom Prospectus, 2008, page 121

<sup>43</sup> Privatisation Act, 2005, section 4



## Divestiture objectives contradicted

Given the character of the sale of the two corporations, it is not apparent that the privatisation exercises in each respect met set objectives for divestiture. It appears that rather than generate additional revenues for the government, these privatisation exercises only succeeded in retiring debt. Additionally, although divestiture is expected to broaden the ownership of state-owned corporations, the sale of the two corporations appeared to destabilise rather than enhance the broad ownership of corporations.

## More questions than answers

In July 2009, Vodafone Plc bought out its controversial minority shareholder in its Kenyan subsidiary. *The Daily Nation*<sup>44</sup> newspaper reported that Vodafone may have paid as much as KES2.4 billion for the stake in its local holding company held by Mobitelea. The transaction does not answer questions as to who were the ultimate owners of the shares and why Vodafone entered into a deal with the mystery company in the first place. The newspaper asserts that Mobitelea could have been paid more than KES2.4 billion,<sup>45</sup> given

the eagerness of Vodafone to disengage itself from Mobitelea. The accounts not only fail to specify the amount paid but lump together some undisclosed acquisitions that cost 457 million pounds.<sup>46</sup>

## Conspiracy to defraud

The inevitable conclusion is that there were sufficient irregularities to warrant the government's insistence on privatising Telkom outside of the Privatisation Act regime. Given the high profile of Telkom Kenya in the portfolio of assets owned by the public, its sale outside the structure of established laws should alert us to the possibility that certain elements of the process were themselves questionable. This may also explain why Mobitelea, supposedly an upright investor with nothing to hide, chooses to remain secret even in the face of accusations and suspicions of corruption by no less than a parliamentary committee.<sup>47</sup>

The 2007 PIC Report categorically states that "there appears to have been a conspiracy by some officers of government, Mobitelea Ventures, Vodafone Plc and Telkom Kenya Board to defraud the public of its shares in Safaricom".

**"There appears to have been a conspiracy by some officers of government, Mobitelea Ventures, Vodafone PLC and Telkom Kenya Board to defraud the public of its shares in Safaricom."**

*Public Investments Committee, 2007 Report*

<sup>44</sup> The *Daily Nation*, Wednesday, July 8th 2009, page 10

<sup>45</sup> Ibid.

<sup>46</sup> Vodafone Group Annual report 2009 available at [http://www.vodafone.com/etc/medialib/agm\\_09.Par.22820.File.dat/VF\\_AnnualPercent20Report\\_2009.pdf](http://www.vodafone.com/etc/medialib/agm_09.Par.22820.File.dat/VF_AnnualPercent20Report_2009.pdf)

<sup>47</sup> See 'Cause for Public Concern on the Telkom Privatisation and Safaricom IPO [www.africog.org/reports/cause\\_for\\_concern\\_over\\_safaricom\\_IPO.pdf](http://www.africog.org/reports/cause_for_concern_over_safaricom_IPO.pdf), Continuing Public Concern around the Safaricom IPO [www.africog.org/reports/Continuing\\_public\\_concern\\_over\\_safaricom\\_IPO.pdf](http://www.africog.org/reports/Continuing_public_concern_over_safaricom_IPO.pdf), East African Standard 'The Sh7 Billion Mystery - Who Owns Mobitelea in Kenya?', Issue No. 360, 24 June 2007

# 6. LESSONS FROM THE TELKOM/SAFARICOM PRIVATISATION

From the foregoing, it is clear that the privatisation of Safaricom and Telkom Kenya raises some fundamental issues that should be resolved prior to government divestiture of other corporations.

## 1. Hasty, opaque privatisation

The latter stages of the Telkom/Safaricom privatisation were conducted with undue haste. The processes did not benefit from the advice or direction of the Privatisation Commission, which is by law required government to prepare a privatisation proposal, assess the assets of the entity being privatised, and make all this information public.

## 2. Misuse of power to delay privatisation law

The privatisation of Telkom Kenya and Safaricom took place outside the legal framework of the Privatisation Act. The Minister for Finance's refusal to gazette it and set up the Privatisation Commission kept the Act, though duly passed by Parliament and signed into law by the President, in abeyance.

Although the Commission was consequently gazetted, this was a case of closing the stable door after the horse had bolted. That the law was kept in abeyance suggests that there was an interest on the part of the government for the Privatisation Act not to apply in the privatisation of Telkom Kenya, which in turn can only imply that there was something untoward about the privatisation exercise. In any event, the fact that the Privatisation Act, 2005, did not guide the privatisation of Telkom and Safaricom translates to a dereliction of duty on the part of the then Minister for Finance. In itself, this amounts to the abuse of power. Simply put, the Minister used his executive power to defeat the coming into force of a law.

The delay by the Minister for Finance in activating the Privatisation Act flies against the constitutional checks and balances that guide law making in Kenya. This is because the constitution deems a law to be in effect after it has undergone parliamentary passage and presidential assent; any other requirements, such as ministerial action to operationalise the law, are merely intended as practical regulatory or administrative measures that cannot constitute grounds for delay or thwarting of the law.

## 3. Just cause for suspicion

Vodafone Kenya, Telkom Kenya and Safaricom, have gone to great lengths to hide the details of Safaricom's relationship with Mobitelea Ventures. This is fair grounds to suspect foul play in the sale of Safaricom shares.

The transfer of Safaricom shares from Telkom was neither above board nor even regular. The privatisation of Telkom Kenya cannot, therefore, be deemed regular until the true picture of its ceding of Safaricom shares to Vodafone Kenya is unravelled and rectified.

## 4. Disregard for Parliament's recommendations

The transfer of Safaricom's shareholding from Telkom Kenya was not only convoluted and shadowy but also possibly illegal and corrupt. An investigation by the parliamentary Public Investments Committee graphically illustrates the point. The Committee, moreover, made several specific recommendations that have not been effected to date. The privatisation of Telkom and Safaricom therefore remains suspect until and unless the PIC recommendations are implemented or new information is tabled before the Committee to persuade it otherwise.

The Telkom/Safaricom privatisation is a direct affront to the PIC and the authority of Parliament since the Committee specifically recommended that the IPO be suspended pending a resolution of the Telkom-Safaricom shares scandal. Unless the link between Telkom Kenya and Safaricom is explained to the satisfaction of the PIC, the Safaricom IPO remains suspect.

### 5. No room for appeal

To date, the Privatisation Appeals Tribunal, which receives and deals with complaints concerning government divestiture, is still not in place.

### 6. Unanswered questions

The two transactions changed the fundamental design of ownership of the telecommunications sector in Kenya. They placed the largest companies

in the sector out of reach of parliamentary oversight and scrutiny. This was at a time when there were, and still are, questions as to how their ownership patterns changed hands over a nine-year period.

### 7. Governance gaps in the use of loans for investment in the capital markets

The Safaricom IPO exposed governance gaps in the use of loans to invest into the capital markets and saw investors that used loans to finance the purchase of their Safaricom shares saddled with debt when the value of their shares halved in the first year of listing.

Further, lack of enforcement of the 'know-your-customer' (KYC) principle for stock brokerage firms, as discussed elsewhere in this report, almost saw them get away with putting in multiple applications for the shares under fictitious names.

## 7. KEY RECOMMENDATIONS

In order to avoid recurrence of the anomalies witnessed in the privatisation of the two corporations, and to ensure that such exercises are professionally conducted, transparent and successful, some areas need to be looked into and appropriate measures taken:

### 1. Changes to the Privatisation Framework

- a) The Privatisation Act should be reviewed and amended where applicable, and its provisions fully implemented to ensure more transparency, and disclosure in government divestiture of public entities. As things stand, there is too much room for executive discretion, interference and distortion in the privatisation process.
- b) A preliminary independent performance review of the Privatisation Commission's first year in office should be carried out and resultant recommendations implemented.
- c) The Privatisation Appeals Tribunal to oversee all Government divestiture disputes and ensure privatisation is above board needs to be set up.
- d) Section 50 of the Privatisation Act states that any "person (who) knowingly mislead(s) a person carrying out a duty or function of this Act (shall be) guilty of an offence and is liable... to (a) fine not exceeding two hundred thousand shillings (or) imprisonment for a term not exceeding one year or both." This penalty is too lenient for any person faced with the prospect of earning billions of shillings. Reforms should provide for some retroactive punishment where public officers are involved in actions that amount to implicit involvement in the theft of public resources.

### 2. Changes to the Capital Markets Regulatory Framework

- a) The Capital Markets Authority Act (CMA) should be amended and the Authority strengthened to enable it to function as a regulator with teeth rather than just a spectator in the securities market. Laws regarding bank lending for securities should be monitored carefully and remodelled in order to afford greater protection to investors.
- b) At present, capital market disclosure requirements are arguably inadequate and are largely limited to disclosure of financial information. Information about company directors and management is perfunctory. Rules and regulations should be put in place or reinforced to require full and comprehensive disclosures from and on companies listed on the NSE together with full disclosures about transaction advisors and beneficial owners. These rules should also cover individual investors.
- c) The institutional and skilled personnel capacity of the CMA needs to be built up so that it can adequately understand and monitor the often-complex activities of the sector it oversees and act in a timely manner. In particular, the CMA needs to strengthen its oversight of the performance and capacity of the various listed stockbrokers. The CMA should use its powers boldly to intervene in such cases as soon as possible. The CMA should work more closely with all players and consult widely, particularly in large exercises such as the Safaricom IPO. The penalties for breaking the rules and regulations resulting in the loss of clients' money should be commensurate with the crime committed.

### 3. Changes related to Corporate Governance and Company Law

- a) The Companies Act should also be amended to give the Registrar of Companies the power to exercise authority over companies that fail to meet their obligations under the law. In evidence to the PIC in 2007, the Registrar said that neither Vodafone Kenya nor Safaricom had been filing their annual reports as required by law. There is no obvious explanation for why no action was taken over this omission other than sheer negligence. The Registrar of Companies is short on capacity and needs urgent strengthening to carry out its mandate. Although the Companies Act (Section 323 of the Penal code) provides that a director or officer of a company who makes, circulates or publishes or concurs in making statements that s/he knows are false is liable to imprisonment for seven years, no one has ever been jailed.
- b) Transaction advisers (accountancy firms, auditors, registrars and lawyers) and their professional organisations need to be imbued with responsibility through the enactment of laws and regulations that bind the professionals to take action against those that abet suspect transactions.

The following statement of auditors in the Safaricom prospectus is a case in point: "After reviewing the condensed balance sheet of Safaricom Limited as of 31 December 2007 and the related condensed statements of income, changes in equity and cash flows for the nine-month period then ended, Price-Waterhouse Coopers said: *"A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion."*

Professionals must take personal responsibility for statements and especially those that may be relied on by the public.

- c) The Companies Act provides adequate protection for majority shareholders or those with a controlling interest in a company. There is a need to amend the law so that minority shareholders' rights are protected. At the moment, their rights are limited to asking questions during annual general meetings (AGMs) or special general meetings (SGMs), removing directors during such meetings, selling off their interest, seeking government intervention or going to court.<sup>48</sup>
- d) Investment codes are still vague on the definition of a foreign investor. In view of the Mobitelea and Alcazar experiences, there is need for deeper scrutiny of organisations claiming to be foreign by virtue of being registered in jurisdictions other than Kenya. Foreign investors have shareholding reserved for them in the event of public listings. If there is to be a distinction between them and Kenyan investors, the difference ought to be easy to discern.

#### 4. The Discretion of ministers in implementing legislation

The leeway that ministers have with respect to gazetting legislation should be limited. It is, therefore, necessary for the relevant parliamentary committees to fully exercise the powers vested in them by the Powers and Privileges Act, standing orders and the Fiscal Management Act:-

- to refuse to hear a Minister on the floor of the house who defies the recommendations or instructions of a committee,
- to disallow a minister from bringing any legislation relating to that ministry before


Parliament should the Minister defy or ignore a committee recommendation,

- to deny the relevant ministry a budget should the Minister or ministry defy or ignore a committee recommendation,
- to surcharge and punish public servants who ignore or defy the committee's recommendations.

These measures became easier to implement with the passage of the new Parliamentary Standing Orders in 2009. The orders establish an Implementation Committee, which has powers to follow up and implement recommendations of parliamentary committees.

48 Africa Peer Review Mechanism Country Self-Assessment Report of the Republic of Kenya, page 233.

Advertiser's Announcement



## Cause for Public Concern on the Telkom Privatization and Safaricom IPO

**YOU KNOW**

- The Government of Kenya is in the concluding stages of privatizing Telkom Kenya. The winning bidders France Telecom will take Board control by December 21, 2007.
- The government is also planning to offload shares of Safaricom through an Initial Public Offer (IPO) before the end of this year.

**BUT DO YOU KNOW**

**About Telkom Kenya:**

- The conclusive stages of Telkom Kenya's privatization have been conducted with undue haste. The process has unfolded barely a month to the General Election and is set to close just **six days** to voting. **Why could it not be delayed for a short period, two months perhaps, to allow for the electoral season?**
- The privatization of Telkom Kenya has taken place outside the legal framework of the *Privatization Act*. The Act, was passed by Parliament and **signed into law by the President in 2005** but has been kept in abeyance by the Minister of Finance for two years. The Minister is simply required to gazette it and to embark on the establishment of a Privatization Commission. The failure by the Minister of Finance to gazette the Privatization Act amounts to the misuse of power. Simply put, **the Minister has used his executive power to thwart the coming into force of a law.**
- The refusal by the Minister of Finance to activate the Privatization Act flies against the constitutional check and balance mechanism that guides law making in Kenya. **This is because the constitution deems a law to be in effect after it has undergone parliamentary passage and presidential assent;** any other requirement, such as ministerial action to operationalise the law is merely intended as practical, regulatory or administrative considerations that cannot constitute grounds for delay or thwarting of the law.

**About Safaricom:**

- Safaricom Limited was established in 1997 as a fully-owned department of the Kenya Post & Telecommunication Corporation (KP&TC). The department was inherited by Telkom in 1999, when KP&TC was broken up into Posta, the Communication Commission of Kenya (CCK) and Telkom Kenya. But somewhere along the way, 40 % of Safaricom shares were transferred to Vodafone Kenya Limited, which in turn sold 25% of its own shareholding – and therefore 10% of Safaricom's shares – to Mobitelea Ventures Limited, a company resident in Guernsey. On January 29, 2007, Gavin Darby, CEO of Vodafone Americas, Africa, China, India wrote to the Clerk of Parliament that Mobitelea had offered "valued advice" on "local business practices and protocol" and had in return been "offered the opportunity to acquire 25% of VKL".
- The transfer of Safaricom shares from Telkom to Vodafone and Mobitelea was neither aboveboard nor even regular. **The privatization of Telkom Kenya can not, therefore, be deemed regular until the true picture of its ceding of Safaricom shares to Vodafone Kenya is unraveled and rectified.** As it is, the ownership of a significant 5% of the Safaricom remains engulfed in a cloud of controversy that has a strong whiff of underhand wheeler-dealing.
- Vodafone Kenya and Telkom Kenya have **gone to great lengths to hide the details** of Safaricom's relationship with Mobitelea Ventures. That this should be the case is fair grounds to suspect foul play in the sale of Safaricom shares.
- These transactions are being investigated by the Serious Fraud Office of the United Kingdom.


THE PARLIAMENTARY INVESTMENT COMMITTEE'S RECOMMENDATIONS:

- The transfer of Safaricom's shareholding from Telkom Kenya was convoluted and possibly **illegal and corrupt**. An investigation by the parliamentary **Public Investment Committee** graphically illustrates the point. The committee, moreover, made several specific recommendations that are yet to be effected. Among the PIC findings and recommendations are that:
  - 10% shareholding of Telkom Kenya Limited was **irregularly transferred to Mobitelea Ventures Limited** without the consent of Treasury and that of the parent ministry;
  - The Director of the Kenya Anti-Corruption Commission (KACC) should immediately institute investigations into the circumstances and manner in which Telkom's shares were transferred to Mobitelea and take action against anyone found culpable;
  - The Director of KACC should include a progress report on the Telkom-Mobitelea investigations in the Commission's quarterly report to parliament;
  - The PIC, on behalf of Parliament, invites the Organization of Economic Cooperation and Development (OECD), the United Nations (UN), Transparency International (TI), and the Serious Fraud Office of London to also undertake investigations on the apparent grand corruption conceived and orchestrated by Vodafone PLC in Kenya.
  - The **Chief Executive of the Communications Commission of Kenya (CCK), Eng. John Waweru**, should be asked to step aside until the investigations are completed "due to his role on the Board of the defunct KP&TC and Telkom Kenya at the time of changes in Safaricom shareholding...";
  - The **Board members** who discussed the Telkom Kenya Board Paper No. 56/99 and seem to have abetted the irregular transfer of public shares of Safaricom should be barred from holding public office.
  - The **value of the 10% shares of Safaricom ceded to Mobitelea Ventures should be determined and Mobitelea and or Vodafone PLC be made to redeem the determined value by June 2008;**
  - The awaited **Initial Public Offer (IPO) of Safaricom Limited should be suspended** until such time when the investigations into the transfer of Safaricom's shares to Vodafone PLC and Mobitelea are completed;
  - The 10% of Safaricom shares that was irregularly transferred to Vodafone PLC should immediately revert to Telkom Kenya to hold in trust for the Kenyan public.

**The privatization of Telkom therefore remains suspect until and unless the PIC recommendations have been implemented or new information tabled before the Committee to persuade it otherwise.**

The government should respect the recommendations of the PIC which directed that " **the awaited Initial Public Offer (IPO) of Safaricom Limited should be suspended until such time when the investigations into the transfer of Safaricom's shares to Vodafone PLC and Mobitelea are completed**". Why the rush? Both the CEO of Safaricom and the Association of Stockbrokers and Investment Banks recommend delaying the Safaricom IPO until after the electoral season. This time can be used to complete the investigations into the transfer of Telkom shares in Safaricom and to ensure that the interests of Kenyan citizens are safeguarded.

Signed:  
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 Haron Ndubi, **Haki Focus**



## Continuing Public Concern around the Safaricom IPO

### MOBITELEA SHARES SHOULD BE FROZEN!

**YOU KNOW THAT**  
 Beginning March 28, 2008, the Government will sell off 25% of its stake in Safaricom through an Initial Public Offer (IPO).

**BUT DO YOU KNOW ...?**  
 Big questions hang over the transparency and accountability of dealings involving the Vodafone Group PLC, its local subsidiary Vodafone Kenya Ltd, the then Board of Telkom Kenya and a shadowy company called Mobitelea. The Government has ignored recommendations of the parliamentary Public Investments Committee, which only last year spoke of "apparent grand corruption" orchestrated by Vodafone Kenya Ltd in giving away 10 per cent of Safaricom's shareholding to Mobitelea.

**BACKGROUND:**

- Safaricom Limited was established in 1997 as a department of the Kenya Posts & Telecommunications Corporation (KP&TC), which was fully owned by the public. When the corporation was split into the Communications Commission of Kenya, Postal Corporation of Kenya and Telkom Kenya in 1999, Safaricom was left with Telkom Kenya.
- The KP&TC entered into a strategic partnership with the UK-based Vodafone Group PLC to run Safaricom. The shareholder agreement, signed on January 25, 1999, enabled Vodafone Group PLC, through its subsidiary, Vodafone Kenya Ltd, to acquire 30% shareholding in Safaricom from Telkom. At the time, Government policy on investments required that the share of Kenya ownership be not less than 70%. The shareholding was only paid for in 2000 – and then only after Vodafone Kenya Ltd requested and received an additional 10% of Safaricom. The policy was changed to accommodate this.
- Vodafone Kenya Ltd was not established in Kenya as a direct subsidiary of Vodafone Group PLC. Rather, it took over an existing local company, Shomoro Limited, which had been established in 1998, and changed its name to Vodafone Kenya Ltd. The records for Shomoro Limited and Vodafone Kenya Ltd are not in the Companies Registry.

**SO WHAT??**

- Granting 40% shareholding to a foreign entity, Vodafone PLC UK, went against the investment policy that required 70% local ownership. Also, 10% shareholding in a public utility, Safaricom, changed hands on the strength of a 'verbal request pending official written request'. In fact, as it turned out, the Telkom Board (**John Waweru, W.N Ayah, A.K Cheserem, M.P Manji, K.K Cherogony, D.A Oyatsi and G Mitine**) did not even receive the so-called 'verbal request' – it merely 'was informed of it'.
- Vodafone Group PLC 'offered Mobitelea an opportunity to acquire' 25% of its shareholding in Safaricom. In effect, it brought a third party to the shareholding agreement without consulting its other partner or offering it the chance to buy that stake. That effectively gave Mobitelea Ventures Ltd 10% ownership of Safaricom.
- Going by Vodafone's figures, Mobitelea received in a barter arrangement \$10 million for a 25% stake in Vodafone Kenya Ltd – that being 25% of the \$20 million that Vodafone paid for its share of Safaricom, plus the \$22 million Vodafone supposedly paid as part of its contribution to Safaricom's licence fee. **This is the basis for the oft-made assertion by Safaricom Kenya that it has only two owners, namely the Kenya Government and Vodafone Kenya Limited.** However, Vodafone Group PLC has itself confirmed that Mobitelea is a shareholder in Safaricom.
- On January 29 2007, Gavin Darby, the CEO of Vodafone Americas, Africa, China, India wrote to the Clerk of the Kenyan Parliament that the 25% offer was made to Mobitelea 'in return for its valued advice'. His explanation was that whenever Vodafone Group PLC invests in 'new territories', it is not uncommon for the company to work alongside 'a partner who typically gives advice on local business practices and protocols and the various challenges associated in investing in a new market'. However Mobitelea is not based nor does it operate in Kenya for it to understand the 'local investment challenges'. It is not clear what was being paid for. What does Darby's bland language mask?
- Mobitelea Ventures Ltd is registered in Guernsey, an offshore tax haven in the English Channel. Its owners are not known. Why would Vodafone, after paying for services rendered, transfer its shares to a firm to ease entry into a new market that it was already in?
- Vodafone transferred some of its shares in Safaricom to Mobitelea Ventures Ltd in 2002, when there was a General Election pending. That places the deal two years after Vodafone acquired its share of Safaricom – but three years after the shareholding agreement. The timing is suspicious: after at least two years, Vodafone had already established itself in the new market and had certainly consumed and presumably already paid for the advice it required from Mobitelea. **It is unclear why Mobitelea, itself a company presumably chasing profits, would give a client, Vodafone, advice for at least two years without pay.**
- Only one year after Vodafone Group PLC offered the 10 per cent Safaricom stake to Mobitelea, it bought back half of them in unclear circumstances. No one can ascertain the 'competitive process' through which Vodafone PLC supposedly bought back 5% of Safaricom shares from Mobitelea ventures as alluded to by Vodafone's Executive Garvin Darby in his letter to the PIC, nor the price.
- Going by the government projections that 25% of Safaricom shares will bring in Ksh50 billion, the value of 5% that Mobitelea still holds in the company is now worth Ksh10 billion. The Kenya Government appears unwilling to tell the public who owns Mobitelea Ventures Ltd, and what payment (if any) was made or received for the stake in Safaricom. Even Mr Michael Joseph, the Safaricom chief executive officer, stated to the PIC that he is unable to tell who the direct and indirect owners of the company he heads are.
- The transfer of Safaricom shares from Telkom to Vodafone and Mobitelea was neither above suspicion nor even regular. For instance, Mr Joseph Kinyua, Treasury Permanent Secretary, informed PIC that Vodafone first acquired 30%, rather than 40%, of Safaricom in January 1999 and not in 2000. He thus contradicted what Vodafone had indicated. **Therefore the true picture of when and how all these transfers occurred needs to be revealed and the wrongs committed righted.** As it is, the ownership of a significant 5% of the Safaricom stake by Mobitelea remains engulfed in a cloud of controversy that has a strong whiff of underhand wheeler-dealing.

**The PIC's recommendations have been ignored.** The sale of Safaricom shares is proceeding without any attempt to address questions of critical importance to any custodian of the public interest.

**Why the patent lack of interest in investigating the truth about Mobitelea?**

Unanswered questions include:

- Is the rush around the Safaricom IPO meant to enable the shadowy owners of Mobitelea to offload their shares? Who are the mysterious owners of Mobitelea Ventures Ltd? What payment did they make for their stake in Safaricom and what profit have they earned?
- Why is there so much pressure to proceed with the Safaricom IPO during the deepest crisis Kenya has ever experienced? Is it perhaps the case that the pressure for the listing to go ahead unconditionally may be intended to **facilitate the laundering of the proceeds of corruption and render their origins untraceable?**
- Should government not be concerned to do everything to prevent the loss of public funds in the face of the massive needs for reconstruction and rehabilitation of infrastructure?

**The Attorney General and the Minister of Finance, as the main custodians of the public interest in these cases, owe the Kenya public clear and comprehensive answers.**

Given the concerns outlined above, it is not legitimate for the Government of Kenya to ride roughshod over public concerns and ignore the recommendations of Parliament. These concerns are underlined by the present situation on the capital markets, where key players are being placed under statutory management and ordinary investors fear for the fate of their hard-earned funds.

**IT IS IMPERATIVE THAT MOBITELEA SHARES IN SAFARICOM BE FROZEN UNTIL ALL THE ISSUES RAISED AROUND THE ACQUISITION AND OFFLOADING OF THESE SHARES ARE CONCLUSIVELY AND SATISFACTORILY EXPLAINED AND ANY MALFEASANCE PUNISHED.**

Signed:  
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 For THE CIVIL SOCIETY TASK FORCE ON GRAND CORRUPTION



# DELIBERATE LOOPHOLES

Transparency Lessons from the Privatisation of Telkom and Safaricom

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