1. Overview

In the wake of the fuel shortage witnessed in 2008 and following complaints by oil marketers and financiers, the management of Kenya Pipeline Company (KPC) ordered an internal audit of oil stocks in its systems. The audit revealed that stocks amounting to 126.4 million litres were irregularly and illegally released to Triton Petroleum Limited between November 2007 and November 2008. Triton was not entitled to the stocks, nor did financiers authorise the release as required under contractual arrangements.

The Kenyan taxpayer risks losing over KES 7.6 billion\(^1\) as a result of the scam as the KPC breached an agreement with financiers stipulating that financed stocks would only be released on the financiers’ authority. KPC also issued false statements regarding those stocks. The Corporation is therefore exposed to suits by the financiers and defrauded oil marketers. Should existing and other possible suits succeed, KPC will be severely damaged and ultimately, any losses would have to be covered by tax payers.

Kenya Pipeline Company serves as the backbone of East Africa’s petroleum industry – it is critical to operations of the oil industry in Kenya, Uganda, Rwanda, Burundi and Eastern Democratic Republic of Congo.

Besides being a strategic facility, KPC has grown to be a significant revenue source to the government - in 2007, it paid KES 2.2 billion in direct and indirect taxes leading to it being recognised by the Kenya Revenue Authority as a distinguished tax payer.

KPC has assets of KES 20.2 billion. However, lack of professionalism and exposure to litigation from the financiers makes it a less attractive investment in the event that the government would want to privatise it and hinders its ability to raise funds for expansion projects.

As the Triton oil scandal has unravelled, there have been indications that the amount lost may have been underestimated:

---

\(^1\) The amount is arrived at as follows: 126.4 million (litres siphoned off) Multiplied by KES 60 (Price per litre) = KES 7.584 b. The price however during the period under review varied up to a high of KES 105 per litre.
Analysis of the TRITON OIL SCANDAL

- The amount is based on an internal audit covering the period Nov 2007 to December 2008 - it does not cover the period from July 2004 when Triton entered into signed a collateral financing agreement with KPC.
- The amount is calculated using a conservative price of KES 60 per litre, at a time when the average price was KES 100

Other claims are arising - for example, KRA recently informed banks and receivers who attached Triton’s property of its increased claim amounting to KES 4 billion in unpaid taxes and penalties by Triton. KRA had in January revealed that it was seeking KES 2 billion in unpaid corporation taxes for the period ending December 2007 and a penalty for storage at the Mombasa-based Kipevu Oil Storage Facility (KOSF). The taxman’s claim is linked to the financial year which ended in June 2009.

The scandal may have other serious repercussions in terms of:

- Increased cost of doing business due to the increase in country risk and associated higher premiums of access to credit.
- Slowdown in credit/loan approvals by banks affecting future Collateral Financing Arrangements (CFA) as KPC is no longer viewed as reliable and credible.
- Limited access to credit will increase oligopolistic tendencies in the market, with the majors – Shell, Total, Caltex, Mobil and Kenol/Kobil – controlling more than 80 percent of the market share. Small independent players will be locked out of the market leading to cartel-like behaviour.
- Uncertainties concerning future oil supplies created by the financing difficulties.

2. How did it happen?

Kenya’s oil import and trading arrangement is based on a complex Open Tendering System (OTS). Under the OTS, which is operated by the Ministry of Energy, oil marketers compete to import crude and refined products for the whole industry. The winner imports the monthly oil requirements and sells to other marketers at an agreed price.

The import is in some instances guaranteed by financiers under a Collateral Financing Agreement (CFA). The CFA arrangement was

The Kenya Pipeline Company was incorporated on 6th September 1973 under the Companies Act (Cap 486) and started commercial operations in 1978. The Company is a State Corporation under the Ministry of Energy with 100% government shareholding. Kenya Pipeline Company operates a pipeline system for transportation of refined petroleum products from Mombasa to Nairobi and western Kenya towns of Nakuru, Kisumu and Eldoret.

2 http://www.nation.co.ke/business/news/-/1006/516184/-/view/printVersion/-/333j0l/-/index.html accessed on June 4th 2009
3 High-level crime at Pipeline endangers the whole region Daily Nation January 13th 2009
4 The logic behind this relates to economies of scale i.e. large volumes allow importer to get lower prices. It also benefits small players unable to import commercially viable quantities
introduced in 2004 by KPC in order to enable oil marketing companies to use their stock within KPC transport and storage system as security in order to secure financing. Under the scheme, banks issue Letters of Credit committing themselves to pay 80 percent of the total cost of the oil imported. In turn, an oil importer signs an agreement with KPC stating that oil within the KPC system can only be released with the authority and instructions of the financiers of the consignment. The agreement also obliges KPC to release regular statements on stocks held in trust at agreed intervals to financiers. Oil marketers would only have access to their share of the imported oil from KPC on the written authorisation of the financiers after they have paid for their entitlement.

The industry rule is that oil marketers hold ullage (storage) space at the Kipevu Oil Storage Facility (KOSF) in proportion to their market share which at the end of 2007 stood as follows- Kenol/Kobil 22.4 percent, Shell 21.8 percent, Total 21.2 percent, Chevron 13 percent, Oil Libya 7.3 percent, NOCK 2.4 percent and independents (inclusive of Triton) 11.5 percent. Complaints from other oil marketers strongly suggest that Triton Ltd had an undue advantage over other players in the use of KPC facilities as it reportedly often held stocks that took half the space at KOSF!

The apparent purpose of holding such huge stocks was to enable Triton to engage in speculative activities\(^5\). During the year, the price of oil had increased to USD 140 per barrel. Taking advantage of this price volatility, Triton was able to buy crude oil and hold it until prices soared above the buying price before disposing of it at a huge profit.

The scheme collapsed when oil prices plummeted to below USD 50 per barrel in November 2008. The company could not sell its huge stocks at KOSF and the imported consignment at a price that would enable it to recover its costs\(^6\).

As a result, the company started experiencing serious difficulties in honouring its financial obligations to financiers and creditors. It not only fell back in payments to these financiers,

---

Timeline

- **December 2008**: Fuel shortage hits the country.
- **December 19, 2008**: Triton Petroleum placed under receivership
  
  KPC MD orders audit and two officials from Operations Dept suspended.
  
  Audit reveals falsified records
- **January 09 2009**: KPC Chairman and MD sacked and officials sent on compulsory leave.
- **January 9, 2009**: Energy minister instructs KACC to perform audit.
  
  KCB sues Triton.
- **January 14, 2009**: Petroleum Institute of East Africa - PIEA General Manager George Wachira resigns
- **March 2009**: Government commissions PWC audit.
- **March 4 2009**: Kenol wins tender for supply of crude.
- **Present**: PWC Independent report yet to be released to public

\(^5\) This was reportedly the cause of fuel shortages locally and regionally in Dec 08.

\(^6\) Indications are that the spirited demand by Kenyans for reduction in fuel prices and refusal by other marketers to play ball with Triton contributed significantly to the situation.
but was at the same time not able to access the oil it had ordered.

Triton Petroleum Ltd won the October 2008 importation tender for oil that was scheduled to be offloaded in December 2008. The company, though a small player in the oil industry with a market share of less than 1 percent, had signed a Collateral Financing Agreement with KPC in July 2004. The company reportedly imported a consignment of 56,000 metric tons in October 2008 which fell short of the monthly requirement of about 80,000 tonnes.

At the time, KPC was reportedly implementing an advanced computerised system on product accounting and stock movement within its network. The implementation was incomplete and the system could not provide live data. Triton, in collusion with KPC staff, appears to have taken advantage of this and come up with a scheme that allowed it to draw oil from the KPC system without paying for it. Further, KPC officers clandestinely released 126.4 million litres to the company without the consent of financiers.

To achieve this, KPC staff reportedly falsified records to show that the stocks were still with KPC and misled the financiers that their stocks were intact while they had in fact already been released to Triton. Junior KPC officials working in the operations department reportedly wrote letters to financiers (Kenya Commercial Bank, Glencore of the UK and Fortis Bank of France) providing them with false information to the effect that all was well and that the stocks were intact.

Oil marketers had on several occasions complained about dealings between Triton and KPC, complaints which went unheeded. Upon realising or suspecting the information supplied by KPC to be false, the financiers responded by directing that no more product be released to Triton.

The regional fuel shortage prompted the KPC management to order an audit of oil stocks which was to include a reconciliation of amounts of stocks held in trust on behalf of respective financiers. It is through this audit that the shocking revelation was made that stocks which ought to have been held in trust had been clandestinely released to Triton between November 2007 and November 2008.

Once KPC informed the financiers that there were no stocks held in trust for them, One of the main financiers, KCB, moved to court and in late December 2008, Triton was put under receivership. By the time it went bust, Triton owed financiers KES 7.6 billion among them- KCB (owed 1.85b), Glencore (2.3b), Fortis of France (906m), and Emirates National Oil Company (2.5b). Its managing director Yagnesh Devani then reportedly fled the country.
3. Links to Politicians

There is considerable evidence to suggest that Triton enjoyed good political connections which it could have exploited to receive preferential treatment at KPC.

In addition to holding the OTS for the supply of oil, Triton in partnership with Total Kenya, held the tender for the provision of petroleum products to KenGen (up until it was placed under receivership).

Triton’s executive chairman and managing director, Mr. Yagnesh Mohanlal Devani has been described as a shrewd 43 year old businessman who lives large and hobnobs with the high and mighty. A 2006 ceremony to open Triton’s LPG depot was attended by political bigwigs, including then Vice-President Moody Awori, several cabinet ministers, Hon. Raila Odinga, Hon. Uhuru Kenyatta, and several permanent secretaries.

4. Key Players

4.1 Kenya Pipeline Company

Since its establishment in 1973, KPC has been linked to several corruption scandals involving politicians and well-connected individuals. In 2001 for example, KPC spent KES 262.4 m to purchase 32 plots of public land illegally excised from Ngong Forest and irregularly allocated to 13 companies. Four of these companies are reportedly associated with Hon. William Ruto, the current Minister for Agriculture.

The company’s past transactions with the government also tend to support the allegations of links with key political players. During the regime of President Daniel arap Moi, Triton clinched the lucrative contract to supply petroleum products to the Kenya Power and Lighting Company several times. It was the local partner of The Reliance Consortium (led by India’s largest private telecom service provider, Reliance Telecoms) which was poised to take up the second national operator license in 2007 for KES 12 billion.

Triton was among the firms named in Parliament as having received large loans from Charterhouse Bank in contravention of banking regulations and in what was suspected to have been money laundering.

The former MD George Okungu is credited with turning the fortunes of the company around. In 2006, it was ranked the second best performing state corporation. George Okungu assumed leadership at a time when KPC was indebted to the tune of KES 5 billion in unpaid taxes and penalties; by 2006 KPC was reporting KES 2.1b pre-tax profit in 2006.
Blame for the scandal has tended to be heaped on junior officers at the state corporation. Both the Energy Ministry and KPC top officials have maintained that junior clerks at KPC’s operations department, especially “schedulers” (i.e. those involved in the actual release of the product from KPC system), were responsible. They also claim that it was junior officers who gave false information to financiers and falsified records to show the stocks were available. Two junior staff have reportedly been suspended for alleged direct collusion with Triton.

That such irregularity could go on for nine months without the knowledge of top management beggars belief. In the absence of collusion in the fraud, the evidence at a minimum points to gross negligence i.e. neglect of duty of care, or even criminal negligence i.e. fraud or misappropriation by the KPC management.

A vital part of the KPC operations is its product accounting system that enables it to identify products within its system that belong to a particular oil marketing company or that are under a CFA. If the system was operating properly it is hard to fathom how KPC’s internal and external auditors were unable to pick up stock anomalies.

Available information suggests that the top management were indeed informed of the irregularities. Kenol/Kobil Acting Chairman and Managing Director Jacob Segman, while calling for the resignation of the General Manager of The Petroleum Institute of East Africa, said his company had raised the red flag over dealings between Kenya Pipeline Company and Triton Petroleum Limited, which had gone unheeded17. The PIEA managing director was and remains a board member of Kenya Pipeline Company and the oil marketers were of the view that he was not defending their interests in the KPC board.

George Okungu, KPC’s Managing Director at the time the malpractices took place, should be held accountable for the scandal. He was sent on compulsory leave while two other officials were reportedly sacked or suspended by the MD prior to his suspension. The Chairman of the KPC Board of directors was also suspended; although holding oversight it is not clear what role he may have played in the scandal. The Minister for Energy Kiraitu Murungi termed it a “a serious crime of dishonesty and fraud” but to date no criminal charges have been brought and Devani has sought to have the criminal charges against him dropped by settling out of court with KCB18. In addition, the Minister offered financiers a guarantee to prevent the financiers suing KPC.19

4.2 Ministry of Energy
Top officials at the Ministry of Energy, in whose docket the oil sector falls, have absolved themselves from blame. Energy Permanent Secretary Patrick Nyoike says he was kept in the dark over illegal dealings between KPC and Triton Company. He has nonetheless
vowed to step aside if implicated in the scandal. Energy Minister Kiraitu Murungi on his part denied any wrongdoing. However, as Minister for Energy, Kiraitu Murungi is responsible for overall energy policy, and should therefore accept political responsibility for the failures at KPC. KPC as a parastatal also falls under his docket.

Hon. Murungi claims that the scam was perpetrated by officials of the KPC in cahoots with Mr. Yagnesh Devani. He has been at pains to explain the steps he took to ensure that those involved in the scam were held accountable and steps taken to forestall such occurrences in future including: ordering a full forensic audit by PriceWaterhouseCoopers; a probe by Kenya Anti-Corruption Commission and suspending the KPC Chairman and Managing Director.20

Media reports however suggest that officials at the Ministry of Energy were calling KPCs’ scheduling office directly with instructions to release fuel to preferred oil companies. Reports also indicate that oil marketers had for a long time complained of criminal activities taking place at KPC. Kenol Kobil for instance is on record as having accused KPC of preferentially allowing Triton to take storage space at KOSF despite its lack of a retail distribution network21, which allowed Triton to speculate by hoarding fuel stocks pending price increase. Neither the Ministry nor KPC acted on this information.

When a fuel shortage started to bite, top officials at the Ministry of Energy and KPC attributed it to vandalism, power outages, failure by oil marketers to move their stocks fast enough, and panic buying by consumers22. In light of consequent events, this was a clear misrepresentation by government officials.

4.3 The Energy Regulatory Commission (ERC)
The Energy Act, 2006, under which the ERC was established, lists its objects and functions to include:
• Regulating importation, exportation, transportation, refining, storage and sale of petroleum and petroleum products.
• Protecting the interests of consumers, investors and other stakeholders.
• Monitoring and ensuring implementation and the observance of the principles of fair competition in the energy sector in coordination with other statutory authorities;
• Collecting and maintain energy data.
Its public interest functions include fighting against fuel adulteration and dumping, while also ensuring efficient operation of petroleum sub-sector.

20 http://www.nation.co.ke/News/-/1056/541076/-/u324ym/-/index.html
22 http://www.kpc.co.ke/inside.php?articleid=1
While there is no evidence pointing to the direct involvement of ERC in the scam, the Commission clearly failed to discharge its duty to protect the public interest. The Commission has so far not taken any action in the matter. Its legal mandate empowers it to ensure fair competition in the market. The complaints by other market players suggest that Triton was quite likely engaging in unfair practices.

In addition, Cap 12 Section 6 of the Energy Act gives the Commission powers to investigate complaints or disputes between parties with grievances over any matter required to be regulated under the Act. The ERC is yet to take any action on public reports of the oil scandal despite it having a massive impact on the energy sector as a whole.

4.4 Financiers/Bank Staff

There has been suspicion that staff at some banks may have been involved in the conspiracy through unauthorised signing of letters of release to Triton. Unconfirmed reports indicate that Triton paid bank staff to turn a blind eye. KCB has reportedly sacked three officers over the issue23.

5. Emerging Corruption in KPC

In addition to the Triton scandal, the KPC is currently entangled in another controversy on its procurement and project management methods.

This is specifically regarding the Line 1 (Mombasa – Nairobi) Capacity Enhancement Project aimed at increasing the oil pumping capacity between Mombasa and Nairobi depots at a cost of KES 6.5 billion. Due to what the Energy Minister termed as “a marginal variation of KES 2.1 Billion” the cost variations of the project have raised current expenditure on the project to KES 8.6 billion24. He said the variations were as a result of several factors such as price escalations, time extension, and currency fluctuations. KES 2.1 Billion is hardly marginal as it represent a third of the initial total estimated costs.

In addition to the cost variations, the project is still incomplete and the government still needs to pump in more funds to ensure the intended enhanced pumping capacity is achieved25. According to the Public Procurement and Oversight Authority (PPOA), between KES 2 and 3 billion will be lost by the completion of this project26.

Auditors who probed the Kenya Pipeline’s Line 1 Capacity Enhancement Project identified uncontrolled variations, breach of procurement laws, unnecessary trips,
fictitious claims, inflated costs and unjustified expenditures, in what appeared to be organised graft to fleece the corporation.\(^{27}\)

The audit, among other findings, indicated that KPC Long Lead Items whose original contract amount was KES 1.4 billion, increased astronomically by KES 608 million totalling KES 2.085 billion.

KPC also purchased small capacity pumps than what was originally ordered meaning the oil transporter will ultimately lose KES 419.2 million in the transaction.\(^{28}\)

In a current court case between KPC and two companies associated with a former MP, Triple Eight Construction Kenya Limited, and Njuca Consolidated Company, KPC indicated that it awarded a tender to the two companies worth KES 262,633,005 but court documents contradict this stating that KES 685,848,563.74 was paid in excess, in relation to the said contract.\(^{29}\)

The KPC claims that its officers and the two companies defrauded the company “through the disguise of unauthorised amendments and outright single sourcing at exorbitant and non –competitive prices”\(^{30}\)

In the contract for building and civil works within Plant Area awarded to Triple Eight Construction Limited/Njuca Consolidated, the original sum of KES 262.6 million was varied at the cost KES 310 million and attracted price fluctuation of KES 116.3 million in addition to other claims totalling KES 982.6 million. The auditors stated that the project proceeded with the new costs without reference to the approving authority.\(^{31}\)

The initial cost of the Triple Eight Construction Limited tender for site camps was KES 171.3 million but was varied by KES 71.5 million, pushing up the cost to KES 242.9 million.\(^{32}\)

The unfolding of the Line 1 scandal further illustrates the rot at KPC and poor oversight by the KPC Board. In addition, audit queries raised by the PPOA have gone unanswered and the Minister’s statements appear to downplay the queries raised.\(^{33}\)

\(^{27}\) http://www.eastandard.net/InsidePage.php?id=1144017537&cid=48
\(^{28}\) Ibid.
\(^{29}\) Ibid.
\(^{30}\) http://www.eastandard.net/InsidePage.php?id=1144017704&cid=48
\(^{31}\) http://www.eastandard.net/InsidePage.php?id=1144017537&cid=4
\(^{32}\) Ibid.
\(^{33}\) http://www.kpc.co.ke/inside.php?articleid=1 The report was said to be a draft and the final report is yet to be released.
6. Lessons & Conclusions

Given its political connections, allegations that Triton was operating as a corruption conduit involving very senior people at both KPC and the Ministry of Energy appear credible. This would explain why there appears to be a concerted effort to conceal the real reasons behind the fuel shortage. An argument has also been put forward that the fraud was committed by an oil marketer and that it is the banks, not the government which have been defrauded. The impression created is that the public does not stand to lose from this scandal and this despite the fact that KPC, a wholly publicly-owned parastatal, stands exposed to be sued.

This impression has been supported by Yagnesh Devani’s apparent willingness to pay the amounts he owes to local banks in exchange for a withdrawal of the warrant of arrest and cases filed against him and the lifting of a receivership over his property. Other recovery efforts include the attachment of a Triton oil storage facility under construction in Mombasa as security to compensate financiers who lost their money. KCB sought and received court orders freezing all Triton assets.

It is not clear whether Triton has assets sufficient to meet the amount demanded under the various deeds of guarantee and indemnity and to compensate all claims - Mr. Devani had reportedly disposed of some of these assets, including his matrimonial home in Nairobi’s upmarket Lavington area before fleeing. Given the foregoing, and in light of the concept of limited liability, it is highly likely that some of the claimants may seek remedies from other sources. The KPC, as a party to the CFA, may then be sued for breach of trust as its officials appear to have colluded to release oil without approval from the financiers.

As has been pointed out, Kenya Pipeline Company is seriously exposed to a lawsuit by financiers for releasing the oil products without their authority. It is also significant that Triton did not acknowledge receipt of the 126.4 million litres of oil products siphoned-off. KPC has already been sued by KCB, Total Kenya as well as Shell. The burden of the scam may very well eventually be borne by the taxpayer.

Recommendations:

- Review the KPC internal risk management systems
- Audit all KPC projects, including enhancements of the main line or the new IT system, the planned laying of a new line to Uganda and the completion of the KenPipe Plaza.
- Reform the sector to address monopolistic

---

34 http://www.eastandard.net/InsidePage.php?id=1144014901&cid=14&j=/&m=/&d=  
35 Ibid.
and oligopolistic industry structures. Economic theory predicts that they tend to be inefficient and also exploit consumers.

- Release KACC reports on the oil scandal and prior scandals at KPC to the public and prosecute those adversely mentioned. It would also be worthwhile to determine why KACC did not prosecute the MD prior to the exposure of this scandal.
- Release the PWC audit report to the public. This will inform the public and enhance future vigilance over public institutions.
- Release the Audit report by the PPOA to the public.
- Address the inefficient fuel distribution system. This is epitomised by the outdated Mombasa Oil refinery and infrastructure including the pipeline, which has serious capacity constraints.
- Review the oil procurement system with the aim of locking out collusion and cartel-like behaviour. The OTS system should also be made more transparent.
- Analyse the KPC board’s review functions for major procurement projects to ascertain whether board failure to carry out its oversight responsibility is the result of incompetence, lack of capacity, or involvement in fraud.
- Make public the technical audit report of experts from Jomo Kenyatta University of Agriculture and Technology on the capacity of the Line 1 enhancement.
About AfriCOG

Africa Centre for Open Governance (AfriCOG) is a civil society organisation dedicated to addressing the structural and institutional causes of corruption and bad governance in Kenya.

Africa Centre for Open Governance
Kasuku Road, Off Lenana Road next to CVS Plaza
P.O. Box 18157-00100, Nairobi, Kenya
t: +254 20 2723031 / 0737 463166, f: 2714675,
email: admin@africog.org
www.africog.org