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Taking Security in Kenya

A Comparative Guide for Investors

ABOUT THIS GUIDE

In light of Africa's sustained economic growth over the last decade, the continent has become an increasingly attractive destination for investment.

However, to a foreign investor, assessing legal risk requires an understanding of the laws and the legal system particular to the jurisdictions in which the investment is being made.

Taking Security in Kenya - A Comparative Guide for Investors provides an overview of the types of assets over which security can be taken in Kenya, the different types of security, as well as the related procedures for the perfection and enforcement of such security.

This Kenya guide forms part of wider series focusing on the most active jurisdictions in Africa, and was prepared with the help of Kenyan firm Anjarwalla & Khanna.

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KENYA

TYPES OF SECURITY INTERESTS

What categories of assets are typically provided as security to lenders in Kenyan financings?

Shares

Security over shares in a Kenyan company can be taken by way of a charge or a deposit of share certificates:

- **Charge:** Security over shares can be taken by way of a fixed or floating charge.
- **Deposit of share certificates:** Where shares have not been dematerialised, security can be taken over such shares by depositing the relevant share certificates with the secured party.

Bank Accounts

Security over the proceeds of a bank account is taken by way of a fixed or floating charge.

Land

Security can be taken over land by way of a charge, or a deposit of title deeds with the secured party.

Contractual Rights

Security can be granted over contractual rights by way of a fixed or floating charge or an assignment, in each case provided that there is nothing in the relevant contract that prohibits the granting of such security.

Insurance Proceeds

Security over proceeds from an insurance policy can be taken by way of a charge over, or by way of an assignment of, the relevant insurance contract.

Authorisations and Licences

Security can be taken over authorisations and licences by way of a fixed or floating charge or an assignment, in each case provided that there is nothing in the relevant contract, licence or authorisation that prohibits the granting of such security or assignment thereof.

Many authorisations and licences (such as oil mining licences, mining permits, electricity generation and distribution licences and rights under petroleum agreements) are considered to be personal to the beneficiary or licence holder and therefore will prohibit the holder from assigning, charging or otherwise encumbering such authorisation or licence without the prior consent of the issuing authority.

Intellectual Property

A company will typically take security over trademarks, copyrights and other intellectual property by way of a fixed or floating charge.

Personal Property and Tangible Assets

Security in the form of a fixed or floating charge or a pledge may be taken over personal property such as merchandise/goods.

Special rules apply regarding the taking of security over aircraft and ships.

Can security be taken over future assets?

Security can be created over future assets.

Are there any restrictions on who can legally grant and/or hold a security interest?

Generally, a company may grant or hold a security interest provided the company has sufficient capacity and authority. More restrictive regimes apply to certain types of companies, such as insurers and statutory corporations.

There are certain restrictions on the acquisition of shares by non-Kenyan nationals in certain types of companies, such as listed companies (i.e., listed on the Nairobi Securities Exchange), insurance companies and private companies that own agricultural land.

Are security trustees or security agencies recognised under Kenyan law? If so, do any steps need to be taken to ensure the enforceability of a security trustee's or a security agent's right in the secured property?

Security trustees and security agents are recognised under Kenyan law, and a security trustee or agent can be appointed to hold security for the benefit of lenders and other secured parties. If a security trustee or agent is validly appointed, no additional steps are required for the trustee or agent to be recognised under Kenyan law. Provided that the security granted in its favour has been properly perfected, the trustee's or agent's rights regarding the security interest should be enforceable.

What about third-party security?

Under Kenyan law, a person or entity can generally grant security over its assets to secure the obligations of a third-party. Regarding Kenyan companies, the ability to grant security over a company's assets to secure the obligations of a third-party is permitted only to the extent the company's constitutional documents authorise it to do so and the grant is for the company's commercial benefit. A shareholders' resolution is also required for a public company or a company connected to a public company.

PERFECTING SECURITY INTERESTS AND PRIORITY

Are there any asset-specific perfection requirements?

Shares

- **Registration:** For shares that are listed on the Nairobi Securities Exchange and have been dematerialised, security over those shares should be registered in accordance with the provisions of the Central Depositories Act 2000 by the delivery to the chargee of a prescribed form. The latter requirement is in addition to the process of registering a charge at the Companies Registry. The chargee is required to send the form to the Central Depository and Settlement Corporation via a central depository agent. The Central Depository and Settlement Corporation will record the security interest and freeze the shares in the chargor's account. This additional process is not required for a floating charge over listed shares.

Alternatively, the Registry may issue a letter confirming that the charge is not registrable. In such a case, the company secretary of the chargor should undertake not to allow the chargor to deal with the shares and note the charge in the chargor company's register of members.

- **Deposit of share certificates:** The terms of the deposit, enforcement rights and rights to return of the shares upon satisfaction of the underlying debt should be set out in a memorandum of deposit, accompanying the share certificate. The chargor must deliver the share certificates (and accompanying memorandum of deposit) and a signed but undated share transfer form to the chargee.
- **Power of attorney:** The chargor must grant and deliver an irrevocable power of attorney to the chargee.

Bank Accounts

In the case of a fixed charge, the secured party must take control over the charged accounts and prevent the chargor from withdrawing monies from, or otherwise dealing with, the charged accounts without the chargee's consent. With a floating charge, the chargor is permitted to retain control of the charged accounts unless and until the charge converts into a fixed charge following a specified event occurring as set out in the account charge documents.

Land

- **Charge:** The charging instrument must be in a prescribed form. Third-party consent may be required prior to creation of the charge in certain cases, e.g., charges over leasehold property, land leased from the Kenya Railways Authority or the Kenya Ports Authority, or agricultural land.

A charge over land must be registered at the applicable Lands Registry. There is no applicable time limit, although charges are only effective upon registration, and the date of registration determines the priority between charges. Registration will be carried out once the Registry receives three original copies of the charging instrument, the completed prescribed form, and a nominal fee per document and per title.

If the chargor is a company registered in Kenya, the charge over land must also be registered at the Companies Registry.

- **Deposit of title deeds:** The grantor of the security interest is required to deposit the title deeds with the secured party.

Contractual Rights and Insurance Proceeds

Notice of the security interest must be given to the counterparty of the underlying contract. For an assignment of insurance proceeds, this means giving notice to the relevant insurer.

The failure to give notice to a counterparty does not invalidate the security assignment; it may however, affect the priority of the security interest.

Authorisations and Licences

Provided any necessary consent from the issuing authority has been obtained, the assignment can be perfected in the same manner described above. Importantly, even if the issuing authority's consent is not required to create security over the authorisation or license, consent may still be required to effect a transfer of the authorisation or license upon an enforcement.

Intellectual Property

As with other contractual rights, the licensor must be notified of any assignment of rights under an intellectual property license agreement.

Personal Property and Tangible Assets

- **Charge:** The charge must be registered at the Registrar of Chattels within 21 days of the charge's creation via the delivery of the original charging instrument attached to an Affidavit of Due Execution in a prescribed form, and a schedule of the property charged and a nominal fee paid. This registration must be renewed every five years.
- **Pledge:** The pledgor must deliver possession of the personal property to the pledgee.
- **Mortgage:** The process of perfecting a mortgage over personal property is the same as that outlined in above.
- **Ships and aircraft:** For aircraft, a security interest is noted on the certificate of registration, which is issued by the Kenya Civil Aviation Authority and registered at the International Registry of Mobile Assets (and the Companies Registry, if the chargor is a company registered in Kenya). For ships, registering the security interest at the Kenya Maritime Authority is recommended.

What are the fees, costs and expenses associated with creating and perfecting security in Kenya?

- **Stamp Duty:** Subject to certain limited exemptions, stamp duty is payable on all security documents. The stamping process must be completed within 30 days of executing the document (or, if the security was executed outside Kenya, within 30 days of the security document entering into Kenya). The person taking security bears the costs related to stamp duty. However, the parties usually agree to have the security provider bear these costs. The failure to stamp a security document can result in a fine, inability to register the security document, and the security document being declared inadmissible in court.

Stamp duty is typically payable at the rate of 0.1% of the amount secured by any principal security document. Stamp duty is payable on supplemental security documents at the nominal rate of KES20 (US\$0.25).

- **Companies registry:** After stamping, all registrable charges and mortgages a Kenyan company creates must be registered at the Companies Registry within 30 days of creation (*i.e.*, typically the charging instrument's date of execution) via the delivery of the original charging instrument, the completed prescribed form and fee of KES600 (US\$7).

Section 878 of the Companies Act 2015 (the Companies Act) lists the types of charges and mortgages that are registrable.

Charges over assets situated in Kenya, and created by a foreign company with a place of business in Kenya, must be registered at the Companies Registry within 21 days. Registration is effected by the delivery of a notarised copy of the charging instrument, a completed prescribed form and the payment of a registration fee (as stated above) to the Companies Registrar.

Can security over the same asset be granted to two creditors? If so, how will priority be determined?

A person can grant security over the same asset to two or more creditors.

For a security over land, date of registration determines priority among creditors. The creditor who is registered first has priority over the other creditors.

For security over other types of assets, either date of creation and registration of the security, or the date on which notice is given to a third-party, determines priority among creditors.

Creditors can also enter into a security sharing agreement in which they agree to disregard priority as determined by the date of registration, and instead, agree to prioritise their security as set out in the security sharing agreement.

ENFORCEMENT OF SECURITY

Outside the context of bankruptcy or insolvency proceedings, what steps should a secured party take in order to enforce its security interest?

When a debenture is used to create a security interest, the terms of the debenture will typically set out the enforcement procedure and provide for the appointment of a receiver and/or manager to undertake the procedure.

In a charge over shares, a chargee would enforce by using the power of attorney and share transfer form (both granted to it by the chargor upon perfection) to transfer the shares to itself or a nominee. The chargee must then stamp the share transfer form and notify the Companies Registry of its newly acquired interest in the shares. Finally, the company secretary of the company whose shares were transferred must register the chargee in the company's register of members.

The Land Act (Number 6 of 2012) and the Land Registration Act 2012 govern enforcement of a charge over land. The chargee can commence enforcement proceedings only if the chargor has been in default for a month or more. The chargee must then serve notice upon the chargor to cure the default. If the default has not been remedied within two months (or three months, if there has been a payment default), the chargee may then either:

- Sue for the amount due
- Appoint a receiver of the income from the property
- Lease the land
- Take possession of the land
- Sell the land by private contract or public auction

However, remedies (a) and (d) described herein are not applicable if the land is considered to be customary or community land. Currently, there is a requirement to issue a notice in a prescribed form to carry out the remedies set out in (b) through (e); however, the prescribed form has not yet been determined, and consequently, the ability to enforce charges over land is uncertain at this time.

If the chargee elects to sell the land by private contract, the chargee must give the chargor 40 days' notice. A sale by auction requires the auctioneer to give the chargor 45 days' notice and to advertise the sale publicly. In either case, the chargee must obtain a "forced sale valuation" of the land. The chargee is under a legal duty to achieve the best price reasonably obtainable at the time of sale.

Are any governmental or other consents required in connection with an out-of-court enforcement of security?

Land Control Board consent is required for any lease or sale of agricultural land. Otherwise, out-of-court enforcement of security is generally permitted under Kenyan law.

In cases where a creditor has taken security by way of a deposit of an ownership instrument, the creditor must obtain permission from the courts prior to possessing or selling the secured land.

Are there any restrictions on who can enforce a security interest over assets located in, or governed by the laws of, Kenya?

There are no such restrictions.

INSOLVENCY/BANKRUPTCY PROCEEDINGS

Overview

Insolvency in Kenya is governed by the Insolvency Act 2015.

This section deals with bankruptcy and insolvency law as it applies to incorporated companies only. This section does not cover the insolvency of statutory corporations, banks or insurance companies, which are subject to special insolvency legislation under the laws that regulate the licensing of such institutions.

- **Members' voluntary liquidation:** The members of the company in a general meeting must appoint one or more liquidators for the purpose of liquidating the company's affairs and distributing its assets.

Upon the liquidator's appointment, all the powers of the directors cease, except in so far as the company in general meeting or the liquidator sanctions their continuance. A liquidator will then be appointed to conduct the formal winding-up of the company.

Only an insolvency practitioner is eligible for appointment as a liquidator.

As soon as practicable after the company's liquidation is complete, the liquidator must prepare an account of the liquidation showing how it has been conducted and how the company's property has been disposed (the Liquidator's Account). Within 30 days of preparing the Liquidator's Account, the liquidator must convene a general meeting of the company and the company's creditors. The liquidator must ensure that the notice for the meeting is published once in the Kenya Gazette, once in at least two newspapers (circulating in the location of the company's principal place of business) and on the company's website, and specify the time, date, place and purpose of the meeting. Within seven days of the meeting, the liquidator must lodge with the Registry a copy of the Liquidator's Account together with a return giving details of the holding of the meeting and the meeting date.

- **Creditors' voluntary liquidation:** The creditors and the company can nominate an authorised insolvency practitioner to be the liquidator for the purposes of liquidating the company's affairs and distributing its assets.

The requirements for a meeting and for a Liquidator's Account.

- **Liquidation by court:** A company may be wound-up by petition to court if:
 - The company is unable to pay its debts as they fall due
 - The company passes a special resolution that it be liquidated by the High Court
 - At the time which a moratorium for the company ends, an agreed voluntary arrangement does not have effect regarding the company
 - Except for a private company limited by shares or by guarantee, the number of members is reduced below two
 - Being a public company that was registered as such on its original incorporation, (A) the company has not been issued with a trading certificate, and (B) more than 12 months have elapsed since it was so registered
 - The company fails to commence its business within a year of its incorporation or suspension of its business for one year or longer
 - The court decides that winding up the company is just and equitable
 - The Attorney-General makes an application to that effect

Winding up or insolvency registers

The Official Receiver must maintain a public register of undischarged and discharged bankrupts, debtors subject to current summary installment orders and persons admitted to (and discharged from) the no-asset procedure.

Are "company rescue" or reorganisation procedures available?

Yes, such procedures (in particular, administration and company voluntary arrangements) are available under the Insolvency Act 2015.

- **Administration:** A company is put under administration when an administrator is appointed over it. An administrator may be appointed by the courts, by the holder of a floating charge or by the company or its directors. In all instances, the administrator must be a qualified insolvency practitioner and will be regarded as an officer of the court.

The main objectives of administration are to maintain the company as a going concern and to achieve an outcome for the company's creditors that would be better than a liquidation of the company. The administrator will typically develop a plan of action to rescue the company while the administration order is in effect and will act in the best interest of all the company's creditors.

Once an administration order is made, a moratorium comes into effect and a creditor may only take steps to enforce security with the consent of the administrator or with the court's approval. While an administration order is in effect, an application for the liquidation of the company cannot be made and any pending application for liquidation will be suspended.

While a company is under administration, the administrator shall ensure that all business documents issued by or on behalf of the company or the administrator, state the name of the administrator and that the affairs and property of the company are being managed by the administrator.

- **Company voluntary arrangements:** The directors of a company may make a proposal to the company and to its creditors for a voluntary arrangement in respect of the company's debts and financial affairs. An authorised insolvency practitioner must be appointed to supervise such an arrangement. Such voluntary arrangements may also be proposed by an administrator if a company is in administration or by a liquidator if the company is in liquidation.

When a company enters into a voluntary arrangement, a moratorium takes effect. The company is restricted from obtaining further credit and/or paying its liabilities during the moratorium. The company's creditors will require the court's approval to enforce security over the company's assets or to commence proceedings against the company.

Will the commencement of insolvency proceedings against a grantor of security affect the ability of a secured party/creditor to enforce the security interests granted to it by that company?

No, a secured creditor will still be able to enforce its security.

However, if a company is under a moratorium, a secured creditor must first seek court approval to enforce the creditor's security.

Are there any preference periods, claw-back rights or preferential creditors' rights that creditors should be aware of?

- **Preferential creditors' rights:** Preferential creditors include (in order of priority): reasonable costs of the liquidator; wages and salaries; and government taxes.
- **Fraudulent preference:** Any transfer, conveyance, mortgage or charge, delivery of goods, payment, execution or other act relating to the debtor's property occurring six months or less before the commencement of insolvency proceedings, and that had as its motive the favouring of one creditor's interest over others', may be set aside as a fraudulent preference.
- **Floating charges:** Floating charges over a debtor's assets created within 12 months of the presentation of a winding-up petition may be invalidated unless the chargee was solvent immediately after the creation of the charge. There is an exception such that the invalidation of a floating charge will not affect a creditor's ability to claim amounts of cash paid to the chargee (plus interest at the prescribed rate) subsequent to, and in consideration of the creation of the charge.

Can debt a company owes a creditor be contractually subordinated to debt that company owes another creditor? Are contractual subordination provisions that are agreed among creditors legally recognised on the insolvency or bankruptcy of the company?

Debt a company owes a creditor can be contractually subordinated to debt owed to other creditors, and contractual subordination is typically recognised under Kenyan law in the event of insolvency.

How is priority among secured parties determined on the insolvency of the debtor?

Priority between creditors will be as follows:

- Secured creditors holding a first fixed charge
- Preferential creditors
- Creditors with floating charges
- Unsecured creditors

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