

**LEGAL BUSINESS SCOPE  
AND  
OPPORTUNITY IN THE CONTEXT OF  
CAPITAL MARKETS INDUSTRY  
AND  
PRICING OF SERVICES**

A paper presented by

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# **LEGAL BUSINESS SCOPE AND OPPORTUNITY IN THE CONTEXT OF CAPITAL MARKETS INDUSTRY AND PRICING OF SERVICES**

## **1. INTRODUCTION**

The last time I visited Dar-es-Salaam was back in 1998. My mission then was to look for suitable premises in which to open a branch of a Kenyan bank. I recall that we had a problem of registering the name of the bank as the word "National" was not acceptable to the authorities. Unfortunately the project did not take off and I moved on to do other things. So when Mr. Jimna Mbaru, the respected former Chairman of the Nairobi Stock Exchange contacted me on the telephone and asked me whether I would accept an invitation to address a workshop on capital markets in Dar-es-Salaam, I was somewhat excited. This excitement stemmed from two reasons; firstly, the prospect of a visit down here would afford me an opportunity to deal with a subject which I find fascinating and to listen to and share views with you - the participants and, secondly having graduated from the "hill", thirty- one years ago, I felt a sense of nostalgia for such a visit. After determining my schedule and getting some clarifications from Mr. Malauri, particularly regarding the topic and the duration of my presentation, I accepted to come. In fact I joked with Mr. Malauri that even politicians who are, normally, generously endowed with the gift of the garb would find a three plus hours presentation fairly challenging. Be it as it may, I am here and glad to be.

The topic of my presentation and discussion today ***"Legal Business Scope and Opportunity in the Context of Capital Markets and Pricing of Services"*** is a vast one and I do not pretend that we shall exhaust this interesting subject to-day, but we shall attempt to focus on critical issues – more so from a legal practitioner's perspective.

For easy of presentation, I decided to split the topic into two broad sections, i.e.

(a) Legal Business Scope and Opportunities.

(b) Pricing of Services.

all within the context of the Capital Markets.

## 2. **DEFINITIONS.**

Before we delve further into these topics, given my brief that some participants may not have had an opportunity to practice in this area, I thought that it will be important to understand what we mean by the term capital markets. For those in the audience who may have studied the topic or who are active in the industry, I will request that you bear with the rest of us as we examine the meaning of this term within the overall context of the topic of discussion today.

Black's Law Dictionary defines the phrase as:

***"A securities market in which stocks and bonds with long term maturities are traded."***

David Adams in his Corporate Finance: Banking and Capital Markets - a legal practice course publication - defines the capital markets thus;

***"A capital market is not a market place in the sense of a physical place, such as a trading floor with people waving their arms and trading in securities. It refers instead to the vast amount of capital available from financial institutions, pensions funds, and investment funds (and a few high-net-worth individuals) who want to buy securities either to hold as an investment or to trade."***

The Capital Markets is therefore essentially a source from which or a medium through which governments, institutions or entities with substantial borrowing or financial needs use to raise funds. Sometimes confusion may arise on the difference between raising funds through capital market issues and obtaining a commercial loan from a bank; perhaps a couple of examples may suffice to distinguish the basic differences.

- In a capital markets issue the borrower issues a document(s). This may be in the form of a debt security, evidencing the issuer's acknowledgement of the debt.
- Whilst majority of loans are issued by commercial or development banks as lenders, the "lenders" in the capital markets context are basically investors investing their money through the medium of the specific instrument issued by the issuer. (Here you may have investors with long term objectives in as far as their investments are concerned. And these may be interested more with capital appreciation over time rather than immediate returns, or speculators with short term objectives who would normally dispose of their investment as soon as they are in a profit taking position).
- Given the state of development and depth of the capital markets and the awareness by investors, of risks or opportunities, it may be cheaper (particularly where equity or share capital is involved) to raise funds from the capital markets than borrowing from a bank. Furthermore where the securities involved are traded, it is easier for an investor to sell his securities whenever he so chooses. This helps attract other investors for they know that they may exit at any time they so desire. It is not always easy to sell bank loans to third parties.

- Potentially, the number of investors willing to invest in securities is far larger than the number of commercial banks issuing loans, the amount of funds available to an issuer is therefore potentially large.
- A listed equity or debt security would normally be public knowledge whereas a commercial loan remains confidential between the bank and the borrower.

The above brief examples of the differences between a commercial loan from a bank and an equity or a debt security is certainly not exhaustive, but will suffice for our purposes.

The terms security, equity and debt security have been used often in the preceding paragraphs. It is now opportune for us to define these terms as they will be central to this presentation.

For our purposes, we shall therefore focus on:

- Security
- Equity Security and
- Debt security

Section 2 of the Capital Markets Authority Act (Cap 485A of the Laws of Kenya) defines the term "**securities**" as –

- (a) debentures, stocks or bonds issued or proposed to be issued by a government;**
- (b) debentures, stocks shares bonds or notes issued or proposed to be issued by a body corporate;**

**(c) any right, warrant option or futures in respect of any debenture, stock, shares bonds notes or in respect of commodities; or**

**(d) any instrument commonly known as securities,**

**but does not include-**

**(i) bills of exchange;**

**(ii) promissory notes; or**

**(iii) certificate of deposit issued by a bank or financial institution licensed under the Banking Act, 1989;**

Black's Law dictionary defines security as:

**"an instrument that evidences the holder's ownership rights in a firm (e.g. shares or stocks) the holder's creditor relationship with a firm or government (e.g. a bond) or the holder's other rights (e.g. an option )."**

and it defines equity security as,

**"A security representing an ownership interest in a corporation as a share, rather than a debt interest such as a bond; any stock or similar security or any security that's convertible into stock or similar security or carrying a warrant or right to subscribe to or purchase stock or a similar security, and any such warrant or right".**

and a debt security as,

**"a security representing funds borrowed by the corporation from the holder of the debt obligation, especially. a bond or debenture....."**

From the above definitions, equity and debt securities are capital market instruments which governments or corporate bodies may use to raise funds from financial institutions, pension funds, investment funds or individuals. Let us now, in a general way and each in turn, outline some of the essential features of an ***equity security*** and ***a debt security***.

**(a) Equity Securities**

For the rest of this presentation, holding equity in a company will basically mean holding shares in that company; and shareholder is an investor in the subject company.

Once an investor has bought into a company and is allotted shares, he can only realize the funds so invested by selling his shares through a stock exchange or upon winding up of the company. Even so, upon winding up he can only realize his capital investment and only if there is a surplus.

- Basically the investor has no absolute right to receive a return on his investment i.e a dividend or a bonus share.
- Should the company be wound up the investor ranks last after all creditors have been paid.
- With allotment of shares to the investor, comes the right to attend shareholders' meetings either in person or by proxy and to vote on any resolution put before that meeting. To this general statement an exception may exist, particularly in those instances where the shares of the company are divided into different classes and one class of shares are conferred with different rights including a restriction not to

vote at any general meetings of the company. In most companies whose shares are traded on the Nairobi Stock Exchange ( NSE ) such restrictions are an exception rather than the norm and would be contra to The Capital Markets Authority (CMA ) Regulations and NSE listing and continuing listing requirements. It is expected that shares of the same class will always have the same rights attached to them without any discrimination.

**(b) Debt Securities**

- The investment will have a definite maturity date. At maturity the issuer is obligated to redeem the security and pay the investor. One attraction of debt security is that most are tradable at the stock exchange giving the investor an option to sell his security and realize the capital sum before maturity. (One of the very first debt security to be traded at the Nairobi Stock Exchange was the East African Development Bank's floating rate bond. This was developed jointly with the National Bank of Kenya who acted as the receiving and paying agent as well as the registrar).
- Before the date of maturity the investor is entitled to receive a regular return on his investment often by way of interest. Other debt securities may be offered at a discount to its face value (e.g. Government Treasury Bills).
- Some of the investments may be secured, although often they are not. If not secured they will rank behind secured and preferred creditors but ahead of shareholders in a winding up.



- In certain cases, the investor and the issuer may agree that the debt may be converted into equity at the option of the investor upon the happening of some event. Except for this type of arrangement the investor does not generally take any shareholding in the issuer.

In the foregoing paragraphs an attempt has been made to define the capital markets, both the equity and debt securities and the extent to which the latter two differ from each other and the rights and obligations attached to each.

The Rules and regulations which have been enacted to deal with instances where either a body corporate or a government wishes to raise funds through capital markets instruments are many and detailed. The task of a lawyer practicing in this area is how best to navigate quickly through the labyrinth of these rules and regulations and ensure that the ensuing documentation protects both the issuers and the investors while making the regulator and the stock exchange happy.

We shall now turn and examine the scope and opportunities which issuance of those securities offer the practising lawyer to do business with the major players in the Capital Markets arena.

### **3. LEGAL BUSINESS SCOPE AND OPPORTUNITIES**

In this section we shall look at and examine the business opportunities for lawyers who may be consulted by clients intending to source funds through either the equity or debt securities or those clients who want to invest funds through these instruments. We shall examine each in turn.

### **3.1 Equity Securities**

The most common method employed by companies to raise funds from the capital markets is through issuance of shares to the public i.e. public share issue also called a public offer of shares. This may be by way of an Initial Public Offering (IPO) also referred to as a primary issue or through a subsequent public issue for an already listed company.

An initial public offering will normally be in respect of a company going to the public to raise funds for the first time. This may be part of a privatization, where a government wants to exit from a commercial or industrial concern, or a hitherto privately owned company whose owners want to expand both the capital and ownership base of the company and in the process raise funds to strengthen its business.

Although the legal work that may be required in respect of both an IPO and any subsequent public share issues is largely the same and we shall examine this shortly, in an IPO the following actions may be necessary:

- Conversion of the company into a public company if it existed as a private company.

As you know one of the major differences between a public and private company relates to the mode of transferability of their respective shares. Whereas in a private company the right of a shareholder in respect of the transferability of his shares are restricted to the existing shareholders, i.e. through the rights of pre-emption, the shares of a public company are freely transferable at prices either agreed upon by the parties, if it is not listed or if it is a listed company i.e. whose shares are tradeable on a stock exchange, the price will be dictated by market forces of supply and demand. In Kenya both the regulations made under the Capital Markets

Authority Act and the Listing requirements of the Nairobi Stock Exchange clearly stipulate that the shares of a listed company or a company seeking listing, must be freely transferable.

For the lawyer advising a company involved in a public issue for the first time the starting point will be to examine the status of both that company's Memorandum and Articles of Association to determine and advise on, inter alia, the following:

- That given perhaps the scope of business it will be involved in after conclusion of the issue, that the Memorandum adequately covers all classes of such business as it will disclose in its information memorandum or prospectus.
- Whether it is necessary to increase the nominal capital of the company.
- That the articles are suitably amended to remove any restrictions relating to the transferability of its shares once trading commences on those shares.
- The mode of electing and retirement of directors.
- That if previously the Articles of Association referred to and adopted Table "A" of the Company's Act, you may wish to advise your client that it is prudent to prepare a full blown articles and cease any reference to Table "A". One major advantage for this, of course, is

- That both the Memorandum and Articles will now be available in one booklet, as opposed to a reference to Table "A", and not all shareholders will have access to Table "A" without buying the Company's Act.

Having determined the nature and extent of the amendments required, the advocate involved will then advise the process of amending both the Memorandum and Articles of Association.

Under Sections 8(1) and 13(1) respectively of the Kenyan Companies Act, a company is empowered to amend its Memorandum and Articles of Association at any time at a duly constituted Annual General Meeting or at an Extra-Ordinary General Meeting which may be called solely for the purposes of effecting the requisite amendments.

Sections 8(1) and 13(1) of the Kenya Companies Act require that those amendments be effected through a Special Resolution. Section 141 defines such a resolution as one which has been passed by a majority of not less than three quarters (75%) of such members of the Company present at a quorate meeting and being entitled to vote, do so either in person or by proxy where proxies are allowed.

The notice circulated to all members convening the meeting must clearly state that a resolution to amend the articles or the memorandum will be proposed as a special resolution.

After the resolutions have been passed at the meeting as stated elsewhere above it, will be the duty of the advising advocate to see to the registration of the amendment by delivering to the Registrar of Companies certified copies of the resolution and the amendment. It is worth noting that the holders of an aggregate of 15% of the issued and paid up share capital of the company or equivalent holders in case of debentures may petition the courts to prevent a company from altering either its Memorandum of Association or the Articles of Association. The right to move to court is not, however, available to a shareholder who was present at the meeting and voted in favor of the resolution.

With the necessary amendments to the memorandum and the articles duly registered, the range of activities by the advising lawyer may cover the whole or any of the following areas. These areas will apply whether the company is making an IPO or being already listed is returning to the market to raise further funds and probably also to enlarge its shareholder base.

To enable the company go to the public and convince investors to invest their money in the company, it will be necessary to issue a prospectus together with several other documents as required by law and regulators.

The role of the legal adviser to the issue may involve all or any of the following tasks. These are not exhaustive and are not ranked according to their importance.

- (i) Attending all meetings of the Committee of Professionals involved in providing specialized input to the Prospectus. These Professionals include the Reporting Accountants, the Company's

Auditors (who may also be the Reporting Accountants), the Lead Stock Brokers, the Underwriters (if any), Financial Advisers, Receiving Bankers, Registrar Transfer Officer and the Company Secretary.

- (ii) Drafting the Prospectus and adding on to it as advised and as documents are availed from various Professionals involved and the management of the company.
- (iii) Advising on the listing requirements of the Stock Exchange (SE) and to ensure that these and the continuing listing requirements of the SE will be adhered to. Perusing the applications to be submitted to SE for the listing of the new shares and to ensure that these comply with the SE's regulations. Advising on any legal matters SE may raise.
- (iv) Advising on the legal requirements of the Capital Markets Authority (CMA) as regards a public issue i.e. eligibility, disclosure etc. and ensuring compliance with the requisite regulations.
- (v) At the Nairobi Stock Exchange equities are listed either on the Main Investment Market Segment (MIM) or Alternative Investment Market Segment (AIM). Listing of shares in either MIM or AIM depends on fulfilling some set eligibility criteria e.g. a company listed under MIM should have a paid up share capital of at least KShs. Fifty Million whereas the requirement under AIM is KShs. Twenty Million. Net assets for listing under MIM should not be less than KShs. One Hundred Million whereas under AIM is KShs. Twenty Million.

- (vi) Drafting Application to the CMA and submitting a Draft Prospectus for their approval. Consulting with CMA throughout the preparation of the Prospectus as necessary.
- (vii) Assisting in preparing the Agent's Manual to ensure that it complies with existing laws and regulations and any agreement reached between the Company and those agents.
- (viii) Drafting or perusing any correspondence between the Company and Banks who may have agreed to provide loans to prospective purchasers of the shares.
- (ix) Drafting or perusing correspondence between the Company and Banks or other agents who may have agreed to collect and forward completed application forms from applicants.
- (x) Perusing and advising on any correspondence emanating from Sponsoring Brokers.
- (xi) To confirm together with Reporting Accountants that the Company is indeed the shareholder of the various companies both public and private listed in the Prospectus as comprising its investments.
- (xii) To confirm through searches in the Land Registry that the Company is the registered and beneficial owner of any landed properties listed in the Prospectus.
- (xiii) To confirm the ownership of the subsidiaries, if any, listed in the Prospectus.

- (xiv) Drafting the procedure and terms and conditions for application and allocation.
- (xv) Perusing and advising on any material agreement between the Company and any other party and confirm that such agreements are valid and binding as at the date of the prospectus.
- (xvi) Confirming and advising on whether or not the existing capital of the Company is subject to any law and if so whether or not it conforms to that law.
- (xvii) Advising and listing all documents which must be available for inspection at the registered office of the Company; such documents would include, memorandum and articles of association, material contracts, a legal opinion, latest audited accounts etc.
- (xviii) Drafting and completing for inclusion in the Prospectus certain portions of the Statutory and General information relating to the Company.
- (xix) Perusing as necessary other documents forming part of the Prospectus and ensuring that they comply with any written law or regulation to which the Company is subject or with which it is necessary to comply.
- (xx) Producing copies of the Prospectus at various stages of drafting to ensure that all involved are up to date on amendments made ready for the next meeting. (This is important as one party must be responsible for producing drafts of the Prospectus. The task according to our experience would normally fall on the Advocates to the issue).



- (xxi) To draft and complete "**preliminaries**" to the Prospectus and produce a table of contents.
- (xxii) To draft the Offer Time-Table and Statistics.
- (xxiii) Throughout the drafting and discussions with other Professionals, rendering any other legal advice touching on the issue whenever this is sought or as necessary.
- (xxiv) Rendering a legal opinion in respect of matters referred to in the Capital Markets Authority Rules 1992 as amended from time to time and other matters. This is one of the documents which is included in the Prospectus and also available for inspection.
- (xxv) Ensuring that the Prospectus is signed by all Directors and delivering it together with any other documents required under the Companies Act to the Registrar of Companies for Registration before the list opens to the public
- (xxvi) Making yourselves available from the date the offer opens for subscriptions until allotments and issuance of Share Certificate to advise on any Post-Prospectus and Post-Issue legal matters.

In the foregoing paragraphs, we have listed a range of tasks and matters in respect of which a legal adviser would bring his knowledge and expertise to bear. In rendering his advice it is very important for the Advocate to remember that he acts as an expert and therefore takes professional responsibility for the statements contained in the prospectus.

Both the Capital Markets Authority (CMA) the Kenyan Securities regulator and the Nairobi Stock Exchange (NSE) have issued extensive regulations and Rules, intended to ensure both transparency in dealing with shares at the exchange and investor protection through adequate disclosure of information to assist investors make informed decisions. ***(See appendix).***

**3.1.1** The foregoing paragraphs have dealt with the role of a lawyer as a legal adviser to a company intending to issue shares to the public (whether as an IPO or in respect of an already listed company ).

In addition, there are other areas in which the lawyer's expert knowledge will be required once the company has successfully sold its shares to the public and its shares are already being traded at the exchange. These other areas include:

- A rights issue
- Bonus Issue
- Scrip Dividend

Let us briefly examine each of them in turn.

**(a) Rights Issue**

Unlike a public share issue where the company (issuer) may invite the whole wide world of investors to purchase its shares, a rights issue only involves an invitation to existing shareholders, initially to purchase shares which the directors have allocated to each existing shareholder on the basis of the shares already held, i.e. on a pro-rata basis.

A legal advisor may be called upon to advise on an appropriate resolution together with other documentation necessary for the shareholders to make an informed decision on whether they wish to participate or not.

If any particular shareholder is not desirous of taking up his rights he can trade those rights on the stock exchange.

Normally the price of shares in a Rights issue may be pegged as near as possible to the last price involving a concluded transaction at the stock exchange. It is not mandatory that a shareholder takes up his allotted shares.

**(b) Bonus Issue**

Bonus issue basically relate to a situation where a company has substantial retained earnings (*certain reserves*) and chooses to capitalize those reserves into equity and allot to the existing shareholders so many shares for so many shares held. For example a company may resolve to give one share for every five shares already held. Such bonus shares are credited to the existing shareholder as fully paid up. This normally happens in lieu of a cash dividend – particularly where a company does not have enough liquid cash to pay a dividend or to reward its shareholders with additional shares without paying for them.

A legal adviser may be called upon to draft an appropriate resolution and possibly see that a return of allotment has been filed with the Registrar of companies.

**(c) Scrip Dividend**

The Scrip Dividend is an option given to existing shareholders to either take a dividend the company has declared in cash or in lieu of cash a certain number of shares equal in value as near as possible to the dividend the shareholder would have received but for his election to receive the shares instead.

On a scrip dividend proposal, an appropriate document is normally prepared explaining the shareholders rights and obligations and dealing with such other matters as taxation eligibility and basis of allotment, among others

Throughout the discussions of the above issues, an assumption is made that the authorized but un-issued share capital of the company is adequate to enable allotment of shares to be effected. If not, the company would be advised to increase its share capital following the procedure previously set out. The nature and extent of such increase is a matter for the directors and members at a general meeting taking into account the financial needs of the company and the circumstances obtaining at the time the proposal is made.

But it is appropriate to state that a company is empowered under Section 63(1) of the Act to increase its share capital at any time it so wishes through an ordinary resolution.

**(d) Underwriting Agreements**

When a company is offering its shares to the public and the funds to be raised are deemed by the directors and member to be critical to the continuation of the company's business, to hedge against the risks of failure or under subscription, the company may enter into an agreement with a third party – normally a bank, an insurance company or other approved person to underwrite the whole or a portion of the shares the subject of the issue.

This would ensure that no matter what happens i.e. if investor response is poor, the company would at least raise the minimum funds it requires to sustain its business activities or at least those disclosed in the prospectus.

The legal adviser to the issue will need to draft and/or peruse the agreement to ensure that it meets the objectives of the company.

**(e) Private Placement**

Unlike a public issue which targets the whole wide world of investors, a private placement focuses mainly on specific investors such as institutional investors or high net-worth individuals. In general terms the tasks which a legal advisor is supposed to undertake in respect of a public share issue as outlined above, may also be applicable to private placement, it will not be necessary to go into any greater details on this therefore.

In addition to advising companies whose shares are listed and traded on the stock exchange, there will always be investors who will seek legal advice regarding their rights *qua* shareholders. For example some shareholder may not be terribly impressed by the way the directors are managing their company and may want to know how they may take action against such directors within the law. They may further wish to know whether or not they can propose themselves or their friends or relatives to be voted in as directors. And if so what is the procedure to do so? They may wish to know the difference, when voting on any resolution at a general meeting, between raising up their hands as a way of casting their vote and voting through a poll. Who for instance should demand for a poll? They may wish to know whether minority shareholders have recourse to any relief or remedy if they felt that the majority was oppressing them. And if so what are these reliefs or remedies?

Some investor may wish to seek advice on whether or not they can instruct their stockbrokers or investment advisor to buy all the shares of a particular company available on the stock exchange or whether they can put an advertisement in a newspaper offering a specific price to any shareholder, who is willing to sell his shares. If so what the legal procedures to enable them accomplish their objectives.

**(f) Mergers And Takeovers**

A dynamic economy, will also see business entities merging or being acquired by others either to eliminate competition or to compliment their existing core business. In such cases, in addition

to financial audit, those concerned may wish to undertake a complete legal audit to determine the legal well being of the entity to be acquired or merged with.

Takeovers may be hostile or friendly. Sometimes the regulator may be convinced by the action and conduct of an investor that a takeover is taking place and may demand that the provisions relating to takeovers be strictly observed.

Under the provisions of the Capital Markets Authority (Amendment) Rules 1996 (Legal Notice No. 286 of 1996), the term "take-over" is defined in an interesting way. I quote in extenso Rule 42(3) of the above Rules:

***"Where any person or any company makes an offer for the acquisition of "effective control" of a company which holds shares which, together with shares, if any, already held by such person or company or by any other company that is deemed by virtue of paragraph (5) to be related to such company, carry the right to exercise, or control the exercise of not less than twenty-five per cent (25%) of the votes attached to the voting share of a company listed on a securities exchange, it shall be deemed to be a take-over and the provisions of these rules with such modifications and qualifications as may be necessary shall apply provided that this rule shall not apply where the first named person or company already holds shares carrying more than seventy-five per cent (75%) voting rights in the second named company."***

An investor who is active on the stock exchange may easily find himself falling foul of this regulation purely by default unless he was carefully monitoring his acquisition of the particular company whose shares he may have been actively purchasing at the exchange.

The preceding paragraphs have generally set out the work that would be expected of a legal adviser, either advising the company about to make a public offer of shares or an investor wishing to understand a little more about his rights as a shareholder relative to the company and the other shareholders.

We shall now focus on

### **3.2 Debt Securities**

Early in this paper we defined debt securities and outlined some basic differences between them and commercial loans. We shall now look at specific instruments which comprise debt securities.

#### **(a) Bonds**

*Issuance of bonds go back a long way. In fact in Shakespeare's Merchants of Venice, Antonio is reported to have signed a bond in favour of Shylock to enable his friend Bassanio borrow from Shylock. In comforting Bassanio, Antonio said:*



***"Why fear not man, I will not forfeit it. Within these two months, that's a month before this bond expires, I do expect a return of thrice three times the value of this bond."***

***Needless to say both Shylock and Antonio went to the notary's to seal the deal!***

A bond is a certificate of debt under which the issuer obligates itself to pay the principal sum to the bondholder at a specified date. Bonds may be issued at a discount to its face value or at regular periods interest is paid to the bondholder by the issuer. As we saw earlier, both governments and corporate bodies issue bonds as a way of raising money to finance their needs.

Bonds may or may not be traded at a stock exchange. At the Nairobi Stock Exchange bonds are traded under the Fixed Income Securities Market Segment.

In this respect the Capital Markets Authority in Kenya, has issued detailed disclosure requirement for instruments traded under this specific market segment. The regulations titled:

***"Capital Markets Regulations and Disclosure Requirements for Public Offers and Listing of Securities, 2002"***

came into force on 7<sup>th</sup> January 2002 and provide that any issuer who intends to issue debt securities or other fixed income security to the public must fully comply with the disclosure requirements contained under ***Part C of the Third Schedule*** of the above regulations. And it does not matter whether or not the issuer intends to list the debt securities on the Stock Exchange or not.

The issuer of a debt security is expected to issue a prospectus or an information memorandum which should contain information which is sufficiently detailed and clear, to enable any person who may wish to enter into a commercial contractual relationship with the issuer to make an informed decision. The names and addresses of expert advisers to the issue which would include, inter alia, legal advisers must clearly appear on the prospectus. It is therefore beholden on the advising lawyer to understand fully the type, nature and contents of the prospectus, in order to adequately advise either the issuer or a prospective investor. Whereas it is not intended to reproduce in detail the disclosure regulations it will nonetheless be in order to highlight some of the areas which you as the advising lawyer will need to focus on. These areas would include:

- The existence and sufficiency of the documents of incorporation i.e. the Memorandum and Articles of Association. That the corporate body has power under its memorandum not only to issue bonds but also to the extent it wishes to do so. *(Some companies may contain limitation clauses in their memorandum and articles of association to the effect that it can only raise funds equivalent to the fully paid up share capital of the company, i.e limiting the power of directors to borrow funds. If one were found in such a situation the advise to the company will be to amend the memorandum at a duly convened general meeting either to remove the clause all together or to increase the nominal share capital of the company and allot shares.)*

- Advising on any material documents that have been reduced into writing, and if not so reduced, a memorandum giving full particulars thereof.
- Service agreements with managers or underwriting vendor's or promoters agreement.
- Any trust deed, of the issuer or its subsidiary undertakings.
- Any contractual arrangements with a controlling shareholder required to ensure that the issuer is capable at all times of carrying on its business independently of any controller shareholders.....
- Information on any legal or arbitration proceedings commenced by or against the company and which has financial or other implications.
- Summary of rights conferred upon the holders of the debt securities.

The above are merely examples of matters which the lawyers may take into account in giving his advise to the client. Given the detailed nature of the regulations, one needs to peruse them carefully so that in drafting the prospectus or information memorandum, no material information is omitted.

**(b) Debentures**

The Companies Act defines a "debenture" thus;

***"includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not."***

A debenture is therefore a document which acknowledges indebtedness of a company to another whether a bank or other provider of finance to that other company.

A debenture whether fixed or floating essentially contains details of the parties i.e. borrower and lender, the amount borrowed the interest charged and assets which are covered by that security, events which will give rise to the debenture holder exercising his rights under the debenture. Normally the debtor would charge "all its assets, fixed or moveable wherever and whatsoever together with its uncalled capital."

### **3.3 CONCLUSIONS**

Whether a company is seeking to raise funds through debt or equity securities, or to reward its existing shareholders through a bonus or rights issue, there will always be considerable documentation and continuous legal advice that is required to meet both the requirements of the law and regulators and as a marketing tool. In the case of a prospectus by disclosing the nature and extent of the business of the company, this may convince prospective investors that they stand to make a decent return if they invested in that particular company.

Depending on the depth, sophistication and dynamism of the Capital Markets in an economy, there will always be considerable business for legal practitioners. The unfortunate aspect of this, however, may be the tendency to concentrate this area of practice in the hands of only a few. But like all other sectors of the service industry, one must positively endeavor oneself to those in search of the service.

#### **4. PRICING OF LEGAL SERVICES**

**4.1** Having been involved in all the work outlined above, what should the Advocate be paid for his efforts?

For developing economies like Kenya and Tanzania where Capital Markets are still in their infancy, this area of practice has been generally confined to a few law firms. Except as detailed below, there are no clear guidelines on how to charge legal fees for services rendered in this important area of practice. However, a set of principles will help guide an Advocate retained to advise on any of the matters set out above and arrive at a fair fee both to himself and the client. These include;

- the time taken to accomplish any of the above matters,
- the number and seniority of the advocates involved,
- the amount of money involved i.e the amount the company is seeking to raise,
- the complexity of the issue or the difficulty or novelty of any matter which the advocate has to deal with,
- the skill effort, specialized knowledge or expertise and responsibility involved,
- the extent of any research that may be necessary,

**4.2** Advocates in Kenya are guided by the Rules laid down in ***the Advocates (Remuneration) (Amendment) Order, 1997*** as detailed in the Advocates Act Cap 16 of the Laws of Kenya and the rules made thereunder. Notwithstanding the existence of the above Order, more often than not when a company is intending to make a Public Share Issue, it is not unusual for that company to request professional service providers, including Advocates, to submit a quotation setting out a statement of their capability, the tasks that they will provide, the fee to be charged and how payment of the fee will be effected.

In addition to the general principles set out above, the order sets out the following guidelines on costing which are relevant for the purposes of my presentation:

Paragraph 4(1) of the said Advocates (Remuneration) Order provides as follows:

***"Where any business requires and receives exceptional dispatch, or, at the request of the client, is attended to outside normal business hours the advocate shall be entitled to receive and shall be allowed such additional remuneration as is appropriate in the circumstances."***

Paragraph 4(2) provides as follows:

***"Such additional remuneration shall, except in special circumstances, be allowable only as between Advocate and Client."***

Paragraph 5(1) and (2) of the said Order further provides as follows:

**(1) "In business of exceptional importance or of unusual complexity an advocate shall be entitled to receive and shall be allowed as against his client a special fee in addition to the remuneration provided in this Order."**

**(2) "In assessing such special fee regard may be had to-**

**(a) The place at or the circumstances in which the business or part thereof is transacted.**

**(b) The nature and extent of the pecuniary or other interest involved;**

**(c) The labour and responsibility entailed; and**

**(d) The number, complexity and importance of the documents prepared or examined."**

**4.3** In addition to the above, Schedule V of the said Advocates Remuneration Order provides in Part I that an Advocate may charge his client fees at such hourly rate or rates as may be agreed upon with his client from time to time. Part II of the said Schedule provides an alternative method of assessment in respect of instructions fee, and states;

***Such instruction fees should take into account the care and labour, length of the papers to be perused, the nature and importance of the matter, the amount or value of the subject matter involved, the interest of the parties, complexity of the matter and all other circumstances of the case...***

From the foregoing, the Advocate should be able to charge fees in this new area of legal practice under any of the above Sections of the Advocates Remuneration Order or agree a fee with his client. I believe that Tanzania would have similar provisions of the law. However, it is obvious that there is some need to have the Kenya's Advocates Remuneration Order amended to specifically deal with legal practice pertaining to the Capital Markets. It is only then that the Law Firms practicing this discipline of the law will have the same base on which to charge their fees. This is more so because of the level of professional responsibility that an advocate is called upon to carry particularly if it turns out that in giving his professional opinion not all the material facts were disclosed to him.



Finally I hope that in some way this document has helped to illuminate an area of this interesting subject that may not have been clear.

Thank you.

JPNS/ Imm

## **APPENDIX**

Legislation referred to in this presentation, is Kenyan.

1. The Companies Act – Cap 486 – Laws of Kenya.
2.
  - The Capital Markets Authority Act – Cap 485A – Laws of Kenya.
  - The Capital Markets Authority (Amendment) Act, 2000.
  - The Capital Markets Authority Regulations, 1992.
  - The Capital Markets Authority Rules, 1992.
  - The Capital Markets Authority (Foreign Investors) (No. 2) Regulations, 1995.
  - The Capital Markets Authority Collective Investment Schemes Regulations, 2001.
  - The Capital Markets Authority and Disclosures Requirements for Public Offers and Listing of Securities, 2002.
3. The Listing Manual and Rules and Regulations of the Nairobi Stock Exchange.
4. David Adams, Corporate Finance: Banking and Capital Markets.
5. Black's Law dictionary - 7<sup>th</sup> Edition.
6. Shakespeare – Merchants of Venice.