REPUBLIC OF KENYA

NATIONAL ASSEMBLY

ELEVENTH PARLIAMENT – SECOND SESSION

THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

PRIVATIZATION OF THE PUBLIC SECTOR OWNED / CONTROLLED SUGAR COMPANIES

(NZOIA SUGAR COMPANY, SOUTH NYANZA SUGAR COMPANY, CHEMILIL SUGAR COMPANY, MUHORONI SUGAR COMPANY AND MIWANI SUGAR COMPANY)

NATIONAL ASSEMBLY,
PARLIAMENT BUILDINGS,
NAIROBI

DECEMBER, 2014

PREFACE

Mr. Speaker, Sir

The Committee on Finance, Planning & Trade is a Departmental Committees of the National Assembly established under Standing Order No. 216 and mandated to:

(a) to investigate, inquire into, and report on all matters relating to the mandate, management, activities, administration, operations and estimates of the assigned ministries and departments;
(b) to study the programme and policy objectives of ministries and departments and the effectiveness of the implementation.
(c) to study and review all legislation referred to it;
(d) to study, assess and analyse the relative success of the ministries and departments as measured by the results obtained as compared with their stated objectives;
(e) to investigate and inquire into all matters relating to the assigned ministries and departments as they may deem necessary and as may be referred to them by the House;
(f) to vet and report on all appointments where the Constitution or any law requires the National Assembly to approve, except those under Standing Order 204 (*Committee on Appointments*); and
(g) Make reports and recommendations to the House as often as possible, including recommendation of proposed legislation.

Mr. Speaker, Sir

The Committee on Finance, Planning & Trade was constituted by the House on Thursday 16th May, 2013 comprising of the following members:-

1. The Hon. Benjamin Langat, MP **(Chairman)**
2. The Hon. Nelson Gaichuhie, MP **(vice Chairman)**
3. The Hon. Jones M Mlolwa, MP
4. The Hon. Anyanga, Andrew Toboso, MP
5. The Hon. Timothy M .E. Bosire, MP
6. The Hon. Ahmed Shakeel Shabbir Ahmed, MP
7. The Hon. Joash Olum, MP
8. The Hon. Dr. Oburu Oginga, MP
9. The Hon. Patrick Makau King'ola, MP
10. The Hon. Abdullswamad Sheriff, MP
11. The Hon. Sumra Irshadali, MP
12. The Hon. Ogendo Rose Nyamunga, MP
13. The Hon. Iringo Cyprian Kubai, MP
14. The Hon. Dennis Waweru, MP
15. The Hon. Tiras N. Ngahu, MP
16. The Hon. Sakaja Johnson, MP
17. The Hon. Jimmy Nuru Angwenyi, MP
18. The Hon. Ronald Tonui, MP

19. The Hon. Mary Emase, MP
20. The Hon. Joseph Limo, MP
21. The Hon. Lati Lelelit, MP
22. The Hon. Kirwa Stephen Bitok, MP
23. The Hon. Sammy Mwaita, MP
24. The Hon. Daniel E. Nanok, MP
25. The Hon. Eng. Shadrack Manga, MP
26. The Hon. Abdul Rahim Dawood, MP
27. The Hon. Sakwa John Bunyasi, MP
28. The Hon. Alfred W. Sambu, MP
29. The Hon. Sammy Koech, MP

Mr. Speaker, Sir,

On 27th November, 2014, the Cabinet Secretary for the National Treasury appeared before the Committee and requested that Parliament approves the privatization proposals for the Public Sector owned / controlled sugar companies (Nzoia Sugar Company, South Nyanza Sugar Company, Chemilil Sugar Company, Muhoroni Sugar Company and Miwani Sugar Company). He submitted that the privatization proposals had been approved by the Cabinet on 14th October, 2010 and brought to Parliament for approval Pursuant to Section 23(2) of the Privatization Act, 2005.

Mr. Speaker, Sir,

On 9th January 2013, Parliament resolved to postpone privatization of the above sugar factories until such a time when all the legislations affecting the Agricultural Sector (sugar) and the County Governments have been put in place. These conditions have since been made through the enactment of Agriculture, Livestock and Food Authority (ALFA) Act in 2012 and the devolution process that ushered in the County Governments in March 2013.

Mr. Speaker, Sir,

The Sugar Sector factories earmarked for privatization have been facing a lot of challenges among them being: obsolete machinery; high level of indebtedness; low productivity; poor management; and uneconomical land use among others. The sugar companies continue to entangle themselves under excessive debt and are unable to invest and compete with sugar imports from COMESA region. This has made it difficult for them to survive once the tariff and quota protection that constitute the COMESA safeguards are removed. Kenya has exhausted her COMESA safeguards extensions which are due for expiry on 28th February 2015. These extensions were meant to protect the companies from collapsing by giving them more time to rehabilitate and modernize hence making them competitive before the safeguards expire.

Mr. Speaker, Sir,

The latest COMESA Safeguards extension, which is the last, was granted on account of progress made as the Government had approved the privatization of the sugar companies in October 2010. There is therefore need to expedite the privatization to avoid collapsing of these companies which would adversely affect the livelihood of the Kenyans in the sugar growing areas. The economy of most parts of Nyanza and Western Kenya sugar belts is sugar based with other crops grown only for subsistence. Therefore the livelihoods of these Kenyans which is estimated to be 20% needs to be protected at all costs.

Mr. Speaker, Sir,

As of 30th June, 2009, the above factories were indebtedness to a tune of Kshs. 59 billion.

Sugar Companies indebtedness as of 30th June, 2009

Details	GoK Debt	KSB debt	Total
Miwani	1,536,783,331	1,400,221,630	**2,937,004,961**
Muhoroni	6,103,989,745	2,048,226,132	**8,152,215,877**
Nzoia	27,300,186,971	1,139,111,865	**28,439,298,836**
SONY	558,723,228	641,198,443	**1,199,921,671**
Chemelil	-	1,097,345,140	**1,097,345,140**
Sub – Total	**35,499,683,275**	**6,326,103,210**	**41,825,786,485**
Tax Arrears			10,851,078,000
Other Creditors			6,333,020,000
Total			**59,009,884,485**

Source: National Treasury

On 10th January 2013, Parliament approved the write-off of excess debt totaling Kshs 33.78 billion through Sessional Paper no. 12 of 2012.

Mr. Speaker, Sir,

The Committee held three Sittings to deliberate on the matter and noted with concern that the sugar sector in Kenya is indeed suffering. This state of affairs would be exacerbated when the COMESA safeguards finally ends in February 2015. The Committee was therefore convinced that privatization was the best option to create a viable sugar sector and protect the interest of the farmers and the livelihood of people that directly or indirectly depend on sugar cane farming.

Mr. Speaker, Sir,

The Committee is thankful to the Offices of the Speaker and the Clerk of the National Assembly for the logistical and technical support accorded to it during its Sittings. The Committee wishes to thank all the stakeholders for their participation in scrutinizing the Sessional paper. Finally, I wish to express my appreciation to the Honourable Members of the Committee who sacrificed their time to participate in the activities of the Committee and preparation of this report.

Mr. Speaker, Sir,

It is therefore my pleasant duty and privilege, on behalf of the Departmental Committee on Finance, Planning & Trade, to table this report on the privatization of the Public Sector owned / controlled sugar companies for consideration of the House and adoption.

Signed ....

(HON. BENJAMIN LANGAT, MP)
CHAIRPERSON,
DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

Date: 01-12-2014

CONSIDERATION OF THE PRIVATIZATION PROPOSALS FOR THE PUBLIC SECTOR OWNED / CONTROLLED SUGAR COMPANIES

INTRODUCTION

1.0 HISTORICAL PERSPECTIVE

i. Kenya's highest potential for industrialization lies in agro-based industries. Farming activities direct contribution to the country's GDP is 26%. Cane as a crop was introduced in Kenya in 1902. The first sugar cane factory was set up at Miwani near Kisumu in 1922 and later at Ramisi in the Coast Province in 1927.

ii. A decade after independence, the Government of Kenya embarked on an expansion programme of sugar production through investments in sugar cane growing schemes, and establishment of new sugar factories.

iii. In 1966, Muhoroni Sugar Factory was put up by the Government. This was followed in quick succession by Chemelil Sugar Factory in 1968, Mumias (1973), Nzoia (1978) and SONY (1979) at Awendo. Today, Kenya has seven major sugar factories with an annual production capacity of between 550,000 and 600,000 tonnes of sugar. The sub-sector remains one of the few areas where government still has heavy business investment. Recent additions to the sugar milling establishments include Kibos Sugar Company and West Kenya Sugar Company both of which are owned by private investors.

1.1 GLOBAL SUGAR PRODUCTION AND TRADE

(i) Over 70 percent of world sugar is derived from cane. The rest is from sugar beet which is a temperate crop. Sugar production is commercially carried out in 127 countries in the world. Whereas this is done on commercial basis, the world market is not the main market but only a residual market for the following reasons:

- Most sugar is produced and consumed in the same country;
- Only about 30 per cent of world output is traded internationally.

(ii) Therefore, the world market sugar prices do not form a suitable basis for determining the "fair" price for sugar, locally and internationally. The prices represent the market only for residual production and residual demand. Russia is the world's biggest importer of sugar while Brazil, Australia, Cuba and Thailand account for 65 percent of the sugar traded in the world.

(iii) With globalization and emergence of trade blocs through integration, non sugar factors among them multilateral trade regimes and preferential arrangements have emerged as strong determinants of world market sugar prices which are basically region specific and not necessarily a reflection of global supply and demand for the commodity.

1.2 POLICIES BEHIND GOVERNMENT INVOLVEMENT IN THE SUGAR SUB-SECTOR

The Government's deep involvement in the sugar sub-sector is informed by the agrarian leaning policies the Kenya government embraced immediately after independence. The following deliberate policy considerations have endeared Government involvement ever since.

(a) The need to ensure self-sufficiency and subsequent exportable surplus in sugar production.

(b) Import substitution - sugar production was targeted as one of the key economic drivers that could secure import substitution and thus save the country some foreign exchange. At independence, the domestic market depended to a large extent on imported sugar; hence the expansionary policies offered a viable alternative.

(c) Tool for social development–sugar growing regarded as a means of creating employment opportunities (farms and factory workers) and wealth in the rural areas, thus ensuring a strong revenue base and stability for the rural economy.

(d) Agent for stimulating rural development - through stimulating other income generating activities and facilities to support the working population in the expansive sugar belts e.g. rural electrification, real estate ventures, schools, hospitals, other supporting businesses and farm enterprises.

1.3 THE SUGAR SUB-SECTOR IN KENYA TODAY

(a) The case for the Kenya sugar sub-sector is one of incomplete Structural Adjustment Programmes (SAPs) which brings to play the political imperatives that characterize the industry today.

(b) The countdown to the lapse of the Common Market for Eastern and Southern Africa (COMESA) safeguards created an atmosphere of uncertainty for the sugar industry in Kenya which remains quite unprepared for the commencement of the COMESA free trade. Internal imperatives occasioned by persistent conflicts between the main state actors in the industry, mainly the Ministry of Agriculture, Kenya Sugar Board, and sugar millers on one hand, and the independent sugar importers have not augured well for the local sugar industry.

(c) The genesis of the recurrent crisis lies in the imports of thousands of tones of duty free sugar from the COMESA region and the perennial inefficiency of the local sugar industry. The duty free import is part of the restricted import quota for duty free sugar under the COMESA safeguards extended to Kenya to allow some grace period as it restructures her sugar sub-sector. Allocation of the import quotas to certain importers and millers alike is done by the Ministry of Agriculture.

(d) The free market forces of supply and demand have not prevailed in the industry despite liberalization of the agriculture sector in Kenya. In 2008/2009, sugar production in the world market had gone down with major exporters such as India and China facing imminent shortages. Brazil, the other key exporter entered into a bilateral agreement with India to export there to meet the shortfall.

(e) Any excess sugar imported into the country outside the COMESA safeguards attracts the following tariffs/taxes: Import duty 100 percent; Value Added Tax 16 percent; and Sugar Development Levy at 2 percent. Imports of industrial sugar are by manufacturers gazetted by the Treasury under the Tax Remission for Exports Office (TREO) Programme. Any industrial sugar imported from COMESA member states by non-manufacturers is subjected to the full taxes and levies.

(f) COMESA has frequently extended the safeguards that have limited sugar imports into Kenya from the trading bloc's member states. The safeguards are meant to give Kenya a grace period to make its sugar industry competitive. The process has been painfully slow despite extension to February 2015. The fact that Kenya is a high cost producer of sugar complicates the situation for the local sugar industry which is quite inefficient by international standards. It costs US$ 1,186 to produce a tonne of sugar compared to

US$ 239 in Mauritius. The high production cost is majorly due to obsolete machinery/technology and high cost of energy.

2.0 CONSIDERATION OF THE PRIVATIZATION PROPOSALS

I. BACKGROUND

1. The inaugural privatization programme under the Privatization Act 2005, which consists of the list of Government enterprises to be considered for privatization, was approved by the Cabinet in December 2008. Subsequently the list was gazetted on 14th August 2009.

2. Under the Privatization Act 2005, following the approval of the list, the Privatization Commission is required to prepare a detailed privatization proposal for each enterprise on the list for consideration and approval by the Cabinet. Section 24 of the Act requires that among other things:

   - each specific proposal should set out the objective of establishing the asset, its performance and how the service being provided by the asset will continue to be met; the financial position of the asset;
   - the recommended method of privatization and timetable for implementing the transaction;-
   - the laws if any required to be amended, repealed or enacted to facilitate implementation of the transaction; recommendations for dealing with employees directly affected by the proposed transaction;
   - the benefits to be gained from the privatised transaction; and
   - how Kenyans are going to be encouraged to participate in the transaction.

3. At its meeting held on 14th October 2010, Cabinet considered and approved the detailed proposals prepared by the Privatization Commission on the privatization of the remaining Government owned/controlled sugar companies. Approval was in this connection granted for privatization of Chemelil Sugar Company Ltd, South Nyanza Sugar Company Ltd, Nzoia Sugar Company Ltd, Miwani Sugar Company Ltd (In-Receivership) and Muhoroni Sugar Company Ltd (In-Receivership).

4. Under Section 23(2) of the Privatization Act, 2005, the Cabinet Secretary for Finance is required to present to the relevant Committee of Parliament a report on the specific privatization proposals approved by the Cabinet.

II. PROBLEMS FACING SUGAR COMPANIES

5. The sugar sector is facing a myriad of challenges currently and therefore urgent remedial measures are required to effectively address them to thus ensuring that the sector is competitive and sustainable. These problems include:-

   (a) Low productivity which is traceable to the whole cane and sugar production chain. This results in a vicious circle since the factories are unable to reinvest and operate efficiently and farmers are not paid on time making it difficult for them to invest adequately at farm level. It also results in poor factory maintenance and breakdowns at factory level and low quality sugar cane at farm level, culminating in poor sucrose content and recovery and low incomes for farmers;

(b) Poor state of infrastructure which contributes significantly to the high transport costs, currently accounting for up to 40% of cane production costs;

(c) Un-economical land sizes with farm units of two (2) to three (3) acres which restricts mechanization and makes it difficult to enjoy economies of scale enjoyed by many sugar producers as nearly 90% of sugar in the world is grown on large sugar plantations;

(d) Variable and low yields due to over-dependence on rain-fed sugarcane;

(e) Poor post-harvest management owing to delays in cane harvesting and milling, cane spillage and low processing efficiencies resulting in cane and sucrose losses as high as 50%;

(f) Weak research-extension-farmer linkages resulting in low adoption of modern technologies and continued planting of low yield cane varieties;

(g) Inadequate funding of the industry which manifests itself in obsolete factory mills, inefficient operations and delayed payments to farmers;

(h) Low crushing time efficiency (time in a year when factory is operating) due to use of very old machinery and equipment and in some cases shortage of sugar cane to be crashed;

(i) Policy inadequacies such as the price control regime with regard to which price adjustments were not always made on time to cushion the companies from increasing costs of production and financing without due regard to appropriate leverage ratios and ability of the factories to service the debt;

(j) Poor Management of the Sugar Industry particularly in the areas of employment and procurement of uncompetitive goods and services. In many cases appointments for senior management were made without due regard to merit, qualifications, experience and appropriate skills in leadership;

(k) Over-employment and corresponding high wage bills that erode the resources that could have been utilized to reinvest in the factories to reduce financial stress for the companies;

(l) High levels of debt mainly attributed to the nature of financing most of which was in the form of debt, mismanagement, competition from imports, loss making operations and related liquidity problems which made it difficult to repay the debt and failed projects that left the companies (especially Nzoia Sugar Company) with huge debt burden without corresponding assets.

(m) Involvement of sugar factories in non-core activities such as running of big football clubs and schools.

6. The poor state of the sugar companies, their inability to compete with sugar imports and the lapsing of the sugar safeguards under the COMESA treaties calls for the need to restructure, rehabilitate and modernize the factories urgently. Urgency is critical in view of the following:-

   (i) Currently the sector supports over six million Kenyans which is about 20% of Kenya's population

   (ii) Compared with other countries in the region and leading sugar producers, in the World, the cost of producing sugar in Kenya is relatively high, inhibiting the sector's competitiveness:

Examples of other countries production costs -2013

Country	Cost per tonne (in USD)in 2008/09	Cost per tonne in (USD) 2013/2014
Kenya	640	1186
Zimbabwe	340	639
Malawi	310	332
Swaziland	320	593
Sudan	340	
Mauritius	470	239
Brazil	250	384

Source: Privatization Commission

(iii) To rehabilitate and modernize the five factories earmarked for privatization, over Kshs. 40 billion will be required as shown in the table below;

Sugar factory rehabilitation budget- KES Billion

Required investment as of 2009				
Company	**Rehabilitation**	**Expansion**	**Agriculture**	**Total**
Chemilil	0	6.1	0.7	6.8
Muhoroni	0	4.6	0.6	5.2
Miwani	0	0	0	0
Nzoia	0.9	14.6	1.4	16.9
Sony	0.9	8.6	0.7	10.2
Total	**1.8**	**33.9**	**3.4**	**39.1**

Source: Privatization Commission

(iv) The Companies are heavily indebted making it difficult for them to meet their current obligations or to mobilize additional resources as they are unable to meet the related debt commitment, or to pay a return on additional capital;

Sugar Companies' valuation

Details	Value of assets as at sep, 2013 in Billions (Khs)	Size of the Land in Hectares	Indebtedness as at 30th June, 2009		
Company			GoK Debt	KSB debt	Total
Miwani	2.274	3,574.06	1,536,783,331	1,400,221,630	**2,937,004,961**
Muhoroni	3.767	2870.09	6,103,989,745	2,048,226,132	**8,152,215,877**
Nzoia	8.89	4,629	27,300,186,971	1,139,111,865	**28,439,298,836**
SONY	5.362	2,998	558,723,228	641,198,443	**1,199,921,671**
Chemelil	4.872		-	1,097,345,140	**1,097,345,140**
Sub – Total			**35,499,683,275**	**6,326,103,210**	**41,825,786,485**
Tax Arrears					10,851,078,000
Other Creditors					6,333,020,000
Total					**59,009,884,485**

Source: Privatization Commission

(v) Lapsing of the COMESA sugar safeguards would leave the sector in insurmountable difficulties;

When COMESA member states launched the Free Trade Area (FTA) on 31st October 2000, Kenya expressed concerns that her sugar sector would not be able to compete against sugar from other COMESA FTA countries and applied for protection of the sector by way of a safeguard under Article 61 of the COMESA Treaty. The safeguards were granted and extended a number of times. Under both the COMESA FTA and the World Trade Organization (WTO) the maximum protection period for industries is 10 years. In this connection, Kenya was granted the maximum period possible under both trade arrangements. The safeguards were then designed to lapse on 28th February 2015.

COMESA Sugar Safeguards

Year	**Size of Quota,** *in metric tones*	**Tariff rate on above-quota imports, %**
2008/09	220,000	100
2009/10	260,000	70
2010/11	300,000	40
2011/12	340,000	10
1st March 2012	**No quota**	**0**

Source: Privatization Commission

Under this arrangement, Kenya committed itself to:-

(a) Adopt a privatization plan and grant the necessary approval for the privatization of all remaining publicly owned sugar mills by November 2008;

(b) Undertake verifiable steps towards the privatization of the publicly owned mills by November 2009; and

(c) Adopt an energy policy aimed at promoting co-generation and other forms of bio-fuel energy production that will contribute to making the sugar sector more competitive.

(vi) Limited resources from the Exchequer which have in the past been availed in small amounts, only providing short term solutions.

The implication of the lapsing of the safeguards in February 2015 is that the public sector owned sugar companies may not survive unless urgent and radical reforms are undertaken.

III. APPROVED RECOMMENDATIONS

7. On 14th October, 2014, the Cabinet approved the following privatization proposals:-

(i) Expediting of the privatization of the five sugar companies to facilitate rehabilitation and expansion with a view to enhancing competitiveness of the industry prior to lapsing of the Common Market for Eastern and Southern Africa (COMESA) sugar safeguards;

(ii) Creation of financially viable sugar companies, able to access adequate cane, considering minimum viable size of area of 29,914 hectares required to supply cane to one factory. The minimum land size was arrived at by taking into account the break-even crushing factory capacity required per annum, the average cane yield per hectare, cane maturity period and the planted cane area required to break even;

(iii) It was recommended that Nzoia and South Nyanza Sugar Companies which have a cane growing area of 49,862 hectares and 31,415 hectares, respectively to be retained as they ar;.

(iv) Chemelil Sugar Company and Muhoroni Sugar Company which have cane growing areas of 18,437 hectares and 22,134 hectares, respectively to be merged to form one company with a total cane growing area of 40,571 hectare;.

(v) The decisions on the Miwani Sugar Company to be made once on-going court cases are determined;

(vi) Investors interested in either Chemelil or Muhoroni Sugar Companies will be required to bid for both. This will facilitate an ownership arrangement that allows for the two factories/zones merging;

Proposed Merging of Existing Sugar Zones

Factory	**Assumed Total Area Available before merger**	**Assumed Total Area Available after merger**
Chemelil Sugar Company	18,437	
Muhoroni Sugar Company	22134	40,571
Miwani Sugar Company	9,143	9,143
Nzoia Sugar Company	49,862	49,862
Sony Sugar Company	31,415	31,415
Total	**130,991**	**130,991**

(vii) Restructuring of the sugar Companies balance sheets as follows:

(a) Out of the total Kshs.41, 825,786,485 owed to Government of Kenya and Kenya Sugar Board by the five sugar companies, Kshs.33,780,465,838, to be written off to clear excess debt from the books of the companies with excess debt (debt in excess of assets) i.e. Nzoia Sugar Company, Muhoroni Sugar Company and Miwani Sugar Company. The Kshs.33.8 billion to be written off to be divided proportionally between GOK and Sugar Board based on the respective amounts owed. **The write off approval was granted by Parliament in January 2013. However, the Government has not executed despite Parliament's approval;**

(b) That out of the remaining Kshs.8,045,320,647 after the debt write off to clear the excess debt, an additional Kshs.5,952,000,000, equivalent to the asset value of plant and machinery, be written off to facilitate reconstruction of the sugar mills (new plant and equipment) if entire change in existing technology is necessary to enhance the sector's competitiveness;

(c) That all the remaining GOK debt in Nzoia Sugar Company, SONY Sugar Company and Chemelil Sugar Company be converted to equity to reduce the debt burden to the companies. Liquidity in the companies to be created through issuing of new shares whose proceeds will be retained by the companies;

(d) That when converting the GOK loans to equity, at the time of conversion, the value of shares held by the other existing shareholders remain as it was prior to write off of the GOK and Sugar Board debt;

(e) The remaining Sugar Board debt to be repaid once adequate liquidity has been created in the sugar companies and the payments to staff and the farmers have been concluded;

(f) All surplus funds attributed to GOK ownership, after payment of farmers and employees to be remitted to the Exchequer;

(g) Write off of tax penalties and interest estimated at Kshs. 4.0 billion as at 30th June, 2009.

(viii) Regulation of Factory Zones to ensure financial viability and future sustainability of the sugar companies by clearly defining each factory zone prior to inviting final bids for the privatization transactions and ensuring that the zones are respected by all stakeholders.

(ix) Formation of an Outgrowers and Employees Investment Trust through which the farmers and employees will buy all the shares set aside for them. The farmers and employees will be allowed to trade the shares among themselves.

(x) Write off of land rates and related penalties amounting to Kshs 117,884,303 to enable Nzoia Sugar Company to obtain title deeds for its Nucleus Estate.

(xi) Sale of 51% shareholding of each of the sugar companies to a strategic partner/s. This takes into account that the farmers are unlikely to be able to pay for their shares at the time of sale and that the law prohibits sale of shares on credit hence the shares reserved for farmers will remain under Government warehousing. It also takes into account that, any sale to the strategic partner that is less than 51% is likely to maintain the company as a state corporation making it difficult to attract a strategic partner. The required resources to acquire the shares of the companies and also to rehabilitate and modernize them are as follows:-

Required amounts to buy and rehabilitate the factories

Kshs Billions	Existing Assets*	Rehabilitation	Expansion	Agriculture	Total
Chemelil	3.6	0	6.1	07	**10.4**
Muhoroni	3.3	0	4.6	0.6	**8.5**

Miwani	1.8	0	0	0	**1.8**
Nzoia	6.1	0.9	14.6	1.4	**23**
SONY	4.5	0.9	8.6	0.7	**14.7**
Total	**19.3**	**1.8**	**33.9**	**3.4**	**58.4**

Source: Privatization Commission

(xii) Sale of 24% of the shares to Outgrowers and Employees Trust with a further 6% shareholding reserved for the Trust if the Government decides to sale its remaining shares at a later date. As the farmers are unlikely to mobilize adequate resources to buy the allotted shares immediately, the shares will continue to be held for them by the Government and released as and when the Trust is ready to buy. In this respect, a moratorium of three years is recommended during which the Trust will be able to buy the shares at the price at which they were sold to the strategic partner. After the moratorium period, the shares will be sold to the Trust at market price that will reflect the market valuation of the shares of the rehabilitated companies.

(xiii) Retention by the Government of 25% of the sugar companies' shareholding which it may decide to sell later through an Initial Public Offer (IPO) or any other method determined at the time of sale to meet the sugar industry's and the country's strategic objectives. In a future sale, part of this shareholding will be reserved for farmers, depending on their ability to buy and the needs of the companies.

(xiv) Amendment of the Sugar Act to repeal the clause which requires that the Outgrowers should hold 51% of a privatized sugar company shareholding as well as appoint 51% of directors of the privatized companies. This provision would work well only if the farmers were able to raise funds to purchase 51% of the current shareholding of the company and also mobilize at least 51% of the resources required for the rehabilitation and expansion of the factories. Investors are unlikely to invest the amount of resources required in the sugar companies unless they have control over the operational management decisions. ***The Sugar Act, 2001 was repealed and replaced with the Agriculture, Livestock, Fisheries and Food Authority Act, 2012***

IV. THE NATIONAL BENEFITS ACCRUING FROM THE PROPOSED PRIVATIZATION

8. The benefits to be accrued from the proposed privatization include:-

(i) Increased efficiency in the sector through private sector participation and introduction of new technologies.

(ii) Improved competitiveness and increased sugar production to meet the domestic demand, saving Kenya substantial foreign exchange used in importing sugar.

(iii) Improved performance of the sector will in turn increase incomes and improve standard of living for the population that relies on sugar cane as the main source of livelihood.

(iv) A diversified Sugar Cane Industry that would expand to include co-generation and power alcohol production. Co-generated power could be fed into the

National grid increasing the country's power supply and reducing the dependency on hydro-electricity. This may reduce the cost of power in the country and the general cost of doing business in Kenya. Power alcohol could be used to blend petrol or diesel resulting in reduced importation of petroleum products, saving Kenya foreign exchange.

(v) Reduce the future reliance on public sector financing through participation of Strategic Investors who will provide future funding for the Companies. This will enable the Companies to raise additional capital to support projected expansion and modernization, which in turn will create employment.

(vi) Raise resources to support the Government's budget through remission of surplus funds to the Treasury. The value of the Government shareholding is also expected to improve as the companies turn around.

(vii) Privatization of the sector and associated regulatory reforms will improve the business environment in Kenya by reducing conflicts between the public sector's regulatory and commercial roles.

V. TIME TABLE FOR IMPLEMENTING THE TRANSACTION AND DEALING WITH EMPLOYEES

9. The implementation of the privatization is expected to be completed within five to six months of clearance by Parliament as follows:-

Implementation Timetable

Task	Expected Dates
Announcement of approved transaction	December
Prequalification of bidders – Request for Expressions of interest	December/January
Completion of prequalification of bidders	January/February
Request for bids	March
Completion of Sale and Signing of Transaction Agreements with a strategic investor	April/May

3.0 COMMITTEE RECOMMENDATION

Having considered the privatization proposals and having listened to the Cabinet Secretary, National Treasury, the Committee recommends that **the House approves the privatization proposals for the Public Sector owned /controlled sugar sugar companies (Nzoia Sugar Company, Chemilil Sugar Company, Muhoroni Sugar Company and Miwani Sugar Company) for the following reasons:-**

i. It is only through privatization that the sugar sector can be revitalized. This is true considering that the COMESA safeguards are lapsing in February, 2015 and that

Parliament had already approved write off of excess debt of Kshs 33.78 billion owed by the public sector owned sugar companies.

ii. The privatization programme should be expedited to save these sugar factories from the eminent collapse. The government cannot continue to inject capital into these factories year in year out without any return.

MINUTES OF THE 66TH SITTING OF THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE HELD ON THURSDAY 27TH NOVEMBER, 2014 IN THE COMMITTEE ROOM 4TH FLOOR CONTINENTAL HOUSE PARLIARMENT BUILDINGS, AT 11.00AM

Present

1. Hon. Benjamin Langat, MP - Chairperson
2. Hon. Dr. Oburu Oginga, MP
3. Hon. Jimmy Nuru Angwenyi, MP
4. Hon. Alfred Sambu, MP
5. Hon. Abdul Rahim Dawood ,MP
6. Hon. Iringo Cyprian Kubai, MP
7. Hon. Joseph Limo, MP
8. Hon. Timothy Bosire, MP
9. Hon. Jones Mlolwa, MP
10. Hon. Patrick Makau King'ola, MP
11. Hon. Kirwa Stephen Bitok, MP
12. Hon. Mary Emase, MP
13. Hon. Sakwa John Bunyasi, MP
14. Hon. Ronald Tonui, MP
15. Hon. Sakaja Johnson, MP

Apologies

1. Hon. Nelson Gaichuhie, MP - Vice-Chairperson
2. Hon. Eng. Shadrack Manga, MP
3. Hon. Shakeel Shabbir Ahmed, MP
4. Hon. Tiras Ngahu, MP
5. Hon. Sammy Mwaita, MP
6. Hon. Sammy Koech, MP
7. Hon. Dennis Waweru, MP
8. Hon. Sumra Irshadali, MP
9. Hon. Abdullswamad Shariff, MP
10. Hon. Joash Olum, MP
11. Hon. Daniel Epuyo Nanok, MP
12. Hon. Anyanga Andrew Toboso, MP
13. Hon. Ogendo Rose Nyamunga, MP
14. Hon. Lati Lelelit, MP

IN ATTENDANCE

1.	Mr. Martin Masinde	Deputy Director, Parliamentary Budget Office
2.	Mr. Evans Oanda	First Clerk Assistant
3.	Ms. Esther Nginyo	Third Clerk Assistant
4.	Mr. Nicodemus Maluki	Third Clerk Assistant
5.	Ms. Briggitah Mati	Legal Officer

MIN.NO. DCF/315/2014 PRELIMINARIES

The Chairperson called the meeting to order at 11:20 am followed by a word of prayer from Mr. Nicodemus K. Maluki.

MIN.NO. DCF/316/2014 PRIVATIZATION PROPOSAL FOR THE PUBLIC SECTOR OWNED/ CONTROLLED SUGAR COMPANIES. (NZOIA SUGAR COMPANY, SOUTH NYANZA SUGAR COMPANY, CHEMELIL SUGAR COMPANY , MUHORONI SUGAR COMPANY AND MIWANI SUGAR COMPANY)

The Committee deliberated on the issue of the privatization of the sugar industry and noted the following;

1. The Western Kenya economy has greatly been affected by the collapse of the sugar companies in the region.
2. There is need to restructure the sugar industry as well as diversify for support programs. In addition, it is important for the government to ensure that the cost of production is brought down if the sugar companies are to be competitive.
3. As proposals are made for the sugar industry companies to be privatized, there is need to ensure that the new owners do not import sugar to the detriment of the farmers in the western region.
4. In a bid to address the issues in the sugar industry, a decision needs to be made urgently on Privatization of the five Sugar Companies following their inability to compete with sugar imports.
5. The lapsing of the sugar safeguards under the COMESA Treaty on 28th February, 2015 calls for urgent restructuring, rehabilitation and modernization of the factories.

MIN.NO. DCF/317/2014 COMMITTEE'S OBSERVATION

The Committee observed that there was need for the Parliamentary Budget Office brief it on issues in the sugar industry before listening to a presentation from the Cabinet Secretary, the National Treasury on the same.

MIN.NO. DCF/318/2014: ADJOURNMENT

The Chairperson adjourned the meeting at 12.25 p.m.

Signed……………………………………………………………………………

Chairperson

Date……………………………………………………………………………

MINUTES OF THE 67TH SITTING OF THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE HELD ON THURSDAY 27TH NOVEMBER, 2014 IN THE COMMITTEE ROOM 4TH FLOOR, CONTINENTAL HOUSE, PARLIARMENT BUILDINGS, AT 4.00PM

Present

1. Hon. Benjamin Langat, MP - Chairperson
2. Hon. Nelson Gaichuhie, MP - Vice-Chairperson
3. Hon. Dr. Oburu Oginga, MP
4. Hon. Jimmy Nuru Angwenyi, MP
5. Hon. Alfred Sambu, MP
6. Hon. Sammy Mwaita, MP
7. Hon. Abdul Rahim Dawood ,MP
8. Hon. Dennis Waweru, MP
9. Hon. Iringo Cyprian Kubai, MP
10. Hon. Sumra Irshadali, MP
11. Hon. Joseph Limo, MP
12. Hon. Timothy Bosire, MP
13. Hon. Jones Mlolwa, MP
14. Hon. Kirwa Stephen Bitok, MP
15. Hon. Mary Emase, MP
16. Hon. Sakwa John Bunyasi, MP

Apologies

1. Hon. Eng. Shadrack Manga, MP
2. Hon. Shakeel Shabbir Ahmed, MP
3. Hon. Tiras Ngahu, MP
4. Hon. Sammy Koech, MP
5. Hon. Abdullswamad Shariff, MP
6. Hon. Joash Olum, MP
7. Hon. Daniel Epuyo Nanok, MP
8. Hon. Anyanga Andrew Toboso, MP
9. Hon. Ogendo Rose Nyamunga, MP
10. Hon. Lati Lelelit, MP
11. Hon. Patrick Makau King'ola, MP
12. Hon. Sakaja Johnson, MP
13. Hon. Ronald Tonui, MP

IN ATTENDANCE

FRIENDS OF THE COMMITTEE

1. Hon. Johnson M. Naicca, MP
2. Hon. Michael A. Onyunga, MP
3. Hon. Emmanuel Wangwe, MP
4. Hon. Benjamin Washiali, MP

THE NATIONAL TREASURY

1. Hon. Henry Rotich	Cabinet Secretary
2. Ms. Esther Koimett	Investment Secretary

PRIVATIZATION COMMISSION

1. Mr. Solomon Kitungu	ED/CEO
2. Mr. Wycliffe Temesa	Finance/ Administration Director

KENYA NATIONAL ASSEMLY

1. Mr. Martin Masinde	Deputy Director, Parliamentary Budget Office
2. Mr. Evans Oanda	First Clerk Assistant
3. Ms. Esther Nginyo	Third Clerk Assistant
4. Mr. Nicodemus Maluki	Third Clerk Assistant

MIN.NO. DCF/319/2014 PRELIMINARIES

The Chairperson called the meeting to order at 4:00 pm followed by a word of prayer from Ms. Esther Nginyo.

MIN.NO. DCF/320/2014 PRESENTATION BY PARLIAMENTARY BUDGET OFFICE ON PRIVATIZATION PROCESS OF STATE OWNED/CONTROLLED SUGAR COMPANIES

The Deputy Director Parliamentary Budget office Mr. Masinde submitted that;

1. The sugar sector in Kenya is faced by various challenges such as ;

- low productivity and high cost of production,
- reliance on small-holder farms,
- over dependence on rain fed farming thus vulnerable to droughts,
- poor post- harvest management owing to cane spillage and low processing efficiencies, low adoption of modern technology,
- low crushing time efficiencies and long maturity periods.

2. The privatization process of the sugar companies should be critically examined by Parliament in the interests of protecting the industry from suffering the same defects. The following policy should be considered by the committee;

a) The government should submit to parliament the most recent comprehensive valuation report of the sugar companies.
b) The names of shadowy shareholders in the sugar companies should be revealed to the public and in cases where they are corporate entities, the name of the corporations and the full list of the directors should be made public.
c) The government should make full financial and non financial disclosure on status of the companies including debts, tax arrears, tax penalties and salaries arrears if any.
d) The full cost that the government will incur in implementing the proposed privatization process.
e) Recommendations for dealing with employees that are directly affected by the proposed privatization.
f) The method of privatization adopted by the government (public offering of shares; Concessions, leases, management contracts and other forms of public-private partnerships, Negotiated sales resulting from the exercise of pre-emptive rights, and sale of assets, including liquidation) and how members of the public especially the local community (Counties) sugar cane farmers will be involved in the privatization.
g) The Privatization Commission should inform the Committee what informed their decision to choose Strategic Partnership as a method of privatization for these companies considering that this method of divestiture has not been very successful in Kenya. Telkom Kenya Ltd and Kenya Petroleum Refineries Ltd are a case in point.
h) The government should simplify the investment codes and clarify the definition of a foreign investor in the legislations to ensure unscrupulous individuals do not use it as a cloak for hiding corrupt and unethical practices.
i) The government to provide the names of the transaction advisors engaged in the privatization process and how they were selected.
j) A detailed proposal on how the minority shareholders rights will be protected in the privatization process.

MIN.NO. DCF/321/2014 COMMITTEE CONCERNS

The Committee noted with concern that;

i. With the proposed privatization of the 5 sugar companies, lessons should be drawn from the privatization of Mumias Sugar Company where majority of the shareholders were not from the region and therefore were not well versed with the industry and hence its current poor performance.

ii. There is need to protect the farmers shareholding from the private investors and therefore, it is necessary for the county government to have veto power to protect the farmers' stakes.

iii. The government should intervene in the current happenings in Mumias Sugar Company. Parliament through the Committees of Agriculture, Finance, Planning and Trade and Public Investment Committee should look into the issues of the company to salvage it from the imminent collapse.

iv. Once privatization of the sugar companies is done, the government should continue holding the shares reserved for the farmers under the government warehousing.

MIN.NO. DCF/322/2014 PRIVATIZATION PROPOSAL FOR THE PUBLIC SECTOR OWNED/ CONTROLLED SUGAR COMPANIES. (NZOIA SUGAR COMPANY, SOUTH NYANZA SUGAR COMPANY, CHEMELIL SUGAR COMPANY , MUHORONI SUGAR COMPANY AND MIWANI SUGAR COMPANY)

The Cabinet Secretary, the National Treasury appeared before the Committee and submitted that;

1. The poor State of the sugar companies, their inability to compete with sugar imports and the lapsing of the sugar safeguards under the COMESA Treaty on 28th February, 2015 calls for urgent restructuring, rehabilitation and modernization of the factories. This is critical in view of the fact that; more than six million Kenyans (over 20% of Kenya population in 2008/ 2009 when the review was undertaken) depend on the sector, the sector's inability to compete effectively on the account of the relatively high production costs compared with other countries in the COMESA region and leading sugar producers.
2. The Cabinet during its meeting of 14th October, 2014 considered and approved the proposal for the privatization of the remaining government owned sugar companies namely; Chemelil Sugar Company, South Nyanza Sugar Company, Nzoia Sugar Company, Miwani Sugar Company and Muhoroni Sugar Company.
3. A presentation on the privatization of the sugar companies had been presented to Parliament on 3rd October, 2013 but the matter did not progress further.
4. The Privatization process remains the most viable way of reviving the sugar sector in Kenya.

MIN.NO. DCF/323/2014 PRESENTATION BY S.KITUNGU ON PRIVATIZATION PROPOSAL FOR THE PUBLIC SECTOR OWNED/ CONTROLLED SUGAR COMPANIES. (NZOIA SUGAR COMPANY, SOUTH NYANZA SUGAR COMPANY, CHEMELIL SUGAR COMPANY , MUHORONI SUGAR COMPANY AND MIWANI SUGAR COMPANY)

Mr. Solomon Kitungu the CEO privatization Commission submitted that;

1. The Privatization Commission following a gazettement of the privatization program in December 2008 made a proposal to the National Treasury which was approved by the Cabinet on 14th Octover 2014. However, when the proposal was brought before Finance, Planning and Trade in January, 2010, the approval was not granted as the proposal was tied to the appointment of the Members of the Commission.

2. A second presentation was made to Parliament after the appointment of the Commission's members on 28th November, 2012. The Committee recommended that the privatization of the sugar companies be postponed until such a time when all the legislations affecting the agricultural sector are enacted and the county governments are put in place.

3. Despite the enactment of Agriculture, Livestock, Fisheries and Food Authority, 2012 and the county governments being in place, no significant progress has been made in regards to the issue of privatization of the sugar factories.

4. Another presentation was made to the Committee on Finance, Planning and Trade on 3rd October, 2013. However, the matter has not been concluded.

5. The following are the problems bedeviling the sugar sector;

    a. Low productivity which is traceable to the whole cane and sugar production chain. This results in a vicious circle since the factories are unable to reinvest and operate efficiently and farmers are not paid on time making it difficult for them to invest adequately at farm level. It also results in poor factory maintenance and breakdowns at factory level and low quality sugar cane at farm level, culminating in poor sucrose content and recovery and low incomes for farmers.

    b. Poor state of infrastructure which contributes significantly to the high transport costs, currently accounting for up to 40% of cane production costs.

    c. Un-economical land sizes with farm units of two (2) to three (3) acres which restricts mechanization and makes it difficult to enjoy economies of scale enjoyed by many sugar producers as nearly 90% of sugar in the world is grown on large sugar plantations.

    d. Variable and low yields due to over-dependence on rain-fed sugarcane.

    e. Poor post-harvest management owing to delays in cane harvesting and milling, cane spillage and low processing efficiencies resulting in cane and sucrose losses as high as 50%.

f. Weak research-extension-farmer linkages resulting in low adoption of modern technologies and continued planting of low yield cane varieties.

g. Inadequate funding of the industry which manifests itself in obsolete factory mills, inefficient operations and delayed payments to farmers.

h. Low crushing time efficiency (time in a year when factory is operating) due to use of very old machinery and equipment and in some cases shortage of sugar cane to be crashed.

i. Policy inadequacies such as the price control regime with regard to which price adjustments were not always made on time to cushion the companies from increasing costs of production and financing without due regard to appropriate leverage ratios and ability of the factories to service the debt

j. Poor Management of the Sugar Industry particularly in the areas of employment and procurement of uncompetitive goods and services. In many cases appointments for senior management were made without due regard to merit, qualifications, experience and appropriate skills in leadership.

k. Over-employment and corresponding high wage bills that erode the resources that could have been utilized to reinvest in the factories to reduce financial stress for the companies.

l. High levels of debt mainly attributed to the nature of financing most of which was in the form of debt, mismanagement, competition from imports, loss making operations and related liquidity problems which made it difficult to repay the debt and failed projects that left the companies (especially Nzoia Sugar Company) with huge debt burden without corresponding assets. The amounts owed to the Kenya Government and the Kenya Sugar Board are indicated in the table attached as Appendix 1 to this Paper.

m. Involvement of sugar factories in non-core activities such as running of big football clubs and schools.

APPROVED PRIVATIZATION STRATEGY

To mobilize required resources (financial and management resources) the Cabinet approved the strategy outlined below and directed that the process be expedited as follows;

STRATEGY		COMMENTS
(i)	Sale of 51% shareholding of each of the sugar companies to a strategic partner/s	This took into account the fact that the farmers were unlikely to be able to pay for their shares at the time of sale and the law prohibits sale of shares on credit. The shares reserved for farmers would remain under Government warehousing. It also took into account that, any sale to the strategic partner that is less than 51% would maintain the company as a state corporation making it difficult to attract a strategic partner. 51% shareholding was also considered necessary to attract required investment.
(ii)	Formation of an Outgrowers and Employees Investment Trust through which the farmers and employees would buy all the shares set aside for them.	This was considered necessary following fears expressed by farmers that if most of them sold their shares, a situation similar to that of Mumias would arise, whereby they would not have any influence in the company affairs.

(iii)	Sale of 24% of the shares to Outgrowers and Employees Trust with a further 6% shareholding reserved for the Trust if the Government decides to sell its remaining shares at a later date. Cabinet approval also included a moratorium of three years during which they would be sold to the strategic partner. After the moratorium period, the shares would be sold to the trust at market price that reflects the market valuation of the shares of the rehabilitated companies.	As the Privatization Act does not allow sale of shares on credit and also given that the farmers had indicated that they did not have resources to buy the shares immediately, the shares would continue to be held for them by the Government and released as and when the Trust is ready to buy.
(iv)	Retention by the Government of 25% of the sugar companies shareholding which it may decide to sell later through an Initial Public Offer (IPO)or any other method determined at the time of sale to meet the sugar Industry's and the country's strategic objectives. In a future sale, 6% would be reserved for farmers, depending on their ability to buy and the needs of the companies.	This would increase option for mobilization of resources.

MIN.NO. DCF/324/2014 COMMITTEE RESOLUTIONS

The committee unanimously resolved to approve the privatization of the 5 sugar companies, namely; Chemelil Sugar Company, South Nyanza Sugar Company, Nzoia Sugar Company, Miwani Sugar Company and Muhoroni Sugar Company to protect the sugar sector in the country as the COMESA sugar safeguards which come to an end on 28th February, 2015, will hurt the sector further. This will protect the livelihoods of about 6 million people from the sugar belt area.

The Committee finally asked the Chairperson to sign and table the Committee's report for debate before the House proceeds on recess.

MIN.NO. DCF/325/2014: ADJOURNMENT

The Chairperson adjourned the meeting at 6.05 p.m.

Signed...

Chairperson

Date...

NATIONAL TREASURY

REPORT TO THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING AND TRADE ON THE APPROVED DETAILED PRIVATIZATION PROPOSAL FOR THE PUBLIC SECTOR OWNED/CONTROLLED SUGAR COMPANIES

(Nzoia Sugar Company, South Nyanza Sugar Company, Chemelil Sugar Company, Muhoroni Sugar Company and Miwani Sugar Company)

OCTOBER 2013

I. BACKGROUND

1. The inaugural privatization programme under the Privatization Act 2005, which consists of the first list of Government enterprises to be considered for privatization under the Act, was approved by the Cabinet in December 2008. Subsequently the list was gazetted by His Excellency the President (then the Deputy Prime Minister and Minister for Finance) on 14th August 2009.
2. Under the Privatization Act 2005, following the approval of the list, the Privatization Commission was required to prepare a detailed privatization proposal for each enterprise on the list for consideration and approval by the Cabinet. Section 24 of the Act requires that among other things, each specific proposal should set out the objective of establishing the asset, its performance and how the service being provided by the asset will continue to be met; the financial position of the asset; the recommended method of privatization and timetable for implementing the transaction; the laws if any required to be amended, repealed or enacted to facilitate implementation of the transaction; recommendations for dealing with employees directly affected by the proposed transaction; the benefits to be gained from the privatised transaction; and how Kenyans are going to be encouraged to participate in the transaction.

3. At its meeting held on 14th October 2010, Cabinet considered and approved the detailed proposals prepared by the Privatization Commission on the privatization of the remaining Government owned/controlled sugar companies, which the Treasury submitted to the Cabinet jointly with the Ministry of Agriculture and Ministry of Lands. Approval was in this connection granted for privatization of Chemelil Sugar Company Ltd, South Nyanza Sugar Company Ltd, Nzoia Sugar Company Ltd, Miwani Sugar Company Ltd (In-Receivership) and Muhoroni Sugar Company Ltd (In-Receivership).

4. Under Section 23(2) of the Privatization Act, 2005, the Minister/Cabinet Secretary responsible for Finance is required to present to the relevant Committee of Parliament a report on the specific privatization proposals approved by the Cabinet. In this connection:
   - In November 2010, the Treasury sent a report to Parliament for presentation to the Finance Planning and Trade Committee.
   - A meeting between the Committee and the Deputy Prime Minister and Minister for Finance (DPMMF) took place in January 2011. The DPMMF made a presentation to members with respect to which Members indicated that they need more time (one week) before discussions. At the meeting, the DPMMF

also presented the list of Commission members whose term had expired, which he had earlier (in 2010) submitted to Parliament for approval.

- Subsequently the Committee advised that conclusion of the presentation by the Minister for Finance awaits its approval of the Commission members. In addition, the committee directed that the Commission members' positions be advertised.
- The positions for the Commission members were advertised and the selected members were approved by Parliament on 19th September 2012.
- Final presentation on the Sugar Companies privatization was made by the Minister for Finance to the Committee on 28th November 2012.
- Thereafter the committee considered the sugar companies proposals and submitted a recommendation to the House that the Privatization of the Sugar Companies be postponed until such a time when all the legislation affecting the Agricultural Sector (sugar) and the county Governments have been put in place. This recommendation was adopted by Parliament on 9th January 2013.
- On 10th January 2013 Parliament approved the write-off of excess debt for the Sugar Companies to facilitate their privatization.

- Since then:-
  - The Agriculture, Livestock, Fisheries and Food Authority Bill, 2012 Act was enacted by Parliament on 10th January 2013 and assented to by His Excellency the President (then Hon. Mwai Kibaki) on 14th January 2013.
  - Following the elections, the County Governments are now in place.
  - In May 2013 the National Treasury wrote to Parliament requesting for a meeting with the Committee to obtain approval to proceed with the privatization.
  - All the updated due diligence information which is necessary to implement the transactions will be available by Friday this week.

II. PROBLEMS ADDRESSED THROUGH THE APPROVED STRATEGY

5. The poor state of the sugar companies, their inability to compete with sugar imports and the lapsing of the sugar safeguards under the COMESA treaties that called for need to restructure, rehabilitate and modernize the factories urgently. Urgency was and still is critical in view of the following:-

    (i) In 2008/09 the sector supported over six million Kenyans which was over 20% of Kenya's population;

    (ii) Compared with other countries in the region and leading sugar producers, in the World, the cost of producing sugar in Kenya is relatively high, inhibiting the sector's competitiveness:

Examples of other countries production costs - 2009

Country	Cost per tonne (in USD)	Threat from sugar imports from COMESA countries & other sugar producing countries **(Updated cost data attached)**
Kenya	510 to 640	
Zimbabwe	340	
Malawi	310	
Swaziland	320	
Sudan	340	
Mauritius	470	
Brazil	250	

    (iii) Rehabilitation and modernization of the factories (2009) required over Kshs. 40 billion. Further deterioration has increased the amounts significantly.

(iv) The Companies were heavily indebted making it difficult for them to meet their obligations or to mobilize additional resources as they were unable to meet the related debt commitment, or to pay a return on additional capital.

Sugar Companies indebtedness – 2009

Actual Debt	GoK Debt	KSB debt	Total
Miwani	1,536,783,331	1,400,221,630	**2,937,004,961**
Muhoroni	6,103,989,745	2,048,226,132	**8,152,215,877**
Nzoia	27,300,186,971	1,139,111,865	**28,439,298,836**
SONY	558,723,228	641,198,443	**1,199,921,671**
Chemelil	-	1,097,345,140	**1,097,345,140**
Sub – Total	**35,499,683,275**	**6,326,103,210**	**41,825,786,485**
Tax Arrears			10,851,078,000
Other Creditors			3,530,783,000
Total			**59,009,884,485**

(v) Lapsing of the COMESA sugar safeguards would leave the sector in insurmountable difficulties:

When COMESA member states launched the Free Trade Area (FTA) on 31st October 2000, Kenya expressed concerns that her sugar sector would not be able to compete against sugar from other COMESA FTA countries and applied for protection of the sector by way of a safeguard under Article 61 of the COMESA Treaty. The safeguards were granted and extended a number of times. By February 2008, the sector was still not able to compete effectively because necessary measures had not been taken to improve its competitiveness. Kenya therefore requested for further extension of the safeguards. Under both the COMESA FTA and the World Trade Organization (WTO) the maximum protection period for industries is 10 years. In this connection, Kenya was granted the maximum period possible under both trade arrangements. The safeguards were then designed to lapse in March 2012

COMESA Sugar Safeguards

Year	**Size of Quota,** *in metric tones*	**Tariff rate on above-quota imports,** %
2008/09	220,000	100
2009/10	260,000	70
2010/11	300,000	40
2011/12	340,000	10
1st March 2012	**No quota**	**0**

Under this arrangement, Kenya committed itself to:-

(a) Adopt a privatization plan and grant the necessary approval for the privatization of all remaining publicly owned sugar mills by November 2008;

(b) Undertake verifiable steps towards the privatization of the publicly owned mills by November 2009; and

(c) Adopt an energy policy aimed at promoting co-generation and other forms of bio-fuel energy production that will contribute to making the sugar sector more competitive.

(vi) Limited resources from the Exchequer which have in the past been availed in small amounts, only providing short term solutions.

The implication of the lapsing of the safeguards in 2012 (extended to February 2014) is that the public sector owned sugar companies may not survive unless urgent and radical reforms are undertaken.

6. The Country needed to, and still need to take measures that will effectively address problems currently affecting the sector's performance, competitiveness and sustainability adversely. The problems include:-

   (a) Low productivity which is traceable to the whole cane and sugar production chain. This results in a vicious circle since the factories are unable to reinvest and operate efficiently and farmers are not paid on time making it difficult for them to invest adequately at farm level. It also results in poor factory maintenance and breakdowns at factory level and low quality sugar cane at farm level, culminating in poor sucrose content and recovery and low incomes for farmers.

(b) Poor state of infrastructure which contributes significantly to the high transport costs, accounting for up to 40% of cane production costs.

(c) Un-economical land sizes with farm units of two (2) to three (3) acres which restricts mechanization and makes it difficult to enjoy economies of scale enjoyed by many sugar producers as nearly 90% of sugar in the world is grown on large sugar plantations.

(d) Variable and low yields due to over-dependence on rain-fed sugarcane.

(e) Poor post-harvest management owing to delays in cane harvesting and milling, cane spillage and low processing efficiencies resulting in cane and sucrose losses as high as 50%.

(f) Weak research-extension-farmer linkages resulting in low adoption of modern technologies and continued planting of low yield cane varieties.

(g) Inadequate funding of the industry which manifests itself in obsolete factory mills, inefficient operations and delayed payments to farmers.

(h) Low crushing time efficiency (time in a year when factory is operating) due to use of very old machinery and equipment and in some cases shortage of sugar cane to be crashed.

(i) Policy inadequacies such as the price control regime with regard to which price adjustments were not always made on time to cushion the companies from increasing costs of production and financing without due regard to appropriate leverage ratios and ability of the factories to service the debt.

(j) Poor Management of the Sugar Industry particularly in the areas of employment and procurement of uncompetitive goods and services. In many cases appointments for senior management were made without due regard to merit, qualifications, experience and appropriate skills in leadership.

(k) Over-employment and corresponding high wage bills that erode the resources that could have been utilized to reinvest in the factories to reduce financial stress for the companies.

(l) High levels of debt mainly attributed to the nature of financing most of which was in the form of debt, mismanagement, competition from imports, loss making operations and related liquidity problems which made it difficult to repay the debt and failed projects that left the companies (especially Nzoia Sugar Company) with huge debt burden without corresponding assets. The amounts owed to the Kenya

Government and the Kenya Sugar Board are indicated in the table attached as Appendix 1 to this Paper.

(m) Involvement of sugar factories in non-core activities such as running of big football clubs and schools.

(n) Cane poaching.

III. APPROVED RECOMMENDATIONS

7. Measures proposed in the detailed proposal that were approved by the Cabinet to deal with these problems include:

   (i) Expediting of the privatization of the five sugar companies to facilitate rehabilitation and expansion with a view to enhancing competitiveness of the industry prior to lapsing of the Common Market for Eastern and Southern Africa (COMESA) sugar safeguards in February 2012/February 2014.

   (ii) Creation of financially viable sugar companies, able to access adequate cane, considering minimum viable size of area of 29,914 hectares required to supply cane to one factory. The minimum land size was arrived at by taking into account the breakeven crushing factory capacity required per annum, the average cane yield per hectare, cane maturity period and the planted cane area required to break even. Nzoia and South Nyanza

Sugar Company which have a cane growing area of 49,862 hectares and 31,415 hectares, respectively to be retained as they are, Chemelil Sugar Company and Muhoroni Sugar Company which have cane growing areas of 18,437 hectares and 22,134 hectares, respectively to be merged to form one company with a total cane growing area of 40,571 hectares and decisions on the Miwani Sugar Company to be made once on-going court cases are determined. (Investors interested in either Chemelil or Muhoroni Sugar Companies will be required to bid for both. This will facilitate an ownership arrangement that allows for the two factories/zones merging).

Proposed Merging of Existing Sugar Zones

Factory	**Assumed Total Area Available before merger**	**Assumed Total Area Available after merger**
Chemelil Sugar Company	18,437	
Muhoroni Sugar Company	22134	40,571
Miwani Sugar Company	9,143	9,143
Nzoia Sugar Company	49,862	49,862
Sony Sugar Company	31,415	31,415
Total	**130,991**	**130,991**

(iii) Restructuring of the sugar Companies balance sheets as follows:

(a) Out of the total Kshs.41, 825,786,485 owed to GOK and Kenya Sugar Board by the five sugar companies, Kshs.33,780,465,838, to be written off to clear excess debt from the books of the companies with excess debt (debt in excess of assets) i.e. Nzoia Sugar Company, Muhoroni Sugar Company and Miwani Sugar Company. The Kshs.33.8 billion to be written off to be divided proportionally between GOK and Sugar Board based on the respective amounts owed.

(b) That out of the remaining Kshs.8,045,320,647 after the debt write off to clear the excess debt, an additional Kshs.5,952,000,000, equivalent to the asset value of plant and machinery, be written off to facilitate reconstruction of the sugar mills (new plant and equipment) if entire change in existing technology is necessary to enhance the sector's competitiveness.

(c) That all the remaining GOK debt in Nzoia Sugar Company, SONY Sugar Company and Chemelil Sugar Company be converted to equity to reduce the debt burden to the companies. Liquidity in the companies to be created through issuing of new shares whose proceeds will be retained by the companies.

(d) That when converting the GOK loans to equity, at the time of conversion, the value of shares held by the other existing shareholders remain as it was prior to write off of the GOK and Sugar Board debt.

(e) The remaining Sugar Board debt to be repaid once adequate liquidity has been created in the sugar companies and the payments to staff and the farmers have been concluded.

(f) All surplus funds attributed to GOK ownership, after payment of farmers and employees to be remitted to the Exchequer.

(g) Write off of tax penalties and interest currently estimated at Kshs. 4.0 billion.

(iv) Regulation of Factory Zones to ensure financial viability and future sustainability of the sugar companies by clearly defining each factory zone prior to inviting final bids for the privatization transactions and ensuring that the zones are respected by all stakeholders.

(v) Formation of an Outgrowers and Employees Investment Trust through which the farmers and employees would buy all the shares set aside for them. The farmers and employees would be allowed to trade the shares among themselves.

(vi) Write off of land rates and related penalties amounting to Kshs 117,884,303 to enable Nzoia Sugar Company to obtain title deeds for its nucleus estate.

(vii) Sale of 51% shareholding of each of the sugar companies to a strategic partner/s. This took into account the fact that the farmers were unlikely to be able to pay for their shares at the time of sale and that the law prohibits sale of shares on credit hence the shares reserved for farmers would remain under Government warehousing. It also took into account that, any sale to the strategic partner that is less than 51% would maintain the company as a state corporation making it difficult to attract a strategic partner. In 2009, the required resources to acquire the shares of the companies and also to rehabilitate and modernize them were as follows:

Required amounts to buy and rehabilitate the factories -2009

Kshs Billions	Existing Assets*	Rehabilitation	Expansion	Agriculture	Total
Chemelil	3.6	0	6.1	07	**10.4**
Muhoroni	3.3	0	4.6	0.6	**8.5**
Miwani	1.8	0	0	0	**1.8**
Nzoia	6.1	0.9	14.6	1.4	**23**
SONY	4.5	0.9	8.6	0.7	**14.7**
Total	**19.3**	**1.8**	**33.9**	**3.4**	**58.4**

(viii) Sale of 24% of the shares to Outgrowers and Employees Trust with a further 6% shareholding reserved for the Trust if the Government decides to sale its remaining shares at a later date. As the farmers were unlikely to mobilize adequate resources to buy the allotted shares immediately, the shares would continue to be held for them by the Government and released as and when the Trust is ready to buy. In this respect, a moratorium of three years was approved by the Cabinet during which the Trust would be able to buy the shares at the price at which they were sold to the strategic partner. After the moratorium period, the shares would be sold to the Trust at market price that would reflect the market valuation of the shares of the rehabilitated companies.

(ix) Retention by the Government of 25% of the sugar companies' shareholding which it may decide to sell later through an Initial Public Offer (IPO) or any other method determined at the time of sale to meet the sugar industry's and the country's strategic objectives. In a future sale, part of this shareholding would be reserved for farmers, depending on their ability to buy and the needs of the companies.

(x) Amendment of the Sugar Act to repeal the clause which requires that the Outgrowers should hold 51% of a privatized sugar company shareholding as well as appoint 51% of directors of the privatized companies. This provision would work well only if the farmers were able to raise funds to purchase 51% of the current shareholding of the company and also mobilize at least

51% of the resources required for the rehabilitation and expansion of the factories. Investors are unlikely to invest the amount of resources required in the sugar companies unless they have control over the operational management decisions.

IV. THE NATIONAL BENEFITS ACCRUING FROM THE PROPOSED PRIVATIZATION

8. The benefits to be accrued from the proposed privatization include:

   (i) Increased efficiency in the sector through private sector participation and introduction of new technologies.

   (ii) Improved competitiveness and increased sugar production to meet the domestic demand, saving Kenya substantial foreign exchange used in importing sugar.

   (iii) Improved performance of the sector will in turn increase incomes and improve standard of living for the population that relies on sugar cane as the main source of livelihood.

   (iv) A diversified Sugar Cane Industry that would expand to include co-generation and power alcohol production. Co-generated power could be fed into the National grid increasing the country's power supply and reducing the dependency on hydro-electricity. This may reduce the cost of power in the country and the general cost of doing business in Kenya. Power alcohol could be used to blend petrol or diesel resulting in reduced importation of petroleum products, saving Kenya foreign exchange.

(v) Reduce the future reliance on public sector financing through participation of Strategic Investors who will provide future funding for the Companies. This will enable the Companies to raise additional capital to support projected expansion and modernization, which in turn will create employment.

(vi) Raise resources to support the Government's budget through remission of surplus funds to the Treasury. The value of the Government shareholding is also expected to improve as the companies turn around.

(vii) Privatization of the sector and associated regulatory reforms will improve the business environment in Kenya by reducing conflicts between the public sector's regulatory and commercial roles.

V. TIME TABLE FOR IMPLEMENTING THE TRANSACTION

The implementation of the privatization is expected to be completed in the next six to nine months as follows:

Implementation Timetable

Task	Expected Dates
Announcement of approved transaction	October/November 2013
Prequalification of bidders – Request for Expressions of interest	November/ December 2013
Completion of prequalification of bidders	January 2014
Request for bids	February/March 2014
Completion of Sale and Signing of Transaction Agreements with a strategic investor	June/July 2014

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KENYA NATIONAL ASSEMBLY
OFFICE OF THE CLERK

11th January 2013

CERTIFICATE – ADOPTION OF SESSIONAL PAPER NO 12 OF 2012 ON WRITE-OFF OF EXCESS GOVERNMENT OF KENYA DEBT OWED BY THE PUBLIC SECTOR OWNED SUGAR COMPANIES

I, JUSTIN NTHIIRI BUNDI, Clerk of the National Assembly, do hereby certify that the Kenya National Assembly, by a Resolution passed on Wednesday, 9th January, 2013, approved the Sessional Paper No. 12 on Write-Off of excess Government of Kenya Debt owed by the Public Sector Owned Sugar Companies.

Signature: Bundi
Clerk of the National Assembly

Date: 11/1/2013