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**REPORT OF THE SELECT COMMITTEE ON THE INQUIRY INTO THE
AFFAIRS OF KENYA AIRWAYS LIMITED AND ITS SUBSIDIARIES**
(Established, Thursday 18th June, 2015)

Clerk's Chambers,
The Senate,
Parliament Buildings,
NAIROBI

November, 2015

Hon. Speaker
*You may approve
for tabling.*
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ABBREVIATIONS AND ACRONYMS

AAWU - Aviation and Allied Workers Union

ANR - Air Navigation Regulations

AOC - Air Operator Certificate

ASL - Air Service License

CBA - Collective Bargaining Agreement

CDL - Career Directions Limited

CEO – Chief Executive officer

COO - Chief Operating Officer

DSE - Dar-es-Salaam Security Exchange

GoK – Government of Kenya

HR – Human Resource

IFC - International Finance Corporation

ILO - International Labour Organisation

IOSA - IATA Operational Safety Audit

IPO - Initial Public Offering

JKIA - Jomo Kenyatta International Airport

JV - Joint Venture

KALPA - Kenya Airlines Pilots Association

KAWU - Kenya Aviation Workers Union

KCA - Kenya Civil Aviation

KCAA - Kenya Civil Aviation Authority

KCAR's - Kenya Civil Aviation Regulations

KQ – Kenya Airways

MD – Managing Director

NHIF – National Hospital Insurance Fund

NSE - Nairobi Securities Exchange

NSSF – National Security Social Fund

OTP - On Time Performance

PAYE - Pay As You Earn

PDP - Pre-Delivery Payment

PwC - Price Waterhouse Coopers

SPV's - Special Purpose Vehicles

US\$- United States Dollar

USA - United States of America

USE - Uganda Security Exchange

VVIP – Very Very Important Person

PREFACE

Mr. Speaker Sir,

1. The Senate Select Committee on the Inquiry into the Affairs of Kenya Airways Limited and its Subsidiaries was established by this house on Thursday 18th June, 2015. The mandate and life of the Committee was further extended on Wednesday 30th September, 2015.
2. The Committee was mandated to conduct an inquiry taking into account the following:
 - i. The leasing and buying arrangement of aircrafts since 1996;
 - ii. The role of off-shore companies in the investment affairs of the airline;
 - iii. The identity of the shareholders of these off-shore companies and their relationship with the management of Kenya Airways Limited;
 - iv. The employment policies and practices of personnel, including engineers, pilots, cabin crew and ground personnel;
 - v. The reason for delayed and cancelled flights, their frequency and the magnitude of losses attendant therein; and
 - vi. Any other matter that may shed light on the financial and management crisis currently facing the airline;
3. The Committee comprised of the following Senators:-
 1. Sen. (Prof.) Anyang' Nyong'o, M.P. - Chairperson
 2. Sen. Mutahi Kagwe, M.P. - Vice Chairperson
 3. Sen. James Orengo, M.P. - Member
 4. Sen. Billow Kerrow, M.P. - Member
 5. Sen. Hassan Omar, M.P. - Member
 6. Sen. Mutula Kilonzo Jr, M.P. - Member
 7. Sen. Peter Mositet, M.P. - Member
 8. Sen. Daniel Karaba, M.P. - Member
 9. Sen. (Prof.) Wilfred Lesan, M.P. - Member
 10. Sen. Naisula Lesuuda, M.P. - Member
 11. Sen. (Dr.) Agnes Zani, M.P. - Member
 12. Sen. Boni Khalwale, M.P. - Member
 13. Sen. Stephen Sang, M.P. - Member

Pursuant to standing orders 187, the Select Committee established a sub-committee to analyse documents and issues submitted before the Committee. This sub- Committee comprised of the following Members:-

1. Sen. James Orengo, M.P. - Member
2. Sen. Hassan Omar, M.P. - Member
3. Sen. Mutula Kilonzo Jr, M.P. - Member
4. Sen. Stephen Sang, M.P. - Member

EXECUTIVE SUMMARY

Mr. Speaker Sir, when the Government of Kenya privatized Kenya Airways in 1996, it was dubbed as the most successful privatization process in the Country's history. The coming on board of a strategic partner, KLM Royal Dutch Airline in 1995, and the subsequent listing at the Nairobi Securities Exchange was viewed as the beginning of a new era of vibrancy, transparency, profit making and national pride in the carrier. Subsequently, the airline dominated the skies of Africa and beyond. Unfortunately, Mr. Speaker Sir, as I stand here today, the airline, just this November announced a half year loss of close to KSHS.12 billion and this follows a KSHS 28 Billion loss for the period ending 31st March, 2015.

Mr. Speaker Sir, pursuant to the mandate bestowed upon the Select Committee on Inquiry into the Affairs of Kenya Airways and its Subsidiaries, the Committee has conducted an in depth and substantive inquiry on the areas of concern during the last 5 months.

Mr. Speaker Sir, in executing its mandate, the Committee was motivated the desire to see Kenya Airways retain and live up to its slogan, "the pride of Africa". The Committee also wishes to make it very clear that it acted within its mandate as espoused in Article 94 and 96 of the Constitution. Indeed the people of Kenya, through their Government, collectively own 29% shares in the company, and for that very reason, this senate must oversight and protect this interest. The Committee, during the inquiry, held a total of 41 meetings, visited the Kenya Airways Hub and received submissions from a large number of both individuals and corporate entities. When we could not meet certain individuals and entities, we wrote letters with specific questions seeking answers that could shed light on the issues at hand.

Mr. Speaker sir, among the Submissions that were received by the Committee and that revealed vital information included the Minutes of the Board of Directors, financial statements, confidential management letters from the airlines auditors and aircraft Purchase and Leasing Contracts. The Committee analyzed these and other documentation and submissions and deciphered a trail of actions and decisions indicating poor management practices over time. In this regard, the Committee established a Legal Sub-Committee which carefully interrogated the submissions.

It is imperative **Mr. Speaker Sir**, to note that Kenya Airways may not have done anything illegal, but our Committee can conclusively state that the current situation bedeviling the national airline is a direct result of bad decisions made over time by individuals given the responsibility to steer the Company. In that regard, the Committee is unanimous that those decision makers must be held to account for the sorry state of affairs in which the company now finds itself in.

Mr. Speaker Sir, the Committee was cognizant that even as this inquiry progressed, various court cases touching on Human resources matters in the organization were still pending in court. The Committee was throughout the process guided by our standing order 92 and the rules of natural justice.

Mr. Speaker Sir, the Committee unearthed among other issues a deliberate attempt by management to force dubitable expansion plans of the airline despite expert advice against this. The much famed '**Mawingu**' 10 year project was the highlight of these schemes. A grand project, **Mr. Speaker Sir**, costing the Airline colossal sums of money and eventually landing the company into unsustainable debt levels and a diminishing market share both locally and abroad. This coupled with a loss inflicting fuel hedging regime and a shift towards outsourcing of critical labour had sunk the company to lows never witnessed before.

Granted, **Mr. Speaker Sir**, that the global environment in the aviation industry has proved difficult for many airlines over the last decade, there are many examples where sound and imaginative management has made certain airlines to weather these storms. This has been achieved by minimizing risks, reducing on operational costs, capitalizing on efficiency gains, improving customer satisfaction, motivating the workforce to maximize productivity and maintaining sound profit margins.

Mr. Speaker Sir, other airlines, faced with grueling competition from the gulf airlines have kept afloat admirably led by management teams capable of rising to the occasion.

Observations

Mr. Speaker Sir, the Committee has observed, and this report will show, that Kenya Airways has been mismanaged and any bailout from the taxpayer must be preceded by a visible and top level management shakeup. The Committee during its inquiry observed a myriad of issues which among these are;

1. The current Group Managing Director and Chief Executive Officer (CEO), Mr. Mbuvi Ngunze, was the former Chief Operating Officer (COO) of Kenya Airways for three years. The Committee observed that at the point of being recruited to the position of COO, Mr. Ngunze was not qualified for that position as outlined in the Kenya Airways operations manual (**Appendix page 31 of 118**). The Board of Kenya Airways submitted to the Committee that it exercised its discretion to waive the requirement for 8-10 years' experience which allowed the current Group Director and Chief Executive Officer to be recruited as Chief Operating Officer before the current appointment to Group Managing Director and Chief Executive Officer.
2. Kenya Airways has severally received funds in the form of cash bail outs from the government. The most recent of this bail out was an amount of KShs.4.2 Billion approved by the National Assembly in May, 2015. It only follows therefore that the principles of public finance contained at Article 201 of the Constitution especially the principle of openness and accountability must be adhered to. Secondly, Article 229 (5) & 229 (6) of the Constitution which provides that *the Auditor-General may audit and report on the accounts of any entity that is funded from public funds. An audit report shall confirm whether or not public money has been applied lawfully and in an effective way.*

Mr. Speaker Sir,

3. Having gone through the above, the Committee observed that in order to solve the current fiscal crisis in Kenya Airways, there can only be three options for Kenya Airways-
 - (a) Dissolution of the Company;
 - (b) Recapitalization of the Company through a rights issue or bringing on board additional stakeholders; or
 - (c) Sale of the government's 29% share.
4. The Committee observed that KQ as at 20th November, 2015 had appointed McKinsey and Company as lead Consultants to ensure the turnaround of the Company within the next 18 months.

Recommendations

Mr. Speaker Sir, having observed these very serious issues, the Committee recommends a plethora of curative measures. Key among them:

1. Given the importance of the KQ to the Kenyan economy, the Committee recommends that the shareholders inject new capital into the airline to facilitate the turnaround of the airline.
2. The shareholders should provide a financial bailout in form of equity under the following conditions-
 - a) A reconstitution of the Board of Directors by the Major shareholders,
 - b) Restructuring and putting into place a management team with sufficient skills and experience in the aviation industry and with an ability to turn around and build the company.
 - c) Hire a new commercial director with proven international experience to turn around its ticketing system and ensure proper accounting of revenue from market sales.

But it should be noted that infusion of capital can only be made upon meeting the conditions stated above. The committee does not recommend any bailout that is not sufficient to meet the outstanding company's obligations.

3. The shareholders should review and restructure Board of Directors composition since in the current composition the management team is over represented; this overrepresentation undermines the Board's advisory role.
4. The Committee further recommends that the new management team should:
 - i. Explore arbitration alternatives with employees and their unions with aim of ending the long standing litigation.
 - ii. Apply prudence in outsourcing of services without compromising the morale and efficiency of the existing employees.
 - iii. Review the Joint Venture with KLM especially on the provisions of code sharing, revenue management and sales tracking to ensure equity in revenue sharing.
5. The Committee welcomes the Mckinsey initiative and emphasized the importance of taking into account this Report, its observations and recommendations.

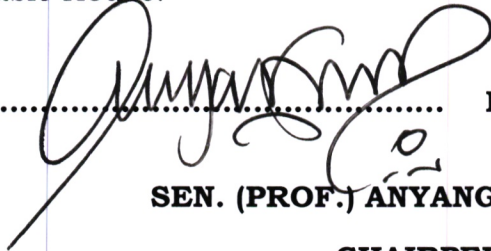
ACKNOWLEDGEMENT

Mr. Speaker Sir, the Committee takes this opportunity to thank the offices of the Speaker and the Clerk of the Senate for facilitating the technical and administrative work of the Committee. The Committee is also grateful to the Chairman of the board and the entire management of the Kenya Airways Ltd for appearing before the Committee on various occasions and submitting documents required by the Committee. The Committee further, thanks the employees and unions representing employees of the airline for patriotically presenting concerns and proposals on ways and means to redeem the Pride of Africa.

Mr. Speaker Sir,

It is my pleasant and duty, pursuant to Standing Order 203, to table the Report of the Select Committee on the Inquiry into the Affairs of Kenya Airways Limited and its Subsidiaries for consideration and adoption by this honourable House.

Signed.....



Date... 25th November 2015.

SEN. (PROF.) ANYANG' NYONG'O, M.P.

CHAIRPERSON

**THE SELECT COMMITTEE ON THE INQUIRY INTO THE AFFAIRS OF
KENYA AIRWAYS LIMITED AND ITS SUBSIDIARIES**

CHAPTER ONE: INTRODUCTION

The Senate on Thursday 18th June, 2015 approved a motion moved by Sen. (Prof.) Anyang' Nyong'o, M.P. pursuant to the Senate Standing Order No. 48 establishing a Select Committee to inquire into the affairs of Kenya Airways and its Subsidiaries. This report has been done pursuant to the motion tabled in the House of the Senate and adopted for actualization.

Motion

Establishment of Select Committee to Look into the Affairs of Kenya Airways Limited

THAT, aware that the Government of Kenya has a 29.8% shareholding in Kenya Airways Limited thereby being the largest single shareholder in the company;

COGNIZANT of the fact that Kenya Airways Limited, the National Flag carrier, has been experiencing tremendous delays and cancellation of flights;

AWARE that each delay and/or cancellation has led to grave losses to the airline thereby worsening the debt burden of the corporation;

REALIZING that the airline is now in debt to the tune of Kshs18 billion;

FURTHER AWARE that the current business plan of the airline does not seem to take into full account necessary measures to turn the company around;

CONCERNED that the situation, if left unchecked, may lead to the collapse of the company and great loss to the nation, investors and the Kenyan taxpayers;

NOW THEREFORE, the Senate resolves to establish a select committee to conduct an inquiry into the affairs of Kenya Airways Limited and its subsidiaries, and report to the Senate within three months, taking into account the following:-

- 1) The leasing and buying arrangement of aircrafts since 1996;
- 2) The role of off-shore companies in the investment affairs of the airline;
- 3) The identity of the shareholders of these off-shore companies and their relationship with the management of Kenya Airways Limited;
- 4) The employment policies and practices of personnel, including engineers, pilots, cabin crew and ground personnel;
- 5) The reason for delayed and cancelled flights, their frequency and the magnitude of losses attendant therein; and

- 6) Any other matter that may shed light on the financial and management crisis currently facing the airline;

Extension of Mandate

THAT, AWARE THAT the Senate, on 18th June, 2015, resolved to establish a Select Committee consisting of 11 Senators to conduct an inquiry into the affairs of Kenya Airways Limited and its Subsidiaries and report back to the House within three months of its establishment;

REALIZING THAT the three month period lapsed on 18th September, 2015 but owing to the magnitude of the work involved the Committee was not able to complete its work within the duration;

NOTING THE NEED for more time to carry out a thorough inquiry into this matter;

NOW THEREFORE the Senate resolves to renew the mandate of the Committee for a further period of two months to enable the Committee to complete its work and report to the House and further resolves that the following two Senators be added to the membership of the Select Committee;-

1. Sen. Stephen Sang; and
2. Sen. Mutula Kilonzo Jnr.

Methodology

The Committee pursuant to its mandate adopted various methods in executing the inquiry as listed below:

- 1) Deliberative meeting sessions;
- 2) Interrogative sessions;
- 3) Analysis of submitted documents; and,
- 4) Public hearings.

CHAPTER TWO: BACKGROUND

1. Kenya Airways Limited was incorporated in January, 1977 as Kenya's national flag carrier and was fully owned by the Government. In response to a long period of gradual deterioration in financial and operating performance, the Government of Kenya in 1991 appointed a new Board of Directors with the main objective of commercializing the airline and preparing it for privatization.
2. In 1992, a new management team was appointed to implement a major restructuring of Kenya Airways which inter alia involved;- the installation of strong financial control and budget processes, a reduction in the fleet and an increase in aircraft utilization, a major training to transform existing organizational culture to be focused on customer services and a reduction in staff through a voluntary severance program.
3. In 1994, the new management team made significant progress in the airline performance by streamlining its operations and restructuring its financials and in 1995, the management established a strategic partnership with the KLM Royal Dutch Airline;
4. In 1995, the International Finance Corporation (IFC) – an investment arm of the World Bank successfully advised and guided the Government of Kenya on the privatization of Kenya Airways. After selling 26 percent of the airline to a strategic partner, the frequency of the airline's flights grew by 61 percent in six years. The sale was completed in December 1995 and the Initial Public Offering (IPO) was undertaken in April 1996.
5. The Government privatized Kenya Airways with the following three-fold objectives-
 - (i) To ensure the continued operation of Kenya Airways as the country's National Airline;
 - (ii) To transfer the bulk of ownership of the airline to the private sector; and;
 - (iii) To allow the airline to build on its improved operating performance and profitability with support from the private sector.
6. The Initial Public Offering (IPO) of the Company's shares was the biggest share offering in Kenya's history at the time and was oversubscribed by 82 per cent. This floatation on the Nairobi Securities Exchange (NSE) resulted in the government of Kenya ceasing to be the major shareholder in the company reducing its holding to 23 per cent while KLM became the major shareholder with 26 per cent shares.
7. KLM Royal Dutch Airlines purchased 26 percent of the equity and the Kenya Government through the National Treasury received over US\$70 million from the sale. Over 113,000 Kenyans were able to buy 22 percent

of the shares in the airline (the vast majority bought the equivalent of about US\$200 worth). Kenyan financial institutions bought 12 percent, international financial investors 14 percent, and employees of the airline acquired 3 percent.

8. The completion of privatization of Kenya Airways coupled with strong management and partnership with KLM, led the Airline back to the profitability path. The cooperation between the two airlines was geared towards pooling of their strengths thereby achieving economies of scale through sharing resources, combining route networks, and assessing new markets in Sub-Saharan Africa. The success of this joint venture led to the doubling of passenger traffic and cargo between 1995 and 2003 and a boost to tourism.
9. 1997 signaled the beginning of the management's significant commitment to grow its fleet and in 2001 the company continued its investments in fleet renewal leasing three Boeing 767-300 and two Boeing 737-700. The company also ordered three Boeing 767 -400ERX (which subsequently changed to 777-200 ER) and two Boeing 737-700 which marked the gradual withdrawal of the Airbus A310 fleet.
10. In 2002 and 2005 Kenya Airways undertook a successful cross listing in the Uganda Security Exchange (USE) and the Dar-es-Salaam Security Exchange (DSE) respectively.
11. In 2010, Kenya Airways became a full global airline partner of the Sky Team global alliance alongside KLM having been an associate partner since 2007.
12. In July, 2011 as part of its overall strategic position, the Board of Kenya Airways approved its 10 year business plan (Project *Mawingu*). The management has since embarked on the implementation of the first five year plan.
13. In March, 2012, Kenya Airways offered a Right Issue totaling to 1,477,169,549 new shares at Kshs. 14 each that was estimated to raise approximately Kshs. 20.68 billion.
14. Reasons for this rights issue were-
 - i. To assist in funding the pre-delivery payment (PDP) to aircraft manufacturers in connection with the acquisition of nine (9) Boeing 787 Dreamliner Aircrafts and ten (10) Embraer 190 aircrafts for which the company had placed;

- ii. To assist in funding the pre-delivery payment (PDP) to aircraft manufacturers in connection with the acquisition of other aircrafts for which the company may in future place orders; and,
 - iii. To finance KQ's capital expenditure requirements related to the additional aircraft and equipment such as hangers and engines.
15. The GoK, having applied for its full entitlement of new shares, resulted to the increase of its shareholding to 29.80% from the previous 23%, whereas KLM subscribed for its full entitlement of new shares, its application was scaled back such that it was allotted 280 million shares, this altered its shareholding in KQ from 26.00% to 26.73%.
16. In March 2011, KQ was a profitable company since it had declared a Ksh. 5 billion profit and was in a solid financial state. In 2012, the profit declined to Ksh. 2 billion. In the Financial Years ending March 2013 and 2014 KQ declared a loss of Ksh. 10.8 billion and Ksh. 4.8 billion respectively.
17. In 2015, KQ declared a loss of Kshs. 25 Billion and this was attributed to various factors key among them being losses accruing from fuel hedging, Ebola epidemic in West Africa, threat from terrorism, expansion of routes and ambitious expansion plan (Project *Mawingu*).
18. Kenya Airways Group Limited is composed of Kenya Airways Limited and other subsidiaries/related companies including: Kenya Airfreight Handling Limited, JamboJet Limited and African Cargo Handling Limited.
19. Kenya Airways Limited holds a 41.23% equity interest in Precision Air Services Limited (a Tanzanian based Company) with a code share on the route between Nairobi and Dar es Salaam.

CHAPTER THREE: SUBMISSIONS FROM KEY STAKE HOLDERS

SCHEDULE OF MEETING WITH KEY STAKEHOLDERS

NO.	DATE	ORGANIZATION	SUBJECT
1.	13/7/2015 (9.30a.m.)	Aviation and Allied Workers Union	Briefing by the Chairperson of the Aviation and Allied Workers Union
2.	13/7/2015 (11.30a.m.)	Kenya Airlines Pilots Association	Briefing by the Secretary General KALPA
3.	13/7/2015 (2.30p.m.)	Chairman, Cabin Crew Branch Aviation and Airport Services Workers Union	Briefing by the Chairman of AAWU
4.	20/7/2015 (9.30a.m.)	Kenya Airways Board and Management	Presentation by the Chairman, KQ Board of Directors
5.	20/7/2015 (11.00a.m.)	Kenya Airways Board and Management	Briefing by the MD and CEO of Kenya Airways Limited
6.	20/7/2015 (2.30p.m.)	Kenya Aviation Workers Union	Briefing by the Secretary General of KAWU
7.	22/7/2015	Members of the Public	Presentation by the Public
8.	31/7/2015	Financial Consultant	Evidence by the Financial Consultant
9.	7/8/2015	Kenya Airways Board and Management	House Keeping Presentation of A Memorandum by the Management of KQ Ltd
10.	13/8/2015	Kenya Civil Aviation Authority (KCAA)	Meeting with the Management of Kenya Civil Aviation Authority (KCAA)
11.	19/8/2015	Ministry of Labour, Social Security and Services	Brief on Proposed Questions for the Cabinet Secretary for Labour, Social Security and Services
12.	25/8/2015	Ministry of Transport and Infrastructure	Briefing by the Cabinet Secretary for Labour, Social Security and Services
13.	1/9/2015	National Treasury	Briefing by the Cabinet Secretary, National Treasury
14.	8/9/2015 (10.00a.m.)	Former MD and CEO Kenya Airways	Briefing by former CEO of Kenya Airways
15.	8/9/2015 (12.30p.m.)	Department of Immigration and Registration Births	Evidence on Work Permits
16.	16/9/2015 (9.30a.m.)	Directorate of Immigration and Registration of Persons	Briefing on the issuance of work permits to Foreigners working at Kenya Airways
17.	16/9/2015	Kenya Airways	Deliberation on Submission

	(10.00a.m.)		of KQ documents
18.	23/9/2015	Deloitte & Touche	Audited Kenya Airways (KQ) Books of Accounts for the Financial year 2004-2010
19.	23/9/2015	Price Waterhouse Coopers	Audited the Kenya Airways (KQ) Books of Accounts from the March 2011-March 2014
20.	24/9/2015	KPMG	Audited Kenya Airways (KQ) Annual Report and Financial Statements for the year ended 31 st March, 2015
21.	1/10/2015	Kenya Airways Board and Management	Confirmation by the Chairman to the Committee of Receipt of excerpts of Minutes from Kenya Airways Management for Consideration by the Committee
22.	8/10/2015	Kenya Airlines Pilots Association (KALPA)	Tabling of Documents before the Committee
23.	10/11/2015	KLM President	Deliberations with the Committee
24.	24 / 11/2015	Mckinsey and Company	Deliberations with the Committee

1. Aviation and Allied Workers Union (AAWU)

The Chairperson of the Aviation and Allied workers Union Ms. Perpetua Mponjiwa took the stand and an oath was administered. She informed the Committee as follows;

Registration of Workers Union

AAWU had a recognition agreement with Kenya Airways (KQ) from 2006-2014 until another Union, Kenya Aviation Workers Union (KAWU) was registered with the support of KQ management in an effort to undermine AAWU. The registration of KAWU was however contested and is a matter before court.

Outsourcing

- a) In the past years, the airline engaged itself in the outsourcing of very key functions to external parties. Particularly, two companies namely: Career Directions Limited (CDL) and Insight Management Company; had been involved in the supply of staff to Kenya Airways. The two companies have entered into contracts to supply the company with cadres of staff that the airline engaged directly.
- b) The cadres of staff supplied by the two companies range from customer care, cabin crew, and airside technicians among others. The reasons advanced for outsourcing include; bringing down the wage bill, freeing up management time to concentrate on core functions among others.

Retrenchment/Redundancy

- a) In the year 2011, KQ planned to lay off its workforce claiming that it had a bloated workforce and therefore could not sustain the high wage bill. AAWU contested the planned layoff basing their decision on KQ's management growth plan "Mawingu Dream" which proposed the acquisition of more aircrafts and thus in essence meant more workforce.
- b) Between 1st August and 4th September 2012, KQ management laid off 447 Kenyan workers in the category of cabin crew and airport ground staff. The process was carried out in a brutal and inhumane manner. On 3rd December, 2012, the process was nullified by the Industrial Court citing that it was substantively without justification and procedurally wrong amounting to unfair termination of employment.
- c) Kenya Airways Limited appealed against the ruling of the Industrial Court and managed to secure a stay order against the ruling. By the time of submission, the matter was before the Supreme Court Judges. AAWU sought the intervention of the National Assembly in 2012 on the matter.

However, KQ management stated that KQ was a private company that was not subject to scrutiny or oversight by public institutions and yet KQ had received a bail out from the Government of Kenya in 1996.

Hiring of Foreign Workers

Kenya Airways has been involved in the hiring of foreigners from Thailand, Ghana and Cameroon to work mainly as flight attendants from 2005 and AAWU stated that such action was not fair since these workers bring no exceptional value/ skills. The foreign workers only serve to balloon the wage bill and reduce the morale of the unionisable staff since the law does not allow them to join the local unions. When redundancies are done within the company, Kenyans lose jobs as more foreigners are being employed.

Aircraft Leasing Contracts

In 2011, Kenya Airways embarked on Project *Mawingu*, an ambitious 10 year expansion plan which involved the opening up of new routes and acquisition of new aircrafts. KQ did not directly buy aircrafts from the manufacturer but through intermediaries known as Samburu and Amboseli in Cayman Island.

The deals entered into were questionable. The intermediaries were to provide with loan guarantees to acquire aircrafts and lease them over to Kenya Airways. These contracts were chiefly responsible for the rapid and crippling deterioration of the revenue and capital accounts of Kenya Airways.

Other Pertinent Issues

The management claimed that KQ owned JamboJet but AAWU believed that JamboJet is not 100% owned by KQ. AAWU believes that the problems of KQ revolve around the agreement and operations of CDL, Insight Management Company, JamboJet, Samburu and Amboseli companies. AAWU is of the opinion that the problems facing KQ are as a result of deliberate mismanagement so that the company is taken over at a throw away price by interested parties.

2. Kenya Airlines Pilots Association (KALPA)

Captain Ronald K. Karauri the Secretary General KALPA took to the stand and an oath was administered. He informed the Committee as follows;

Flight Acquisition

- a) That KQ management had acquired aircrafts that were not suitable for the African routes. An example was the acquisition of twenty six

Embraer aircrafts, fifteen of which are always on standby. The Embraer aircrafts have a capacity of ninety passengers but experts have stated that this aircraft can comfortably carry only sixty five passengers.

- b) KALPA was concerned as to the ownership of the 777-200 and 777-300, as the airline had previously informed the pilots that these aircrafts were fully owned by KQ. The pilots however suspected that these were on lease and the leasing costs were not sustainable, hence the plunge of KQ.

Procurement Processes

KALPA suspected that there was a possibility of fraudulent procurement processes within the company, which encouraged overpricing of goods and services, beyond prevailing market rates.

Competition from other Airlines

Prior to 2012, KQ did not face serious competition from other airlines. However, due to unresolved grievances from customers (such as delays in baggage arrival to the West African routes), other airlines zeroed in and addressed the grievances while KQ did nothing. Customers then moved to the other airlines, therefore making KQ lose volumes of business.

Frequent Cancellation of Flights

The Committee was informed that the management of KQ had lost the goodwill of the members of staff. The said staff were not willing to step in while off duty, to assist in case of unforeseen circumstances and hence the reason for delays and frequent cancellation of flights.

Fuel Hedging

The Committee was informed that fuel hedging was a common practice within the airline industry. However, there was a possibility that KQ had hedged for a long duration, which may have been disadvantageous, depending on the stability of the price of fuel during the hedging period.

The Hub Concept

KQ and KLM had an MOU, in terms of sharing profits though KALPA was not privy to the terms of the MOU. They presented that under normal circumstances two airlines would agree on hub concept where KQ would fly passengers destined to European routes from Africa to Amsterdam and KLM flies them to their final destinations while KLM would fly passengers plying the African routes from various destinations to Nairobi and KQ would fly them to their final destination.

The Committee was informed that KLM flew to most African routes, denying KQ this opportunity, while KQ flew to minimal European routes

(Amsterdam, Paris and London) from Nairobi. The prevailing circumstances deny KQ the opportunity to share profits with KLM.

Mismanagement at Kenya Airways

- a) KALPA presented that, despite the challenges Kenya Airways faced it remained a valuable national asset in terms of job creation, boosting the national image and providing other opportunities in the aviation sector. A major shortfall in Kenya Airways was due to inadequate expertise and experience in management of the aviation sector. The management has been making a series of uncalculated decisions that are detrimental to the organization, case in point, disposing the Boeing 777 – 200 while other airlines are making profits using the same aircraft;
- b) The Committee was informed that the management of Kenya Airways has adopted an adversarial relationship with its employees with a bias of taking all matters to court instead of consulting and reaching an amicable solution. Kenya Airways had severally been engaged in un-procedural sacking of employees under various guises which is not good for the business; and that Kenya Airways pilots are willing to improve productivity if only the schedules/rosters are done in line with improving the amount of hours a pilot is supposed to fly;
- c) The eight pilots who were retired by Kenya Airways were still receiving their full salaries. Five other pilots that were trained by Kenya Airways to operate the 787 dream liners in Gatwick, London were also on full salary though they yet to be engaged. The five pilots will have to be retrained since the period that they were supposed to operate the aircrafts lapsed. KALPA recommended that for KQ to return to profitability, the following need to be done:
 - i) A complete overhaul of the board of Directors;
 - ii) A complete overhaul and change of senior management;
 - iii) A forensic audit of the company to uncover mismanagement in the company;
 - iv) The immediate stoppage of hiring of foreign workers in the company;
 - v) Formulation of a coherent strategy to revive the company; and
 - vi) The Government to give KQ financial support.

Presentation by Captain Sharma

He informed the Committee that:-

- a) That he had worked for the airline for 37 years. On 9th March, 2015 he was recalled from regular duty and had a meeting with the Human Resources Director and the Director Flight crew, where he was given a letter communicating that the Company had decided to send him on early retirement. The early retirement letter was based on clause 34(b) of the Collective Bargaining Agreement (CBA), which however, states that early retirement in the company should be as a result of negotiations between the parties. He however declined to sign the letter and requested to consult with his family, friends and KALPA.
- b) Kenya Airways refused to rescind this decision alongside those of seven other pilots who were retired on similar circumstances and as a result, KALPA directed its members to withdraw the goodwill. Kenya Airways filed a case in court on the same matter and got orders directing KALPA members to reinstate the goodwill – at the time of submission the case was at the industrial court awaiting interpretation of clause 34(b). Early retirement was just a decoy for affecting a redundancy exercise without paying severance package to the affected workers. Two out of the ten pilots affected were reinstated after presenting personal petitions for consideration, an opportunity that wasn't given fairly to all the other eight pilots.
- c) At one point, the KQ management asked KALPA to accept pay cuts with the possibility of the 8 pilots being reinstated, a move that was seen to be intimidating. The company however continued hiring other pilots during the same time, making the early retirement exercise unreasonable. On 18th march, 2015, the management wrote to KALPA stating that they had secured alternative employment for the 8 affected pilots but this offer was never followed up with a written offer. The retired pilots had not received any benefits except their provident fund contribution. This treatment was unfair and had caused him and his family, great distress and is willing to settle the issue as long as he and the other pilots are paid their severance package and all the other due benefits.

3. Cabin Crew Branch of Aviation and Airport Services Workers Union

Mr. Julius Chacha took to the stand and an oath was administered. He informed the Committee as follows;

Industrial Court Ruling by Justice James Rika

- a) The case was on the restructuring, redundancy and retrenchment process that was carried out by KQ between 1st August and 4th September 2012, and the court ruled;-
 - i) that the process was substantively without justification, and procedurally wrong, amounting to unfair termination of employment;
 - ii) Reinstatement of all the affected 447 unionisable employees without loss of seniority, continuity, benefits and privileges;
 - iii) Payment of salaries of the employees should be done as far back as September 2012 and
 - iv) All the employees were directed to report to work the next day at 8.00 am;
- b) However, KQ went back to the Industrial Court and at the same time to the Court of Appeal to challenge the ruling. Justice Monica Mbaru on the same day granted a post-dated stay order dated 13th December, 2013. Despite the union's protests, the stay orders were enforced based on section 35 (c) of the Industrial Court procedures which deal with bankruptcy.

National Assembly Report - November, 2012

- a) Hon. John Mututho brought a petition on the redundancy exercise at Kenya Airways and the following recommendations were adopted by the house;-
 - i) That the redundancy exercise be nullified and the affected employees to be reinstated with full benefits unconditionally and without any victimization,
 - ii) That the offices abolished should not be filled through outsourcing as this negates the principle of redundancy,
 - iii) That the government should urgently formulate policies to regulate both labour outsourcing and contracting,
 - iv) Investigations on the foreign workers' permits should be done and relevant authorities should ensure Kenyan's rights are upheld,
 - v) Work permits for jobs that have available and sufficient skills locally should not be issued,

- vi) KQ management should have regard for its worker's Constitutional rights and the Collective Bargaining Agreement that was signed between the airline and Kenya Aviation and Allied Workers Union,
 - vii) That KQ management should stop discriminating its staff on the basis of gender and health status and
 - viii) That investigation into the mismanagement, corruption, negligence and alleged sexual harassment within the airlines management should be done.
- b) In the said report, it was observed that there was sufficient notice given for retrenchment/ redundancy exercise. However, it was a notice of intention to all stakeholders and thus an invitation for them to consult. There should have been a second notice to the specific individuals affected so that they could have taken necessary actions that would not leave them vulnerable.

Cabin Crew Issues

- a) The cabin crew from India at the time of retrenchment/ redundancy exercise were never affected despite the fact that they did not have work permits. Kenya Airways also recruited 36 crews from India a month after the retrenchment and redundancy exercise was done. KQ further contracted a third party to: shortlist, recruit, conduct medical check-up and train the recruits. This was at a higher cost than it would have cost KQ to do it themselves locally.
- b) It was ironical for KQ to put up a job advert in Thailand for cabin crew after the retrenchment and redundancy exercise in Kenya was conducted with the reason of a high wage bill. The new employees would actually cost more than the cabin crew from Kenya. KQ also promoted new employees to the same positions that they had declared redundant. The cabin crew that KQ was employing were under class D of the foreign worker's permits. Among the requirements is an annual fee of Kshs. 200,000 per person.

Cayman Saga

This was about the Kenya Airways Embraer pre-delivery payment financing Structure. The corrupt acquisition of the aircrafts, through which the company is believed to have lost billions by way of mysterious financing deals. The companies involved in this deal(s) could not be traced, but they are registered in the Cayman Islands (a tax haven).

C.B.A Registration

There was a Collective Bargaining Agreement (CBA) between Kenya Airways Limited and AAWU, but KQ went against it by cutting down staff on grounds of a high wage bill.

Abinitio Saga

- a) This was a scheme to con Kenyans who aspired to be trained as pilots. An advert was placed in the Daily Nation Newspaper on 12/11/2008: "We urgently require pilot trainees. For more Details contact 0721435582". A Mr. Timothy Ngure Mwaura (applicant) made a personal statement with names of the people who were involved in the recruitment such as Mr. Steve Francis, the Manager and Coordinator of Travair Training Institute.
- b) The statement indicated that those who would be shortlisted would undergo training in South Africa to pursue the course and the company would cater for all the expenses, with each student being offered a salary of Ksh. 150,000 during the training. Upon successful completion of the training, the trainees would automatically become KQ pilots with a starting salary of Ksh 600, 000. The statement further indicated that to be shortlisted, one was required to pay Ksh. 1,000, 000 to a specified bank account.
- c) The deal appeared suspicious and the applicant opted to report the matter to the then CEO (Mr. Titus Naikuni), CID and KQ security department and there was a voice recording of the conversations that was left with the CID. The matter was still pending with the CID and Management of Kenya Airways at time of presentation.

Guidelines in Dealing with Redundancy and Retrenchment

The process was unfair and did not follow the set out guidelines in the labour laws and employment Act, the important process points were not observed or executed. Staffs were informed via text messages whilst on duty in foreign lands and were asked to still perform their tasks on the flights back to Kenya. This was a great oversight in terms of risk and the Botswana case was given as an example, where a disgruntled employee stole and crashed the plane.

May fly and Other Documents to Support Delays

The Committee was informed that Kenya Airways delayed or cancelled a number of flights due to crew constraints and yet the flights were fully booked leading to massive losses. KQ would compensate passengers for any cancellation of flights with full board accommodation at a 5 star hotel and later fly the passengers to their destinations. There were out of court settlements of cases against KQ for damages caused by the delays.

Job Advert in Thailand for Cabin Crew Positions

As Kenyans were being retrenched on grounds of redundancy, KQ was hiring foreigners for the same jobs through a broker (3rd party) at a higher cost accruing from the processing and payment of work permits, medical examination fees and upkeep.



Communication on JamboJet and List of Crew

KQ staffers were informed that JamboJet and KQ were 2 distinct corporate entities and that Kenya Airways was not in a position to handle issues relating to JamboJet. This was however proven to be incorrect since members of staff were re-designated to work for/with Jambojet without their consent and they were not allowed to initiate any dialogue about the same.

C.E.O's Newsletter

In a newsletter dated 19th September, 2013, the C.E.O admitted that there was a shortage of crew (139) positions despite having employed 70 new crews. All this whilst KQ was fighting to obtain a stay order to appeal against 447 employees. Out of the 447, 150 were cabin crews who were highly qualified, experienced and trained.

5Y-KYL Kenya Airways Embraer

Mr. Chacha stated that KQ had indicated that KYP (5Y) was the only Embraer aircraft that KQ bought in 2010. However, a further search on airlines.com revealed that KQ had bought another Embraer in 2010 Reg No. 5Y-KYL. It was formerly operated by Finair from 2006. It was bought as a new aircraft, but records showed that it was a second hand and the aircraft does not feature in KQ's lists of aircrafts.

Flight 5 Y KYY -767

The report of flight 5Y KYY – 767 that was allegedly flown to Rome (Italy) on 25th February 2011 without insurance resulting to the laying off of the then Chief Operating Officer Mr. Bram Stella, Captain Paul Mwangi and the Director of Operations.

4. Chairman Board of Directors and Management of KQ

The MD & CEO Kenya Airways Ltd., Mr. Mbuvi Ngunze, informed the Committee on his credentials as follows;

Prior to being employed by KQ, he had been working at Lafarge (Uganda and France), where he gained experience in finance and operations and had served as the Chief Operating Officer (COO) at KQ for about three years, before being recruited as MD & CEO on 1st November, 2014. It was a coincidence that Mr. Titus Naikuni (former KQ CEO) had also worked at Lafarge and the nominations committee of the Kenya Airways Board of Directors that undertook the recruitment of the CEO included representatives from the National Treasury and KLM.

Performance of the Airline and Competitiveness

- a) Operational routine in terms of maximum flying hours for pilots and cabin crew are stated in law and are adhered to. KQ and KLM have a joint venture agreement on hubs; which has its advantages and disadvantages. The airline had incurred losses for a while but this was not unique to KQ as an airline.
- b) The past ten years have been extremely difficult for the airline industry and has seen the collapse of many African national carriers because of various problems such as disrupted tourism due to travel advisories, insecurity, geopolitical problems and the weak African currencies. The remaining national carriers have to grapple with financial difficulties often needing bail outs. Airlines fully owned by their governments benefit from protective laws that allow them to thrive. A good example of this is the Ethiopian Airlines, as the government has ensured it remains a virtual monopoly at home.
- c) The CEO further informed the Committee that KQ's competitiveness had mostly been affected by;- travel advisories, infrastructure development at JKIA, as passengers would prefer to transit through an airport with excellent infrastructure; and Gulf carriers have the same target market as KQ and in fact currently, Emirates is the largest carrier in Africa.

KQ's Milestones

The Management informed the Committee that it had many achievements including;- Operating in fifty two (52) countries, employed 600 crew in foreign countries that it operates in, a member of the Sky Team, undergone the eighth (8th) IATA Operational Safety Audit (IOSA), ongoing ground services audit, has the youngest (less than three years old) fleet in Africa, has code shares in nineteen (19) countries, acquisition of the Boeing 787 Dreamliners in 2014, acquisition of ten Embraers (ERJ-190) in 2012, leading African Airline in Business Class infrastructure and service; and hosted the 1st ever Aviation Workshop in February 2015, which drew a 9 point agenda to guide the common vision of developing the aviation sector in Kenya.

Fleet Financing and Acquisition

- a) Prior to privatization, KQ had acquired planes using a different model given that the company was 100% GOK owned and the National Treasury guaranteed the purchases and upon delivery; KQ would make payments to the financiers. This method was used to acquire the Airbus A 310 in 1986. KQ would then take title to the aircraft upon delivery on the strength of the government guarantee;
- b) After the privatization of the airline, it was necessary for the Board and Management to put in place alternative arrangements to finance aircraft

acquisition and hence various Special Purpose Vehicles (SPV's) were set up by the airlines lenders as part of the financing arrangements to facilitate KQ's new aircraft acquisition. Setting up of SPV's is normal airline industry practice as evidenced in relevant IATA aircraft financing literature and also a normal practice for large asset financing such as ships and aircrafts. SPV's are entities created to engage in specific financial transactions for example asset acquisition or leasing and the fact that KQ fully discloses the existence of these SPV's in its annual Reports clearly demonstrates that there is nothing unusual regarding these companies. The practice currently is that, Special Purpose Vehicles (SPV's) are set up to hold title to the aircrafts for as long as the loans are outstanding (this method has been used to acquire the Boeing 777-300);

- c) The airline has acquired its fleet mainly through two methods namely Operating Leases and Finance Leases. Under the Operating Lease scenario, KQ as lessee in most cases seldom acquires title to the leased aircraft at the end of the term, unless the transaction includes an option to purchase the Aircraft under certain circumstances. KQ has on a number of occasions made a decision to lease aircraft on an operating lease due to the capital constraints and hence foregoes any right to the residual value of the aircraft which reverts to the lessor. A case in point is the sale and leaseback of the three B787's with AWAS a major leasing company. The said leasing has greatly assisted the airline in realizing its cash flow objectives given its current situation;
- d) On the other hand under a Finance Lease, substantially all the risks incidental to ownership of the aircraft are transferred to KQ as the Lessee and the arrangement involves payment of specific amounts during a fixed term of say 12 years for a new aircraft and the title to the aircraft passes to KQ at the end of the term of the loan.
- e) In cases where an aircraft is required for a short time, KQ acquires such through charter, wet lease (airline gets an aircraft with crew to do a certain job) or operating lease; and Sale and Leaseback, where KQ leases an aircraft over an agreed period of time e.g. 12 years, under an operating lease. This happens in the absence of sufficient cash to cater for financing costs and related expenses.
- f) Sale and Leaseback, where KQ leases an aircraft over an agreed period of time e.g. 12 years, under an operating lease. This happens in the absence of sufficient cash to cater for financing costs and related expenses;
- g) The Committee was given an example of the purchase of the Boeing 737-300, where KQ made a down payment of 15% of the aircraft's purchase price to the manufacturer-(Boeing), The Export Import Bank of the United States (Ex-Im bank) offered a guarantee for the 85% balance. PEFCO (a group of commercial banks) financed the 85%. Simba Finance Limited was incorporated by Ex-Im Bank in Bermuda as the SPV to hold title, pending completion of the loan by KQ. KQ would under the arrangement acquire the possession of the aircraft without any

documentation, but would hold a 2nd priority charge over the aircraft. The Bill of sale (*log book of an aircraft*) is normally in the borrower's name for the loan period.

h) Kenya Airways acquired the following aircrafts during the years of manufacture;-

Registration No.	MSN	Lessor/Borrower SPV	Year of Manufacture	Aircraft Type
5Y-KQA	28746	Simba Finance Ltd	1997	B737-300
5Y-KQB	28747	Simba Finance Ltd	1997	B737-300
5Y-KQC	29088	Simba Finance Ltd	1998	B737-300F
5Y-KQD	29750	Simba Finance Ltd	1999	B737-300F
5Y-KQU	33681	Ndovu Finance Ltd	2004	B777-200ER's
5Y-KQS	33683	Nyati Finance Ltd	2005	B777-200ER's
5Y-KQT	33682	Kifarua Finance Ltd	2005	B777-200R's
5Y-KYZ	36124	Chui Finance Ltd	2007	B777-200R's
5Y-FFA	19000562	Samburu Ltd	2012	E190
5Y-FFB	19000572	Samburu Ltd	2012	E190
5Y-FFC	19000577	Samburu Ltd	2012	E190
5Y-FFD	19000579	Samburu Ltd	2012	E190
5Y-FFE	19000586	Samburu Ltd	2012	E190
5Y-FFF	19000594	Samburu Ltd	2012	E190
5Y-FFG	19000599	Samburu Ltd	2013	E190
5Y-FFH	19000619	Samburu Ltd	2013	E190
5Y-FFJ	19000633	Samburu Ltd	2013	E190
5Y-FFK	19000642	Samburu Ltd	2013	E190
5Y-KZA	35510	Tsavo Finance Ltd	2014	B787-8
5Y-KZB	35511	Tsavo Finance Ltd	2014	B787-8
5Y-KZC	36040	Tsavo Finance Ltd	2014	B787-8
5Y-KZD	36041	Tsavo Finance Ltd	2014	B787-8
5Y-KZE	36042	Tsavo Finance Ltd	2014	B787-8
5Y-KZF	36043	Tsavo Finance Ltd	2014	B787-8
5Y-KZX	42097	Tsavo Finance Ltd	2014	B787-300

Reasons for use of SPV's from Caribbean's Cayman Island and Bermuda

- a) SPV's may be formed in many jurisdictions, but the Caribbean's Cayman Island and Bermuda have over the years gained favour with lenders. For instance the legal talent available in the Cayman Island a British Overseas Territory ranks among the best in the world, including many attorneys who were educated or have practiced in the United Kingdom. For sophisticated asset financing transactions, conducting business in

Cayman Island is a kin to doing business in New York or London. The political and economic stability of the Cayman Island is certainly appealing to corporations wishing to sponsor SPV's. The Cayman legal structures allows companies to raise capital off their balance sheets often at lower costs, and SPV activities may be insulated from claims of potential creditors.

- b) Cayman Island is a preferred location for many lenders as it has several world class Law firms, trust structures that are easy to arrange. Fees for setting up the SPV's are generally modest and the legal and regulatory framework is extremely flexible. Red tape is minimal in this jurisdiction and incorporation of setting up of SPV's generally takes less than 24 hours and the related costs are modest. In essence, companies from all over the world find that the Caymans are a friendly and advantageous place to do business.

Flight Disruptions

- a) The Committee was informed that the several factors have played to the decreasing of KQ's On Time Performance (OTP) (Timely arrival and departure) leading to frequent disruptions/delays. These factors are;- Withdrawal of goodwill from pilots, following failed negotiations regarding the current CBA and retirement of pilots who flew Boeing 777 aircrafts, Runway shutdown from 24hr plan to 18hr plan to allow for the upgrading of JKIA, VVIP interruptions, Air traffic control issues, Technical glitches; and Adverse weather.
- b) The withdrawal of goodwill by the pilots nearly crippled the airline and has led to numerous cancellations and delays that cost the airline over Kshs. 50 million by the end of May 2015 not to mention the inconvenience and reduction in trust by the travelling public.

Outsourcing

That Kenya Airways had indeed engaged in outsourcing under three broad areas:

- a) **Manpower Outsourcing** whereby the company uses a third party to employ personnel on their behalf. The training of the personnel and its standardization is managed by the airline. The outsourced personnel are employed on fixed term contracts and are paid on a different salary scale compared to the ones currently in use in Kenya Airways. The initial contracts can be as short as three months to support peak period operations to face the additional demand Outsourcing offers not only a significant cost saving but also a higher flexibility in deploying resources against demand. Under this category, they have engaged Insight Management and Career Directions Limited.

- b) **Service Outsourcing** whereby certain amount of handling service is outsourced to other providers. Such services include cabin cleaning and handling of passengers with reduced mobility. These services are currently outsourced to companies like Tradewinds or Eurocraft. This is a very common practice in the airline industry since these services are usually labour intensive which requires attaining a certain volume of handling before breaking even and
- c) **Portage Services**, also known as manpower by the hour. This is an arrangement that enables KQ to obtain portage services for the loading and off loading of baggage and cargo based on demand and payment is agreed on per hour basis with the providers. This arrangement allows KQ to make use of operational support for a definite period e.g 3 hours without having the resource mobilized for the whole duration of a shift. It is an efficient way of handling the peak resource requirement over a very short number of hours. KQ has contracted Tradewinds and Eurocraft to provide this service.

Kenya Airways Subsidiary Companies

- a) The Committee was informed that KQ had the following subsidiaries:
 - i. African Cargo Handling Limited;
 - ii. Jambo Jet Limited (formerly flamingo Airline);
 - iii. Kenya Airfreight Handling Limited; and,
 - iv. Kencargo Airlines International Limited.
- b) The first three listed subsidiaries are profitable and all of them have a presence of the Board and Management of Kenya Airways on their boards with a mix of external members as well. It was noted that Kenya Airways sold a 49% stake of Kenya Airfreight Handling Limited to a strategic investor but retained a controlling 51% stake. Kencargo is currently dormant but could be recalled to service in the event that its services were required and The Management defended the Subsidiary arrangement and the presence of its Board and Management members on the Board of the Subsidiary Companies and claimed that it was an international best practice world over.

Kenya Airways Business Arrangement with KLM

- a) The Committee was informed that International airlines have entered into various commercial agreements in order to derive benefits from each other's networks and passenger/cargo. Kenya Airway (KQ) underwent a commercialization and privatization process in 1996 attracting a strategic partner in KLM Royal Dutch Airlines to become Africa's first privatized flag carrier. KLM acquired 26% of KQ's issued share capital and the parties simultaneously entered into a shareholders' agreement, which provided among other things that the Government of Kenya will remain a key shareholder of the airline;

- b) In 1997, the partnership was extended to a Joint Venture (JV) operation on the Amsterdam – Nairobi route. The route was initially operated 3 times weekly by KLM and KQ launched with 3 weekly flights – These have now grown to 14 flights weekly. In November, 1998 KQ and KLM entered into a code share agreement that covered various points in both carriers network in Africa and Europe. In 2008/2009 KQ operation of Nairobi – Paris was added to the Joint Venture and the flights have grown from 3 weekly flights to 6 weekly flights. The focus on a Nairobi hub to Amsterdam hub strategy allowed KQ to grow its footprint in Africa and the Middle and far East by releasing previously inefficiently utilized assets on European routes. This subsequently enabled new investments in fleet to be made based on more profitable operations over time;

KQ Joint Venture with KLM

- a) KQ had a Joint Venture (JV) business arrangement with KLM on routes from KQ's direct operations from Nairobi to Europe and KLM's direct operations from Europe to East Africa. The JV arrangements are geared towards growth and achieving economies of scale through coordination and optimization of intercontinental operations between routes. Both airlines work towards complementing each other's networks by providing air transport with a global reach while taking into consideration the market dynamics and the economies of scale;
- b) Through the JV, the parties have aimed to further strengthen their cooperation in the field of scheduled passenger air transport services by providing a seamless high quality travel experience on the routes they are serving in the JV model, to develop and enhance services delivered to the travelling public through the use of common customer standards, the integration of passenger services and harmonization and standardization of services and products. The JV also offers customers with a wide range of services and to increase the competitiveness through optimization of the capacities and flight schedules. The joint venture has also seen the signing of a Code Share Agreement that allows KQ access to sell 13 European countries served by KLM and KLM also sells 14 African Countries served by KQ.

KQ Code Share Arrangements

- a) The Committee was informed that Code Sharing allows for a flight operated by one carrier to also be marketed by another carrier under the marketing carrier's code and flight number. The motivation is to enhance customer reach to widen the offer that airlines give to customers in terms of number of destinations. Code Share also enhances the "presence" of an airline in markets where it would otherwise have no profile hence giving confidence to the market about products offered in combination with other carriers;
- b) KQ has many Code Share Agreements with 16 other airlines and a multiplicity of code share flights in various sectors within their networks;

and the Committee noted that Precision Air of Tanzania is one such airline that KQ had a code share agreement covering the routes of NBO/DAR/NBO, NBO/ZNZ/NBO and NBO/JRO/NBO and that KQ had a 41.23% stake in the company.

Fuel Hedging

- a) Fuel hedging is a risk management tool that is applied in organizations where cost and revenue elements are subject to high price volatility and was practiced the world over. Kenya Airways adopted fuel hedging as a policy given that the fuel bill accounted for 35% of the operating costs of the airline. The Airlines policy on fuel hedging allows for up to 80% of fuel for the first 12 months rolling and 50% for the next 12 months rolling;
- b) In line with the policy, the management had used different hedging instruments including call options; put options, three and four way collar instruments. Every month, depending on where the hedge and market prices are, KQ pays and receives some money from the hedge counterparts and that during the last financial year, the Airline reported a fuel hedging loss of 1.2 billion but said that they actually had an operating saving of 4.8 billion as a result of their fuel hedging policy translating to a net saving of 3.6 Billion.

Human Resource issues

- a) Kenya Airways (KQ) had 4000 employees across its network, 600 of this being foreign staff recruited from nationalities of KQ destinations. The airline has also seconded 61 staff members to other countries, to work as expatriates;
- b) In 2012, Kenya Airways realized that there was a lot of wastage of resources and had resolved to cut down the number of staff to match the internationally recognized standards in various categories of employment. The management rolled out a plan for voluntary retirement but only 150 staff opted for this option. The management therefore rationalized the criteria set out in different departments for purposes of increased efficiency, and retrenched 450 staff.
- c) The management was categorical that the retrenchment process did not target union members or expectant mothers. The Group Human Resource Manager dispelled fears that there was nepotism in recruitment of staff, as the recruitment criterion was clearly set out on the company's website where applications were received on-line through the i-recruit portal and various verification stages had been set in the process and Stated that the allegations of nepotism may have arisen as his daughter who followed the due process had been recruited as a pilot;

- d) Kenya Airways had an operations manual that detailed the qualifications of the Chief Executive Officer (CEO)/Accountable Officer as stipulated in the Civil Aviation (Air Operator Certification and Administration) Regulations, 2013. The position of the Chief Operating Officer (COO) fell vacant in November, 2014 when the substantive holder was appointed to the position of Group Managing Director and CEO of Kenya Airways. The candidates presented to the Board by Price Waterhouse Coopers (PwC) were found to be unsatisfactory and the position was re-advertised. On 1st August, 2015, the Board appointed Mr. Yves Guibert, the former Grounds Services Director, to the position of Chief Operations Officer.

Collective Bargaining Agreement (CBA) Between KALPA and KQ

- a) KQ has about 520 Pilots and most of them are dedicated employees, the airline has had cordial relationship with Kenya Airline Pilots Association (KALPA) over the years evidenced by regular communication with Pilots through meetings. KQ has a standing two-year Collective Bargaining Agreement (CBA) with KALPA, the last CBA (2012-2014) expired on 31st March 2014 and negotiations for the CBA running for (2014-2016) are on-going; any frosty relationship with KALPA may have arisen as a result of disagreement on Collective Bargaining agreement (CBA). KQ management and KALPA agreed on most issues but disagreed on a few others and the matter was registered with the Ministry of Labour which has appointed a conciliator to address the various issues that were in contention;
- a) KQ wanted a CBA that encouraged productivity of the Pilots as opposed to the previous ones that have been generous compared to the international market and standards of payments. KQ Management was willing to offer improved terms of service so long as the same would lead to productivity. The deadlock on the CBA was necessitated by the fact that a lot of terms of employment for pilots were put in the CBA which KQ felt would not lead to productivity hence they wanted them revised/changed while KALPA wanted the status quo retained. Some of the issues under dispute were pay and allowances-KQ Management insisted that they paid pilots very well lay over allowance and sick leave requirements were loss and have been misused. KALPA issued a communication to pilots this year asking them to withdraw goodwill;
- b) KQ and KALPA went through an initial conciliation process and were awarded certificates of unresolved disputes by the conciliator and the matter was then supposed to proceed to court. However, KALPA as an aggrieved party did not take the dispute to court. The matter came up in court in June 2015, when the issue of withdrawal of goodwill was being heard and a ruling was made that the dispute should revert to the bipartite level to discuss the matters that were still under dispute. The progress of the conciliation process is ongoing;

- c) KQ management had invited all the ten pilots who were to be retired to individual meetings with the Director HR, Director Flight Operations and the head of Employee Relations to inform them on the decision that had been taken to retire them according to the CBA. All the ten pilots were accorded the same opportunity to present personal circumstance that they would like considered before they were issued with letters of early retirement. Only two pilots responded and one of them disputed the records on his date of retirement stating that he was two years younger than indicated and presented sworn affidavits to that effect. KQ management had targeted for retirement pilots who would retire in the next three years. The other pilot stated that he was due to retire at age 65 in nine months and therefore requested to be allowed to work until his retirement age. The other eight pilots said they needed time to consult on what action to take and consulted KALPA and therefore their retirement was upheld until such time that KQ management would resolve the issue of their retirement through KALPA. It is those discussions that led to withdrawal of goodwill and court case thereafter;
- d) The issue of disagreement between KQ management and KALPA is the guaranteed lay over allowance where KALPA wanted it retained in the CBA which is payable even when an employee does not travel, whereas KQ management wanted the allowance to be paid only to those employees who travelled. As a 'rule of the thumb', the number of pilots is determined by the number of aircrafts and it requires between 4-6 months for a pilot to be trained to operate and fly a new aircraft.

Outsourcing of Labour

KQ operates a training centre called "The Pride Centre", which is open to all and the cost of training cabin crew at the Pride centre is catered for by the trainees themselves. KQ advertised for outsourcing of labour and Career Directions Limited (CDL) won the tender. KQ entered into an agreement with CDL and one of the reasons for outsourcing of labour was to get flexibility of employment during low and peak seasons. Pilots and engineers are employed directly by KQ and therefore are not outsourced. KQ has around fourteen (14) foreign workers who have valid Kenyan work permits. Most of the foreign crew contracted by KQ operate outside Kenya;

5. Kenya Aviation Workers Union (KAWU)

The Secretary General, Kenya Aviation Workers Union (KAWU) Mr. Moss Ndiema informed the Committee that KAWU was registered in 2012 after the fall of Aviation and Allied Workers Union and has recognition agreements with KQ and other different organizations in the aviation sector such as Kenya Airports Authority, Kenya Civil Aviation Authority, Tradewinds aviation services and Swissport Kenya. The current membership of KAWU is about 2,000 and only one union with a simple

majority can be recognized to sign a Collective Bargaining Agreement (CBA) with an employer.

The Secretary General informed the Committee on the following issues bedeviling Kenya Airways Limited;-

Leasing and Buying of Aircrafts.

Project Mawingu aimed at fleet expansion and modernization and KQ conceived that by 2020, it would run a fleet of over 100 modern aircrafts. Aircrafts are very expensive acquisitions and thus KQ could not approach Boeing directly. Therefore, KQ used lease purchasing (through offshore companies) and leasing. There are unanswered questions regarding the engagement of Kenya Airways with the offshore companies in the acquisition of the aircrafts in the name of Special Purpose Vehicles (SPVs) like;- Amboseli, Twiga, Masai Mara, Samburu and Simba that are based in the Cayman Islands.

Recruitment at Kenya Airways

- a) The recruitment process starts with internal advertisement of vacant posts and then external, if the right candidate is not found. Open interviews are conducted and the most successful candidate is given the job. While this applies to most positions in KQ, the same can't be said about pilots, although flying school is quite demanding, the composition of KQ pilots has always raised suspicion as most of them trace their background to some of the prominent families in Kenya. For example:
 - i) The Chairman of KALPA who is a pilot has a son who is a pilot at KQ,
 - ii) The Secretary General of KALPA- wife is a pilot at KQ.
 - iii) Rtd Cpt Josh has 2 sons as pilots in KQ.
 - iv) Director Human Resource has a daughter who is a pilot
 - v) The director of flight operations has a son and a daughter both pilots at KQ and had a son in law who was fired.
- b) KALPA had raised issues that the Director Human Resource was firing pilots whilst employing his daughter. Going by the examples given, there are many other families in other sections who are employed by KQ and KAWU believes that the daughter of Director HR is qualified and was hired competitively.

Frequency of Delayed and Cancelled Flights

- a) The high frequency of delayed and cancelled flights was due to crew constraints and operations at KQ which can be attributed 30% to lack of pilots' goodwill; who are required to work from their days off to cover flights. Many have called in sick at the last minute and thus led to delays and sometimes cancelations of flights. Kenya Airways has a shortage of

pilots and can't manage the roster. There have been delays in the signing of the Collective Bargaining Agreement and other issues with KALPA leading to strained relationship with KQ management. Negotiations for CBA between KALPA and KQ management are still ongoing and Pilots have been reluctant to work on their days off and withdraw their goodwill saying that they will not be available for duties during their off days;

- b) Shortage of engineers due to mass exodus, earlier 2015, to other well-paying airlines such as Qatar and Emirates which have been conducting recruitments in Nairobi over a period of time and are offering competitive packages in comparison to KQ. Therefore aircrafts take longer to be fixed and released for operations. Those working at KQ are demoralized when they realize that their former colleagues working in other airlines are making more than double what KQ is offering and are planning to exit. Lack of spare parts pool in Kenya despite Kenya airways being a shareholder of the same. It takes time to seek and ship these parts from overseas when aircrafts are under maintenance and misconnections, change of reservations, costly hotel accommodation and damage to loyalty of customers who are repeatedly disappointed.

Outsourcing

KQ has outsourced the services of companies such as Insight Management, Eurocraft and Career Directions Limited whom they caution that their employees should not join any trade union. The outsourcing drive provided cheap labour (after the retrenchment exercise of 2012) in respect to all services this led to poor service standards and low morale that affected productivity.

Recruitment of Cabin Crews

- a) There are 2 categories of cabin crews at KQ, those employed by KQ and those by (CDL). They perform the same jobs but are remunerated differently with those employed by KQ earning a gross salary of Ksh. 150,000 per month whereas those employed by CDL earn a gross salary of Ksh. 45,000. KQ has employed about 590 cabin crew, while CDL has employed about 400 cabin crews and 300 customer care agents. However, KQ provides uniform and equipment to all staff including those under the payroll of CDL;
- b) By the time of submission, KQ was not employing directly, with the exception of pilots and management. Any vacancy is filled through outsourcing where KQ will train a person and then release them to wait for CDL to advertise for the positions. Employees of the outsourced companies are denied the benefit of due process in disciplinary cases, whereas KQ staff have the due process that is established; and this has made some cabin crew very desperate and there are unconfirmed stories that some crew have had to engage in illegal or social evils to make ends

meet. e.g the issue of drug trafficking automatically comes in and the condition is a bit dehumanizing.

Wage Bill at KQ

70% of the wage bill at KQ is shared between the pilots and management (about 1,000 employees) whereas the rest of the employees (3,000) share 30%. However, when the redundancies/retranchment took place, it affected the employees in the 30% bracket. i.e the management and the pilots who took a lion's share of the wage bill were not affected and there is a belief of a conspiracy existing between the KQ pilots and management against the rest of the employees.

6. Public Hearing and Receipt of Memorandum

The Committee was informed that there was a crisis at KQ since 2009, but in 2015 the crisis reached intolerable levels. Some members of the public were opposed to the intended government bailout of KQ and hence the accrued KQ debt should be sold out to the public and in a free market economy.

Some members of the public were against a decision by the management to offer a rights issue as way of increasing capital because the process of floating the rights issue was flawed. KQ has not paid dividend since the issuance of the rights issue in 2012 and that KQ misrepresented facts during the floating of the rights issue.

Remuneration for directors and the executive of KQ exceeded Ksh. 600 million since 2003 to date. Project Mawingu was a wrongly conceived and was an ego dream. KQ has 10% equity and 90% debt which is a precarious situation. KQ raised Ksh. 14 Billion through the rights issue in 2012, but has lost all the money to date. KQ is technically insolvent and was opposed to government bailout of KQ because even the amounts involved would not solve the financial problems of the company;

Since 2012 to date, the board of directors has remained the same and more or less the same management at KQ despite taking wrong decisions that have had serious negative financial implications for the company. Board of directors at KQ earned way far more than what they own in shares at the company. Shareholders were not made fully aware of the risks of Project *Mawingu*. KQ bought too many aircraft that some of them have been parked at the airport without flying for some time;

KQ has adopted a sale lease back approach to financing the purchase of aircrafts. KQ should be left to go bankrupt but the airline continues to run. The import of this would be that shareholders would lose their investment but save the country. This would be applying what is referred to as *Chapter 11* in the USA and employee unions in KQ should be

allowed to own the company so as to get the goodwill to work for the company. This approach has been done in German airlines.

KQ used creative accounting during the process of floating rights issue and was concerned on the training of Pilots at KQ and recommended for an independent audit of KQ.

The KQ management ensured the registration of Kenya Aviation Workers Union (KAWU) in order to weaken the Aviation and Allied Workers Union (AAWU). KQ and AAWU had two Collective Bargaining Agreements (CBAs) one running from 2008-2010 and another running from 2010-2012. The current CBA that runs from 2014-2016 was negotiated by Kenya Aviation Workers Union (KAWU) but has no increment in basic salaries. KAWU was being used by KQ management to reduce the terms negotiated by AAWU and gave an example of layover allowance that has now been removed and the Employees at KQ were coerced to join KAWU against their will;

AAWU had agreed with KQ management that since the company was facing financial difficulties, all would take a pay cut, but the KQ management did not implement the agreement but instead proceeded to retrench its employees. AAWU had also recommended a reduction of the number of managers at KQ in an effort to cut costs but that was not honoured. KQ registered a CBA with the Ministry of Labour without the consent of the employees and when some of the employees raised alarm on the matter, they were sacked.

7. Kenya Civil Aviation Authority (KCAA)

Mr. Samuel Poghio the Chairman of the Kenya Civil Aviation Authority (KCAA) took to the stand and an oath was administered. He informed the Committee that;

Certification Status

The Airline holds a current air operator certificate (AOC) WHICH ALLOWS Kenya Airways to specified commercial air transport operations and also demonstrates the technical competence to operate aircrafts and related operations. Kenya Airways also holds a current Air Service License (ASL) which authorizes the airline to operate passengers and cargo services within Kenya and the rest of the world.

Surveillance of Kenya Airways Operations

Given the airline's current financial situation, the Authority's audit team shall pay utmost attention to any potential safety gaps (operations, maintenance and training) that may arise due to possible underfunding.

Documents used for Qualifications of Accountable Managers Prior to KCAR, 2007.

That CAP 394 (Primary Legislation) was the only document which was exclusively used prior to the development, promulgation and subsequent enactment of Kenya Civil Aviation Regulations (KCAR's) 2007. The document were not adequately structured to address the qualifications of the Accountable Manager among many other gaps that were later resolved through the KCAR's 2007 which effectively repealed the Air Navigation Regulations (ANR). The promulgation and enactment of the new set of operating regulations (currently KCAR's, 2013) forms a compliance basis where each air operator's key management posts holders (AOC & Admin Regulation 2013, Regulation 13) inclusive of accountable Managers qualifications (AOC & Admin Regulations 2013, Regulation 14).

KQ Compliance with Stipulated Man Hours/Duty Hours – Pilots & Crew

KCAA confirmed that KQ continues to comply with the provisions of the Civil Aviation (Operation of Aircraft) Regulations, 2013 Regulation 239 through Regulation 246 with no single omission to this rule being reported to the Authority. Flight/Duty time records maintained by all AOC holders including KQ are subjected to thorough scrutiny during the authority's routine and surveillance audits to ensure that in all cases the crew do not burst the regulated flight time (Maximum 105 hours) and duty time (Maximum 160 hours) limits that are established in regulation during any 28 consecutive days cycle.

Report on Flight B767 Registration 5Y -KYY Alleged flown to Rome without Insurance.

The incident has never been brought to the attention of the Authority but would wish to confirm that Captain Paul Mwangi has held and continues to hold the position of Director of Operations at Kenya Airways to date. According to records held, valid certificates for Third Party Insurance reference No. C10/KENY/11000 and No. C10/KENY/11216 for Hull and combined single limit liability insurance dated 1st December 2010 and expiring on 30th November 2011 was in force.

Operations Manual

Kenya Airways Operations Manual as approved entirely complies with the Civil Aviation (Air Operator Certificate & Administration) Regulations 2013, Regulation 35 required cabin crew members, is determined by the total seating capacity of each aircraft operated and that at no given instance have the Authority's audits revealed that the airline operates with fewer than required cabin crew members.

8. Financial Consultant - Dr. Martin Odipo

Dr. Martin Odipo is a Financial Consultant and a lecturer at the University of Nairobi and had provided financial consultancy for the Aviation and Allied Workers Union (AAWU) in a court case involving the retrenchment of KQ workers in 2012. He had been invited to give evidence pursuant to the provisions of Article 125 of the Constitution.

- a) He had analysed the declared financial records of KQ for 2006-2009 and noted that in 2009, KQ incurred a huge loss which was given as the reason for retrenching workers. The reason for the loss in 2009 was due to fuel hedging and was not occasioned by a bloated workforce. Prior to fuel hedging, KQ had not made a loss and therefore he could not understand why the decision to hedge fuel was made in the first place only to result in losses. The principle of hedging is that money is kept with the entity that is hedging to cushion itself against fluctuating prices in the market;
- b) He had advised that the use of current and quick ratios to determine the financial status would not give the accurate position of the Company's financial position and had questioned the rationale by KQ management of retrenching local workers and employing foreign workers to the same positions at around the same time;
- c) The problems facing KQ are mainly as a result of mismanagement of the company arising from poor relations with the employees and purchase of too many aircrafts in 2009 when the company did not have the money to purchase them and sustain its operations. In 2011/ 2012 financial year, auditors of KQ gave the company a clean bill of its financial status. With the huge losses declared in 2014 and 2015, of around Ksh. 25.7 billion it could only mean that the books of accounts of KQ were manipulated;
- d) He did not understand how an international financial institution would be willing to extend a loan of Ksh. 20 billion to KQ when it had declared a loss of Ksh. 25 billion and the same could be seen as a ploy to force a sale of Kenya Airways at a cheaper price. If KQ was declared insolvent, or defaulted on repayment of the expected loan of Ksh. 20 billion, then the lenders would take over the company cheaply. The Government should ensure that the bailout it plans to offer KQ should be given as a soft loan with repayments at minimal interest rates and not shareholding. If KQ was to continue with its operations, then it would have to change its business plan.

9. Cabinet Secretary Ministry of Labour, Social Security and Services

Mrs. Rachel Omamo the Ag. Cabinet Secretary Ministry of Labour, Social Security and Services took to the stand and an oath was administered. He informed the Committee that;

The matter of retrenchment/redundancy of workers at Kenya Airways is before the Supreme Court (Petition No. 4 of 2015) and that seventeen (17) valid Class 'D' work permits have currently been issued in respect of foreign nationals.

Disputes between KALPA and Management of Kenya Airways Limited

Immediately after the disputes were reported, the Ministry set its dispute settlement machinery in motion by appointing a conciliator in March 2015 but the parties could not agree and a Certificate indicating that the dispute had not been resolved was accordingly issued on 31st March, 2015 pursuant to Section 69 (a) of the Labour Relations Act. The parties proceeded to court (Case No. 433, 2015) and were ordered to resume conciliation. Consequently, a conciliator was appointed on 25th June, 2015. A further complaint was referred for conciliation on 15th July, 2015. Negotiations continue between the parties in accordance with section 67 (1) (b) of the Labour Relations Act which permits conciliation processes to continue for 'any extended period agreed between the parties to the trade dispute'. The issues in dispute involve the Collective Bargaining Agreement (CBA) that was recorded at the Ministry on 13th March, 2015, the retirement of 10 (ten) B777 pilots that was recorded at Ministry on 23rd March, 2015 and the alleged harassment of KAPLA members recorded at the Ministry on 15th July, 2015.

Disputes between Other Employees and Management of Kenya Airways

The Ministry is in receipt of complaints and disputes covering the period 2005 to 2015 as listed below;

DATE	UNION	CONCILIATOR	ISSUES	STATUS
2/2/2005	AAWU	J. MWANZIA	Recognition	Referred to Court
8/10/2008	TAWU	J. MWANZIA	Failure to	Referred to Court
19/2/2009	AAWU	J. MAKAA	Job performance	Settled -
7/3/2009	AAWU	F.OKELLO	Dismissal of Karisa	Settled -
25/11/201	AAWU	J. NDHIO	CBA	Settled -28/7/2011
14/12/2010	AAWU	S.KULOBA	Dismissal of Wycliff Ochilo	Parties informed of intention to close file
14/12/2011	AAWU	J. MAKAA	Dismissal of	Settled -3/9/2013
31/10/2013	AAWU	J. MAKAA	5 Issues	Settled -
20/1/2014	AAWU	Referred to court	5 issues	Settled -26/6/2014
13/3/2015	KALPA	I.KIRIGUA	CBA	On going
23/3/2015	KALPA	I.KIRIGUA	Termination of 10	On going
15/7/2015	KALPA	I.KIRIGUA	Harassment -	On going

The relationship between the staff and management of Kenya Airways may have been affected by the current financial crisis of the company. However, it would be necessary to carry out a specific study to empirically establish the precise reasons for the problem.

Recruitment Agencies

The Ministry has formulated guidelines and regulations for private employment agencies though it is yet to originate a specific policy on the outsourcing of labour. However, the issue will be considered as the Ministry develops a comprehensive policy on labour migration and foreign employment. At present no complaints have been referred to the Ministry by Kenya Airways employees regarding wage disparities.

Registration of Labour Unions

The Aviation and Airport Services Workers Union (AAWU), has not been dissolved and remains a registered trade union. The Kenya Aviation Workers Union (KAWU) applied for registration in accordance with the relevant provisions contained in Labour Relations Act, 2007. After the Registrar of Trade Unions was satisfied that it met the conditions required by the Act, the trade union was duly registered. Kenya Airways employees have a constitutional right to join any trade union of their choice.

The matrix below indicates the pending cases involving Kenya Airways limited and its employees as at 11.9.2015 and does not include matters under conciliation.

Case	Parties	Issue	Status
413 of 2015 E&LC	KQ vs KALPA	Action by KQ to restrain withdrawal of goodwill by KALPA	Awaiting Court ruling on interim application
502 of 2015 E&LC	KALPA vs KQ and JamboJet Ltd	Action by KALPA to restrain Dash 8 Q400 operations	Awaiting Court ruling on interim applications
1564 of 2015 E&LC	KALPA vs KQ	Action by KALPA to restrain KQ from disposing of B777-200	Awaiting inter-parties hearing on KALPA application
1436 of 2015 E&LC	Alex N. Mbugua vs KQ	Disciplinary case	Awaiting hearing of application
1491 of 2015 E&LC	Eric M.Ndamburi vs KQ	Wrongful termination	Awaiting filing of KQ's response to the claim
1490 of 2015 E&LC	Isaac K. Korir vs KQ	Wrongful termination	Awaiting filing of KQ's response to the claim
1522 of 2015 E&LC	Jorge Akello vs KO	Wrongful termination	Awaiting filing of KQ's response to the claim
*Application No. 50 of 2014 Supreme Court	AAWU-vs-KQ and 3 others	*Leave to file Appeal; *Appeal /Constitutional Petition	Awaiting the hearing date and Ministry enjoined as a 3 rd respondent.

Source: Kenya Airways Limited & Registrar of the Supreme Court

10. Cabinet Secretary Ministry of Transport and Infrastructure.

Mr. James Macharia took to the stand and an oath was administered. He informed the Committee that;

- a) In 1996, Kenya Airways underwent a commercialization and privatization process attracting a strategic partner in KLM Royal Dutch Airlines to become Africa's first privatized flag carrier. In 1997, the partnership was extended to a Joint Venture (JV) operation on the Amsterdam-Nairobi route. In November 1998, KQ and KLM entered into a code share agreement that covered various points in both carriers' network in Africa and Europe. The Kenya Airways' operated Nairobi – Paris was added into the JV in winter of 2008/2009. The Joint Venture between KQ and KLM worked well for KQ in the mid 2000 but at the moment, the Joint Venture would serve KQ better if it was the sole distributor of KLM passengers in Africa;
- b) In 2005/06, the profits of Kenya Airways were growing steadily at 20%. The management at this time used this percentage growth to forecast the future growth and expansion but were unable to forecast well and therefore received expensive aircrafts with no enough space for passengers;
- c) KQ had a business growth model called *Mawingu* Plan. However, the plan did not take into account the current market trends in the aviation industry and therefore did not have safeguards and hence the *Mawingu* plan has not worked for KQ;
- d) The management of the balance sheet of KQ was not good and this was evident from the revenues of the company. Assets were also not properly deployed or not efficiently used. The business model adopted by KQ had a glitch in that forecasting of future growth was too optimistic because it did not match projections of income & expenditure. This resulted in purchase and leasing of too many aircrafts to the extent that some are lying idle at the airport. KQ had been faced by a number of challenges such as;- Serious labour disputes with employee unions, Global catastrophes such as Ebola epidemic in Western Africa; negative travel advisories, war on terror among other issues;
- e) The Government together with other key stakeholders has been engaging both the Board and Management of KQ for a number of months to understand the specific context of KQ and what actions are required to turn around its fortunes. So far, at the request of Kenya Airways, the Government extended a short term loan of Kshs. 4.2 billion as a bridge. The credit of USD 200 million extended to KQ by the Afrexim bank was contingent on the future financing of KQ. The credit was to ensure that KQ financed its working capital and revisits its strategic positioning, network and revenue/cost structure and this will determine the level of recapitalization required. The Government was willing to support KQ in

its recovery path through various means and not only by injecting money but was also prepared to take up any shares that would be floated in order to rescue the company;

- f) The Ministry of Transport and the National Treasury have questioned the management of KQ in regard to the decisions made in the past. Investigations are ongoing and action would be taken on any persons whether past or current managers found culpable for the financial loss. The sale of the 777-200 aircrafts started in 2013 as a sale and lease back transaction but after due consideration and noting the market deterioration and offers made, the Board of Kenya Airways opted for an outright sale of the asset. The Government does not influence the management of KQ despite being the single majority shareholder because of the political risks in such a competitive commercial market. Government interference may result in more risks than benefits;
- g) The Government has been expanding facilities at the Jomo Kenyatta International Airport (JKIA) in order to strengthen the Airport hub status as a gateway to Africa in line with the Integrated National Transport Policy and Vision 2030. In Order for an Airport to effectively serve as a hub, there is need to have a strong domestic carrier and therefore Kenya Airways Project *Mawingu* has been considered as the Government expands the facility to enhance passenger handling capacity from the initial 2.5 million to 7.5 million passengers per annum and inquiries are still ongoing with regard to the ownership and authenticity of the Special Purpose Vehicles (SPV's);

11. Cabinet Secretary National Treasury.

Mr. Henry Rotich the Cabinet Secretary National Treasury took to the stand and an oath was administered. He informed the Committee that;

Loss of Kshs. 25.7 billion by Kenya Airways in FY 2014/15

- a) Total revenue grew marginally by 3.9% due to a decrease in average fares, which went down by 11%. This is in spite of a 12% growth in passengers and a one-off compensation by Boeing of Kshs. 3 Billion due to delay in delivery of aircraft. Fleet Ownership Costs, which include leases, increased by 107% due to delivery of additional fleet, increased depreciation of operating assets and impairment of assets held for sale. The additional cost of fleet was Kshs. 5.7 billion and depreciation/impairment cost was Kshs. 7.5 billion. Total overheads increased by 17% or Kshs. 3.5 billion due to increase in staff costs by Kshs. 1.6 billion of which (wages and salaries were Kshs. 1.1 billion), selling expenses increased by Kshs. 1.1 billion.
- b) Bad debts increased by 270% or Kshs. 600 million. Net finance costs increased by 186% or Kshs. 2.9 billion due to the increase in interest on

loans resulting from higher borrowing to finance aircraft purchases as well as service short term loans due to cash flow challenges. Losses on fuel hedging increased by 372% or Kshs. 7.3 billion due to lower fuel prices. Of this, Kshs. 5.8 billion related to unrealized hedge losses (this may be reversed in subsequent years if fuel prices increase). The Cabinet Secretary further explained that the Kshs. 5.8 billion represented the evaluation of the actual which is determined by market trends and speculation, and that international accounting standards require recording of potential loss in the present, hence the possibility that this may be reversed if fuel prices increase within the next 5 years; and The loss after tax increased by 661% or Kshs. 25 billion.

The Joint Venture (JV) Agreements between the KLM and KQ

- a) According to documents availed to the Treasury by Kenya Airways, Kenya Airways and KLM entered into a co-operation agreement initially on 15th December, 1995 vide the “Master Co-operation Agreement” and subsequently through the “Joint Venture Agreement” dated 14th May, 2012. These are essentially commercial agreements defining how both airlines would leverage their resources and network for their mutual benefit. The key purpose of the JV was for the airlines to co-operate with one another in order to realise their strategic objectives and for their joint interests;
- b) The key pillars of the JV are **Code sharing** – engaging in the free flow of reciprocal code sharing on the JV Routes as described in the Code Share Agreement; **Network management** – full alignment and coordination of network management activities with respect to the JV; **Revenue management** – full alignment and coordination of pricing of all ticket fares, published and unpublished, with respect of any JV Route operated by either party; **Sales** – setting up of a joint marketing and sales activities with respect to the JV.
- c) In pursuing their long term strategic interests, KLM agreed to make KQ the “pivot of its network in sub-Saharan Africa”; and KQ and KLM agreed to coordinate their flight schedules to provide as many connections as possible at joint gateways and individual hubs and thereby optimise each other’s presence in as many city pair markets as possible.

Savings or Losses as a result of fuel hedging

According to the data availed to the Treasury by Kenya Airways, four of the five years posted net gains. The year 2014/15 posted a net loss of Kshs. 1.7 billion as a result of the drastic drop in fuel prices experienced in the year. The hedge is a double edited instrument – in times of rising fuel prices, the company is cushioned from the shock, but during a period of declining prices, the company is exposed to losses, as illustrated in FY 2014/15.

Plans for Bail out

- a) The Government owns 29.8% of the ordinary shares of Kenya Airways Ltd. It is therefore, the single largest shareholder in the company, followed by KLM with a shareholding of 26.73%. IFC is the next largest shareholder, with about 9%. Besides the shareholding, the Government is a key stakeholder in the company. The Government considers Kenya Airways Ltd as an important part of the strategic positioning of Kenya, and is therefore committed to its success. The Government will therefore continue to provide the necessary support, both as a shareholder and as a Government, to assure its stability and growth;
- b) The National Treasury is aware that Kenya Airways is facing financial difficulties and requires the support of its shareholders to survive. However, the company is working with consultants to review its capital needs going forward based on a restructuring/turnaround plan. The Government, in consultation with the other shareholders will participate in the requisite support based on the capital requirements to support the adopted turnaround plan. Areas of concern are revenue management; the Treasury believe there is more scope for raising more revenue. Previous challenges experienced by the Airline included declining tourism, and the Ebola outbreak.

The cost structure of the Airline is also under scrutiny, this includes the issues of the cost of the fleet and the wage bill. The Government has challenged the board and the management to provide a turnaround plan in the shortest time possible. The Government has received some preliminary reports, however they are not at the stage of adoption and more work needs to be done;

- c) Kenya Airways had been seeking bridging financing in order to meet their immediate costs over several months, however this had not been forthcoming and the Government had to step in and provide the short term facility, in order to ensure that the company keeps operating and meets its urgent operational needs, the Government has provided short term support by way of a shareholder loan of Kshs. 4.224 billion last financial year, to meet its financial obligations and particularly to pay off critical creditors, including suppliers of fuel and other services. In addition, the Government has provided support to Kenya Airways to access a USD 200 million bridge facility from African Export Import Bank (Afrexim) for working capital. This short term facility will be received in two tranches of USD 100 million each; and once the long term capital requirements are firmed up based on the approved turnaround plan, the Government in consultation with the other shareholders will review its options, including equity injection and /or loan guarantees.

Capital injection advanced to Kenya Airways by the Government since 1996.

- a) Prior to the privatization of Kenya Airways in 1996, the KQ owed the GoK a total loan amount of Ksh. 1,506,086,646.72 (Principal Ksh. 1,037,871,517 and Interest Ksh. 468,215,129). This debt was converted to Equity during the privatization process. Equity for debt share subscription Agreement was signed between the Government of Kenya and Kenya Airways on 24th February, 1995. Consequently the debt was treated as fully repaid to the Government by way of conversion of the debt to equity;
- b) In 2012, Kenya Airways undertook a rights issue geared towards raising capital to support the Company's Airways expansion programme. To fully take up its rights and retain shareholding of 23% the Government of Kenya paid Kshs.4, 756,485,930 which was for 339,748,996 million shares at Kshs. 5.00 each. However due to under subscription of the rights issue, the GoK took up an extra 6.8% of the balance of the shares resulting to GOK current shareholding of 29.8% in Kenya Airways.

Dividends paid to KLM and KQ since 1996.

Since its privatization in 1996, Kenya Airways has been self-sustaining and has declared and paid dividends to its Shareholders as and when approved by the Shareholders. Kenya Airways has paid a total of Kshs 1,821 million to the Government of Kenya and Kshs 2,032 million to KLM over the period. The total amount of taxes paid to the Government of Kenya is Kshs 67,124 million.

12. Former Managing Director and CEO KQ - Mr. Titus Naikuni

Mr. Titus Naikuni took to the stand and an oath was administered. He informed the Committee that;

Leasing/ Buying Arrangement of Aircrafts and Off Shore Companies

- a) The selection of an aircraft is a decision that is not taken by one department alone and in 2003 a Fleet Evaluation Committee chaired by Mr. Naikuni was set up in 2003. The membership of the Committee was drawn from different departments including finance, commercial, marketing, ground services and technical. The decision of the evaluating Committee is then taken to the Board of Directors for consideration. When evaluating aircraft ownership the decision must be made to either buy the aircraft outright or lease the aircraft. The best formula that airlines have used is to have at least 50% of the aircraft under lease and 50% owned by the airline. The reason airlines do so is because they may be unable to raise the money to buy aircraft outright;

- b) Prior to 1996, when the Government owned the airline, the airline bought aircraft outright because they could get guarantees from the Government, when the airline was privatized they had to stand on their own, and therefore they had to find means of financing the aircrafts. When buying or leasing aircrafts, the airline borrows money from lenders. These lenders require security. Financing is based on the asset itself, so the asset becomes the security. Because the asset is registered in the country of operation, the lenders have to make sure that the asset is still in the books, and that is why they go for off shore companies;
- c) Off shore companies are set up by the lenders and in the instance of Kenya Airways, there is US Exim Bank who are the guarantors. In terms of aircraft, Standard Bank financed the Embraer's, the 777's were financed by Barclays Bank and those companies then formed off shore companies, which are registered in tax havens like Bermuda, Cayman Island and the United States. It is not Kenya Airways alone that does this, it is a common practice followed by airlines worldwide. The Companies are set up for this purpose alone, and they select names according to their personal preference. Some of the names like Serena, Amboseli, and Tsavo, Samburu etc. have raised eyebrows because they are local names;
- d) To the best of his knowledge, there is no existing relationship between the management of Kenya Airways and the off shore companies (SPV's). The ownership status and shareholder membership of companies set up in the Cayman Islands by US Exim Bank was disclosed to the Board of Kenya Airways, to their satisfaction, after due diligence was conducted by the legal team.

Employment Policies/Matters Personnel

- a) There is a clear policy manual where the airline gives priority in hiring locals where possible. Where local personnel cannot meet the set skill required, the airline looks for foreign nationals. Location also dictates the hiring of foreign personnel, he gave the example of an office in Ghana where it is more cost effective to hire local personnel to man the station rather than exporting local personnel and paying extra allowances because they are expatriates and paying for work permits for Kenyan staff to man the station;
- b) Recruitment is conducted through interview panels and the results of the interviews are handed over to the Heads of Departments before the final recommendations are sent to the Managing Director. Recently there has been emphasis on gender equality and geographical distribution of candidates, however during his tenure they were not able to implement those particular requirements;
- c) The recruitment of cabin crew is covered by the law, the Kenya Civil Aviation Act, and nobody is allowed to fly in an aircraft without the

permission of Kenya Civil Aviation (KCA) and there was no time that KQ employed anybody to fly in their fleet without KCA approval. There are a number of training colleges in Nairobi that train cabin crew, however not all of them are licensed by KCA. Kenya Airways has its own training school that is licensed by KCA. After the individual completes the training, in order to get employment from any civil or commercial airline they must again be licensed by KCA;

- d) The Cabin Crew receive basic pay which is standard and another allowance that is dependent on how many flights the crew member does. Included in these allowances is what is referred to as “guaranteed nights”, and any night in excess of these was a bonus.
- e) During the industrial strike of 2012, the crew requested salary increases and the unions forced the airline into a situation where instead of the individual receiving guaranteed nights and the bonus, they wanted all the nights to be guaranteed. This meant that whether they fly or not, they would still get paid. If the individual called in sick, they would still be paid. In terms of competitive advantage as an industry, Kenya Airways found themselves in a dilemma and the board decided to move towards outsourcing. All major airlines outsource a number of services. The cabin crew was not the only service Kenya Airways outsourced, the ground crew, cleaners and gardeners were also outsourced;
- f) In the process of retrenchment, the retrenched staff were given guidelines to set up a company that would give them an opportunity to continue to earn an income, not only providing services for Kenya Airways, but other companies as well. Kenya Airways Board and the Management had no interest in the newly formed company. At no time did Kenya Airways circumvent procurement practices, and opened the bidding process for service providers competitively. Kenya Airways used the services of Career Directions Limited and Insight Management and this varied mode of recruitment allowed Kenya Airways to remain productive and to the best of his knowledge no manager at Kenya Airways had an interest in Career Directions Limited (CDL) and Insight Management;
- g) Initially there was industrial discord within the company with regard to the different remuneration between the outsourced and the union staff when the union staff was the majority, but as the number of outsourced staffers increased, the problem was resolved. By the time Mr. Naikuni left Kenya Airways, the majority of crew members were outsourced, above 50%. The quality of service was improved in some areas after outsourcing, but in some areas they deteriorated. Improvements included the sick days of the outsourced staff vis a vis the unionised, these were much less; The medical records of the airline are available for scrutiny by the Committee and retrenchment was carried out based on analysis of individual performance, governed by the knowledge of various managers. Age was also a factor, for those who were close to retirement; they were allowed to continue until their retirement date.

Joint Venture and Codeshare Agreement between KQ and KLM

Initially Kenya Airways was flying into Amsterdam and KLM was flying to Nairobi, the two airlines decided to form a Joint Venture to allow the revenues and costs associated with the two flights from each airline to be pooled and what is left is what is shared between the two. Initially the formula that was used was in favour of KLM because KLM claimed they were advanced in terms of their capacity to attract customers from the United States and Europe. This was negotiated to 50/50 by the time Mr. Naikuni left Kenya Airways;

- c) KLM picked up the routes that KQ had previously withdrawn from because they required larger aircraft. When KLM started routes into Africa, KQ was able to pool the traffic that was coming out of Africa that was not going out of Nairobi. This helped because during the expansion of JKIA, many airlines were avoiding Nairobi, and the Middle Eastern airlines were servicing Africa without going through Nairobi. Routes that were negotiated were Lusaka, Kigali and Entebbe to Amsterdam. By the time Mr. Naikuni left Kenya Airways, discussions were underway to pool the KLM flights to Dar es Salaam.

Cancellation and Delay of Flights

Cancellation depends on the surrounding environment. Infrastructure is an issue that has played a part. Mr. Naikuni cited the closure of the runway as a factor that has affected delay and cancellations. Another issue is traffic jams and road closures affect crew and passenger punctuality. Delays are also caused by internal problems such as go slow by staff, or issues that have been historically prevalent at the end of the month, where many staff call in sick or not report for duty and the law dictates that you cannot ask a person who is unwell to report for duty.

The Kenya Airways Fleet Acquisition & Disposal

- a) There is a Fleet Valuation Committee whose recommendations go before the board in terms of fleet acquisitions. 777-200 was bought in 2002, which is due for sale. The 767 Aircraft were sold before Mr. Naikuni joined Kenya Airways, none were sold during his tenure. Embraers were bought to meet the needs of the East Africa and Johannesburg routes. There are four 777-200 with a capacity of 320 passengers, and three 777-300 with a capacity of 400 passengers. The Dream Liners, 787, were acquired to replace the 767 and as an addition to the 777 fleet. The driving factor in the acquisition of the 787 was their fuel efficiency. In the Amsterdam route, the 777's are used during peak times and the 787 are used during off peak times;
- b) The *Mawingu* project gave no room for corruption and that he is open and willing to be investigated and the decision to suspend flights to regions in West Africa that had been plagued by Ebola affected the airline

profits negatively. A clinical analysis needs to be done on how Kenya Airways has been affected by Ebola and terrorism.

13. Department of Immigration and Registration of Persons

The Deputy Director Immigration and Registration of Births Mr. Joseph Munyoki took to the stand and an Oath was administered. He informed the Committee that;-

- a) The foreigners are given Class D Work Permits if the skills are not readily available in the local market. Kenya Airways has 17 Class D active work permits each issued at a cost of between Kshs. 200,000 – 450,000 per year paid by the employer. Those from East African Countries are issued with work permits gratis. Applications for work permits are considered and evaluated on merit and there is a permit determination Committee which comprises of agencies from different government department such as the Ministry of Labour, Social Security and Services which guides on the skills inventory on whether the job applied for can be done competently by Kenyans.
- b) The Directorate was not aware if there were any foreigners working for KQ as cabin crew, however, KQ has employed seventeen (17) foreigners in other cadres other than cabin crew. The Directorate monitors the expiry of work permits regularly and when a job position held by a foreigner is filled by a local, then the work permit of the foreigner stand null and void and Kenya Airways defended its reason for employing some foreign workers and explained that it had a peculiar challenge of multi lingual speakers among its existing pool of In-flight attendants and therefore decided to employ foreigners who spoke Mandarin, Cantonese, Chinese and Thai as it trained local employees to speak those languages.

14. Kenya Airways External Auditors

i) Deloitte & Touche - Financial Years 2004 to 2010

Mr. Sam Onyango took to the Stand and an oath was administered. He informed the Committee that;-

- a) Deloitte & Touche was the audit firm for Kenya Airways from 2004 – 2010. KQ was operating a model of aircraft ownership of purchase and lease at the ratio of 50:50 and the approximate cost of purchase of an aircraft would be around USD 115 million. The cost of purchase of aircraft was good enough because it was negotiated by KQ and the manufacturer of the aircraft; and the Joint Venture between KLM and KQ was to the advantage of both airlines;
- b) Special Purpose Vehicles (SPVs) were set up by the lenders /guarantors and operated by their agents where KQ was to pay an administration fee of the SPVs. In 1998, KQ purchased Boieng 737-700 aircraft through an

SPV named Simba Purpose Trust but the ownership of the two aircrafts was transferred to KQ in 2012;

- c) Fuel accounted for the highest component of the direct costs of KQ operations and in 2009, KQ made a loss of Ksh. 5.664 billion which was largely occasioned by fuel hedging. The factors to consider when making a decision to hedge fuel are percentage of fuel consumption and the period in which to hedge. The shorter the period to hedge, the more the certainty. In 2009, KQ changed its fuel hedging policy from 30% to 70% of fuel consumed and from a period of 3-6 months to 2 years. The decision to hedge fuel was made following the advice of financial consultants based on projections of the price of oil at the international market. KLM and British Airways were also affected by the fuel hedging. Deloitte advised the Board of Directors of KQ, through a presentation they made, that there was need to re-look at the fuel hedging policy;
- d) Deloitte examined Project *Mawingu* and noted that it was a very ambitious project but fleet modernization was necessary to reduce operating costs. Deloitte advised KQ of the coming up of the open skies policy by International Air Travel Association (IATA) and it would open competition and thus negate Project *Mawingu*. KQ was aware of the risks involved in Project *Mawingu* since they were alert to the adoption of the open skies policy which would open the Kenyan airspace to other airlines;
- e) The gearing ratio (proportion of debt to equity) of KQ was okay in 2010 at 104% since it is common to have over 100% gearing ratio in the airline industry. Deloitte did a review on revenue management and ticket pricing for KQ just before their contract on auditing ended and Deloitte undertook a financial and system audit which they compare with data from IATA;

ii) Price Waterhouse Coopers (PwC) - Financial Years 2011 to 2014

Ms. Anne Eriksson took to the Stand and an oath was administered. She informed the Committee that:-

- a) PwC was the audit firm for Kenya Airways (KQ) from March 2011-March 2014. In March 2011, KQ was a profitable company since it had declared a Ksh. 5 billion profit and was in a solid financial state. In 2012, the profit declined to Ksh. 2 billion. In March 2013, KQ made a loss of Ksh. 10.8 billion and In March 2014, KQ made a loss of Ksh. 4.8 billion, an improvement from the previous year which was attributed to favourable fuel prices. In 2015, the magnitude of the loss was massive and attributed to various factors key among them being losses accruing from fuel hedging, Ebola epidemic in West Africa, threat from terrorism, expansion of routes and fleet of aircrafts (Project *Mawingu*). Fuel costs make about 40% of costs of KQ meaning that any change in prices of fuel will affect the airline substantially;

- b) KQ had two types of hedges-fuel and currency and for the period that PwC audited KQ, the airline profited from the hedging. Fuel hedges were done at 80% of consumption for twelve (12) months on a rolling basis and the valuation for fuel hedging was done by Citi Bank and Standard & Chartered Bank;
- c) Project *Mawingu* was conceived in 2010/2011 when the African Airline market was growing. However, the airline industry has changed tremendously with stiffer competition from European and Middle East airlines. In 2012, PwC had observed through projections that KQ would continue making losses in 2013 and 2014. Labour disputes cost KQ a lot of money since it continued to pay the laid off employees for some time as a result of a court ruling;
- d) The increase in the number of passengers may not have contributed proportionately to income of KQ because it depends on the routes that the majority of passengers fly. Domestic routes have lower income compared to international routes. A detailed risk assessment was done prior to the floating of rights issue in 2012. PwC were the reporting accountants during the floating of the rights issue in 2012 and reported on the historical financial statements of KQ. PwC provided assurance services in respect of some international lenders who were to participate in the rights issue, customer satisfaction survey to KQ and offered tax advice on expansion to new routes;

iii) KPMG – Financial Year 2015

Mr. Josphat Mwaura took to the Stand and an oath was administered. He informed the Committee that:-

- a) At the time KPMG began auditing Kenya Airways (KQ), the airline was faced with a number of challenges such as volatility in the oil market, stiff competition from other airlines, security threats from terrorism, Ebola epidemic in West Africa and currency fluctuation. Prior to auditing, KPMG scanned the changes in the operating environment of KQ in order to assess the risks so as to understand the business environment. The management of KQ have a key role in responding to the issues raised by auditors that could affect the company;
- b) The injection of Kshs. 4.2 billion from the government was a result of negotiation by KQ management following growing concern on financial performance of the airline. The money was expected to support certain performance improvement measures. KQ sold one aircraft a B767-KYX for Ksh. 322 million;
- c) The decision to invest in shares of any company is a decision of a shareholder and auditors do not advice on which share to buy. Expansion of KQ through purchase of aircraft led to increased cost yet it

did not lead to improved performance because of other market forces. The key principle in auditing is the independence of the auditor and have unlimited access in law to documents and information or records from management and the board. KPMG undertook a performance audit which looked at strategy on the issue of ticketing.

CHAPTER FOUR: COMMITTEE ANALYSIS OF DOCUMENTS AND SUBMISSIONS MADE BEFORE THE COMMITTEE

The Committee pursuant to its mandate analyzed the documentation presented and the submissions made before it by the various parties: The following papers and documents were tabled by different parties during the inquiry-

1. A compilation of various documents, presented by representatives of retrenched Kenya Airways staff;
2. Nine Volumes of Memoranda from the Management of Kenya Airways containing cross cutting issues;
3. Minutes of the Board (2005 -2015);
4. Management Letters from Auditors of the Company (2005 – 2015);
5. Various letters from the Director of Immigration Services;
6. Responses on various issues raised by the Committee from-
 - (a) The National Treasury
 - (b) The Ministry of Transport and Infrastructure
 - (c) The Ministry of Labour , Social Security and Services
7. Letter from the Registrar of Companies.

After scrutiny of the documents, the Committee noted the following key issues-

1. Qualifications of Senior Management

Kenya Airways provided the Committee with an extract of the Operations Manual (a 2006 document) setting out the responsibilities, knowledge and skills of various senior management officers. Under knowledge and skills, the manual states that the Group Managing Director shall have a background in the management of commercial air transport operations and the Kenya Civil Aviation Regulations.

The Civil Aviation (Air Operator Certification and Administration) Regulations, 2013 defines an accountable manager as *“the manager who has corporate authority for ensuring that all operations and maintenance activities required by the AOC (Certificate holder) holder can be financed and*

carried out to the (standard required by authority) highest degree of safety standards required by the Authority”.

In the case of Kenya Airways, the accountable manager is the chief executive officer. The Regulations contain qualifications of an Accountable Manager as follows-

Regulation 14 Qualification of Personnel

(1) The Accountable Manager shall possess the following qualifications-

(a) a background in the management of commercial air transport operations;

(b) knowledge of these Regulations and other Regulations and materials published by the Authority that are applicable to flight operations and aircraft maintenance; and

(c) Knowledge of the operations and aircraft maintenance requirements of the air operator certificate (AOC) holder.

As per the manual the position of Chief Operating Officer requires a person with at least 8-10 years' experience at senior managerial position in operations in a reputable airline.

The Management of Kenya Airways indicated that the Board had the discretion to waive any of the requirements set out in the operations manual as long as the candidate met the most critical minimum qualifications for the role. **The Committee however observed that the parameters of what amounted to critical minimum qualifications were not defined.**

2. Industrial Relations between KQ and the KALPA

As per the documents submitted to the Committee, the optimum number of pilots required by Kenya Airways is 488. Currently there are 519 pilots employed. 446 of these pilots are active while 77 are inactive. The inactive pilots include pilots who are away attending various training programmes.

A pilot is deployed to fly a plane for which he has trained and qualified to operate. Therefore while there is an overall excess number of a pilot generally, the wide body fleet pilots have exceeded the optimal number required while there is a shortage of narrow body fleet pilots.

The company policy does not preclude the employment of a person who is related to another member of staff. The airline affirms that all its pilots,

including those related to existing members of staff were competitively recruited after fulfilling the set criteria for their positions. The recruitment of pilots may either be *ab-initio* (where the airline undertakes to train a pilot in consideration for a number of years of service) or direct recruitment of self-trained pilots.

Kenya Airways has a recognition agreement with KALPA. The terms of service of the pilots is determined by a CBA that is usually reviewed biennially. The agreement last entered into by the parties expired on 31st March, 2014 and while several meetings have been held to renew the agreement, no consensus has been reached. The contentious issues as set out in the airline's memorandum include-

- (i) Rates of pay and allowance- management contends that layover allowance will be based on time spent in outstations by pilots while KALPA contends that the allowances be based on a guaranteed number of nights.
- (ii) Annual increments- KALPA is demanding a 20% pay rise that the company claims to be unable to effect due to financial problems.
- (iii) Sick leave- management is proposing that an employee provide a sick sheet signed by a medical examiner and confirmed by the Company's examiner on all occasions that the employee is unable to perform their duties due to sickness.
- (iv) Days off; calculation of the days off duty at base *vis a viz* the days away from base is in contention between management and the Association.
- (v) Calculation of maximum flying duty period.

The parties agreed to record a deadlock in negotiations and on 6th March, 2015 reported a trade dispute under section 62 of the Labour Relations Act. The Act provides that once a trade dispute has been reported, the Cabinet Secretary shall appoint a conciliator to attempt to resolve the dispute in thirty days failure to which the matter may then be instituted in the industrial court (now the Employment and Labour Relations Court).

Kenya Airways assessed that it had an excess of 10 captains 4 of whom would be retiring in 2016 and 7 of whom would be retiring in 2018. Notices of retirement were issued to ten pilots based on the age of the pilot, their cumulative term of service and the number of years remaining to retirement in accordance with Clause 34(b) of the CBA in force at the time. Two of the notices were revoked after what the management term as "*consideration of personal representations to Management*".

The decision to retire the 10 pilots was communicated to the Association at its meeting with the management on various dates between 17th November, 2014 and 5th March, 2015 and in a letter dated 27th February, 2015 addressed to the Association from the Group Managing Director and CEO. The Association only challenged the pay of redeployed pilots but raised no objection to the proposal for retirement.

The conciliator appointed failed to resolve the dispute and issued a certificate of unresolved dispute on the matter of the retirement of the B777 pilots on 31st March, 2015.

The airline also instituted a suit and the court ordered that the parties negotiate and attempt conciliation and further that the Association withdraw its directive on withdrawal of goodwill and restrain from calling for industrial action pending the determination of the matter. The court was due to give a ruling on the matter on 14th October, 2015.

3. Engineers

Kenya Airways outsources engineering services in outstations in some of the destinations, based on the cost of contracting versus self-handling, availability of competent maintenance companies in a particular destination, labour laws, availability of sufficient competent man power, quality and safety issues. Similarly Kenya Airways is an Approved Maintenance Organization that handles maintenance for other airlines in Nairobi, Mombasa and other stations.

The management of Kenya Airways contends that there is a high turnover of engineers in the airline because of better remuneration offered especially by Middle East Carriers. Engineers employed by Kenya Airways are highly trained in systems similar to those found in the Middle East Carriers and are therefore on demand.

4. Crew

In 2012, Kenya Airways embarked on a staff rationalization programme. One hundred and thirty one (131) staff opted for voluntary early retirement while four hundred and sixty eight (468) were rendered redundant.

Redundancy was based on the following factors-

- (i) Abolition of offices due to restructuring;
- (ii) Staff performance based on assessment;
- (iii) Productivity and shift/roster changes; and
- (iv) Skills and competencies.

The redundancy process was carried out as follows-

- (i) a notice was issued detailing the process of retrenchment;
- (ii) applications from staff opting for voluntary early retirement were received and processed;
- (iii) assessments were done for customer service agents in the Ground Services Department; and
- (iv) Counselling and training services were made available to staff affected by the retrenchment exercise.

The redundancy process has been the subject of a protracted court battle between Kenya Airways and the retrenched staff. This matter was the subject of an appeal filed by the retrenched staff at the Supreme Court, **in Petition No. 4 of 2015** at time of tabling this report.

In response to a question raised on the recruitment of cabin crew in Thailand, the airline indicated that the crew in Thailand was recruited to deal specifically with the needs of the customers in that region. The cost of labour in Thailand would be cheaper and the airline has saved Ksh.320,000 per day on accommodation costs that would have been spent on Kenyan cabin crew. The airline therefore reiterated that the recruitment of the crew in Thailand was done prior to the redundancy exercise.

5. Outsourcing

Some of the services that Kenya Airways outsources include cabin crew services, cleaning services, security services, information and technology services, transport services, equipment operators and loaders. Outsourcing was part of the cost reduction strategies embraced by the Airline as outsourced labour is cheaper.

a) Contract between Kenya Airways and Career Directions Limited

Kenya Airways has entered into a contract with CDL for provision of skilled personnel to carry out cabin crew services, upholstery and laundry services. The Agreement is for a term of three years commencing 1st August, 2014 and is non-exclusive which allows Kenya Airways to enter into such agreements with other parties.

The outsourced company provides the personnel and ensures that they meet the minimum required standards. The airline however retains the power to request that any undesirable personnel be withdrawn and replaced with better personnel.

Under the Agreement, the outsourcing company is responsible for all wages, salaries and benefits, employment taxes and any insurance required by law for the personnel. The company is also liable for PAYE, NSSF, NHIF and all requisite remittances for personnel.

On its part, Kenya Airways shall pay the company:

- i.) Direct wages of Ksh. 45,000 for cabin crew and Ksh. 40,000 for ground staff ;
- ii.) NSSF contributions;
- iii.) Meal allowances for ground staff; Achieved layovers for cabin crew;
- iv.) Medical expenses (outpatient of Kshs. 27,000; Maternity of Ksh. 45,000; Accident Cover of Ksh. 200,000 and in-patient of Ksh. 800,000)
- v.) Workman Injury Benefits;
- vi.) Overtime; and
- vii.) Management fees at 8% of the basic wage but capped at KShs. 2,500,000/= for Kenya operations and at Kshs. 200,000 for regional operations.

The airline had employed 582 staff from Career Directions Limited. 261 of this crew serve in Kenya and Ghana. The total amount spent on the salaries of this crew is Ksh.12,617,142 per month. In contrast the airline has employed 624 cabin crew staff directly at a cost of Ksh.128, 272,459.

All cabin crew are trained by Kenya Airways in accordance with the Kenya Civil Aviation (Operation of Aircraft) Regulations 2013 and licensed by the Kenya Civil Aviation Authority.

b) Contract between KQ and Insight Management Consultants Limited

Kenya Airways had entered into a contract with Insight Management Consultants Limited for the provision of skilled and semi-skilled labour. The labourers are paid on a daily basis. On its part, Kenya Airways covers the wages, management fees and overtime.

The Contract provides that-

- (a) out of Ksh. 1004, which is the daily employment cost of an unskilled heavy worker, Ksh. 453.50 amounts to administrative costs;
- (b) out of Ksh. 1443.50, which is the daily employment cost of a skilled worker, Ksh. 493.50 amounts to administrative costs; and

(c) out of Ksh. 1663.50, which is the daily employment cost of a driver, Ksh. 513.50 amounts to administrative costs .

From the agreement, it is the outsourced company's responsibility to ensure that the staff appointed under the agreement meet the required skill set and also carry out their duties as required by Kenya Airways. The agreement is for a term of three years commencing 1st January 2014.

5 Ticketing and Passenger Load

The Committee noted that differential in ticketing and the prices of tickets issued by KQ were too high to be competitive as outlined in the table below:

Table showing fares on specific routes between KQ, Ethiopian Airlines, Emirates, South African Airline, Precision Air, RwandAir and KLM.

Based on Travelstart- an online travel booking website- and valid between 16th October 2015 to 15th January 2016. Prepared on the 15th October 2015 at 1822hrs.

The ticket is an economy class, return air ticket inclusive of taxes. The figures are in USD.

1. REGIONALLY

ROUT E	KQ	ETHIOPIA N	SAA	RWANDAI R	KLM	QATA R	EMIRATE S
NBO- EBB	\$334	\$229	\$316 9	\$324			\$1077
NBO- DAR	\$453	\$301	\$153 4	\$368		\$3660	
NBO- KGL	\$294	\$287		\$305			
NBO- ADD	\$294	\$278	\$146 9	\$815			\$946
NBO- BJM	\$559	\$382		\$445			
NBO- ACC	\$135 1	\$840*	\$164 5	\$974			\$1099
NBO- JNB	\$707	\$525	\$763	\$552			\$1755

NBO- LOS	\$106 2	\$693	\$157 2	\$737	\$476 2	\$916
NBO- DLA	\$162 5	\$877	\$175 5	\$1074*		
NBO- ABJ	\$192 4	\$1023		\$1357	\$573 2	\$5511
NBO- ABV	\$157 9	\$599		\$1419*		\$917
NBO- BKO	\$198 0	\$1468	\$381 9	\$1572*		
NBO- BZV	\$173 0	\$1096		\$1251	\$680 6	\$1502
NBO- KSA	\$160 5	\$906		\$1192		
NBO- DKR	\$185 1	\$1260*				

From the above, KQ pricing is quite high as compared to Ethiopian. This might be argued to be as a result of KQ offering direct flights whereas ET flights have at least one stop in Addis. However, some flights are still close to twice as much as ET.

2. INTERNATIONALLY

ROUT E	KQ	ETHIOPIA N	SAA	RWANDAI R	KLM	QATA R	EMIRATE S
NBO- AMS	\$107 0				\$107 0	\$691	\$868
NBO- CDG	\$933	\$803				\$669	\$797
NBO- LHR	\$906	\$814	\$168 6		\$921		\$1048
NBO- DXB	\$549	\$416	\$152 2	\$450		\$461	\$564
NBO- BKK	\$161 1	\$923			\$178 8	\$775	

NBO- BOM	\$709	\$584	\$1383*	\$272 4	\$623	\$565
NBO- HAN	\$217 3	\$1478*			\$1234	\$1255

Internationally the prices are more competitive as compared to regionally. Why? Who keeps KQ in check? Could it be because we operate the right equipment into these areas?

6. Litigation between Kenya Airways and its Staff

a) Industrial Court

The former employees of Kenya Airways filed a matter in the Industrial Court, ***Aviation and Allied Workers Union v Kenya Airways Limited & 3 Others, Industrial Court Cause 1616 of 2012***. The suit challenged the company's decision to declare them redundant. The matter was heard by Honourable Justice Rika. In summary, the Industrial Court made the following findings-

- i.) Historically staff costs do not seem to have directly influenced the profits of the Airline and there must be other factors impacting on the profitability.
- ii.) Although the staff salaries and allowances have steadily gone up, the number of employees was not shown to have consistently matched the rise in the wage bill and there must be other factors raising the wage bill.
- iii.) A cost benefit analysis of labour was not done to show the employees productivity.
- iv.) The Airline was expanding in fleet increase and destination and expansion will need more investment in labour.
- v.) There was need for more consultation. The law secures a right to work and protection from unemployment. The Airline as a national carrier should not be left to conduct its business as it wishes. The Government and courts have an obligation to ensure it is a business that meets its economic strategic and social responsibilities. The Airline was bound to observe the National Values and Principles of Governance in Article 10 of the Constitution.

vi.) Business modes have to be founded on the Constitution. The business model of employing foreigners and outsourcing labour not only lowers the international labour standards but also compromises security.

vii.) The declaration of redundancy lacked procedural fairness on the grounds, inter alia, that:

- a. Consultation before and during the retrenchment exercise is mandatory and the Airline should have consulted the Union, the employees individually and the Government in accordance with Article 10 of the Constitution.
- b. A fair selection criteria such as *last in-first out* which is mandatory under Kenya Law was not applied
- c. The notices were not issued in good faith as they were communicating a decision that had already been made and there were no genuine consultations with the Ministry of Labour, the Union and individual employees after the notice was issued.
- d. The performance and productivity assessment criteria were not fair and work experience criterion should have been applied.
- e. There was a strong anti-union sentiment discernable in the conduct of Kenya Airways.

The Judge found that the declaration of redundancy was unlawful. In particular, the Judge made the following finding:

"An unfair redundancy process results in an unfair termination. Under section 43 and 45 of the Employment Act 2007, the employer must establish valid reason or reasons for termination, and demonstrate that it followed fair procedure. Fairness in all forms of employment termination is the staple of Industrial Law. There is no doubt in the mind of the Court that the reason or reasons advanced by the 1st respondent in the mass retrenchment are objectively, not valid reasons. KQ is merely using a financial downturn to justify its replacement of unionized employees with outsourced and foreign workers. It is a company that is expanding and as stated by its CEO, requires more, not fewer employees. The procedure was fundamentally flawed, and the claimant is entitled to the remedies sought."

The Judge therefore nullified the declaration of redundancy and ordered that the retrenched employees be reinstated immediately and paid their dues for the period they had been out on retrenchment.

b) Court of Appeal

Subsequently, Kenya Airways filed an appeal from the decision of the Industrial Court in *Civil Appeal No. 46 of 2013; Kenya Airways Limited vs Aviation & Allied Workers Union Kenya & 3 Others*.

The Court of Appeal made the findings summarized hereunder-

Githinji, JA.

- i. The Court has no supervisory role. The fact that the Airline was expanding and that the Airline had given an assurance a year before that it was not contemplating redundancies do not solely render the rationalization exercise unreasonable.
- ii. In the circumstances of the case, there was a valid and fair reason for redundancy based on the Airline's commercial operational requirements and the termination of services on account of redundancy was justified.
- iii. The function of the Industrial Court is limited to interpreting and enforcing only those obligations which the parties to employment have agreed to assume.
- iv. Kenyan law does not provide for pre-redundancy consultations.
- v. The employees who complained that their roles should not have been declared redundant should have filed individual claims. The claim lacked any specificity.
- vi. The allegations that services of some employees were terminated because of the previous trade union activities were unsubstantiated.
- vii. The Airline applied fair procedure in the termination of the services of the redundant employees.
- viii. The remedy of reinstatement should only be given in very exceptional circumstances.

- ix. This was a genuine redundancy resulting in loss of jobs and fair procedure was applied. The normal remedy for a genuine redundancy even in cases where the services were not terminated in accordance with a fair procedure would be compensation by way of damages in accordance with Collective Bargaining Agreements and Section 49 of the Employment Act.

Maraga, JA.

- i. The decision to declare redundancy has to be that of the employer. It is the employer's right under Section 40 of the Employment Act.
- ii. Kenya Airways is not a State Corporation. It is a private liability company incorporated under the Companies Act and listed on the Nairobi Stock Exchange as well as in Uganda and Tanzania. The fact that it flies the Kenyan flag does not give the Kenyan Government any right to control its operations to ensure that the conduct of its business meets the country's *"economic, strategic as well as social responsibilities"*.
- iii. Whereas the principles of integrity, good governance, accountability and others in Article 10 are noble and should be embraced by even non-governmental and private organizations, they cannot be prescribed to such bodies as must-follow legal requirements in the conduct of their businesses.
- iv. On a preponderance of evidence on record, the Airline was justified in declaring redundancy.
- v. The notice envisaged by Section 40(1)(a) is to be given to the employee himself if he is not a member of a trade union.
- vi. Given its precarious financial position, the airline was justified to declare redundancy.
- vii. No notice was given to the labour officer and no proper notice was given to the affected employees or their trade union, no meaningful consultations held and the criteria followed to select the affected employees was flawed.
- viii. Despite the fact that the redundancy itself was justified, the airline's retrenchment of 447 employees amounted to unfair termination of employment.

- ix. However, the Industrial Court Judge's order of reinstatement was not an efficacious remedy as it defeats that objective of the justified redundancy. The learned Judge should have considered the alternative remedy of compensatory damages, which the Union had sought.

Murgor, JA.

Justice Murgor, JA. Made the following findings—

- i. The Aviation and Allied Workers Union was satisfactorily informed of the impending redundancy.
- ii. The notice was proper as it clearly stated the reasons for the redundancy, the extent of the redundancies and the number of employees to be affected.
- iii. Consultations in redundancies are two-way discussions between the employer and the union to be conducted with candour, reasonableness and commitment towards addressing the concerns of both the management and the employees.
- iv. It was the union and not the Airline that failed to carry out meaningful consultations as required which compromised the entire process.
- v. There is no legal requirement for the Airline to carry out consultations with the Government.
- vi. Article 10 of the Constitution is not applicable to this dispute.
- vii. It is the Board and management of Kenya Airways, that have the sole mandate and responsibility to manage the company, and make decisions that are in its best interests, whose stakeholders comprise shareholders, creditors, and employees.
- viii. Given the financial status of the airline, and the mitigating initiatives that the airline was forced to employ, there is no reason to doubt the authenticity of the appellant's precarious financial status which clearly threatened the immediate, short and long term future sustainability of the company. This justifies the need for the redundancy.

- ix. The Industrial Court misdirected itself in failing to recognise that certain positions had ceased to exist, which was further justification for the redundancies.
- x. The selection process is required to be based on seniority, skill and experience, reliability and ability of the employee.
- xi. When the evidence is considered, it is doubtful whether the airline's outlined selection process was followed. The airline did not apply a fair selection procedure as required by section 40 (1) (c) of the Act, and in so doing unfairly terminated the contracts of the 447 affected employees.
- xii. Industrial Court indiscriminately awarded reinstatement without due regard to the nature of each position declared redundant, the length of employment of each and every employee, and whether or not their positions remained in existence. The Industrial Court considered it practicable to reverse the retrenchment of 447 employees, and to order their reinstatement to a financially constrained employer, without sufficient regard for the implications of such a decision, including whether the employer could accommodate the affected employees in the workplace, or effectively deploy them within its operations. This was impracticable.

The court therefore overturned the decision of the Industrial Court and nullified the order of the Industrial Court to reinstate the former employees and order that they be paid their back pay. The Court further found that there had not been any procedural unfairness in the declaration of redundancy.

c) Supreme Court

Subsequently, the Aviation and Allied Workers Union filed an appeal to the Supreme Court in *Aviation and Allied Workers Union Kenya vs Kenya Airways Limited & Others; Supreme Court Petition No. 4 of 2015*.

The appeal is based on the following grounds-

- i. The termination of the former employees did not meet the constitutional and statutory requirements.
- ii. The appellate Court erred in failing to consider whether or not the International Labour Organisation, Recommendation

No. 166 of the ILO Convention No. 158 – Termination of Employment Convention, 1982 applies to Kenya or not pursuant to Article 2(5) and (6) of the Constitution of Kenya.

- iii. The Court of Appeal exceeded its mandate and contravened Section 17 (2) of the Industrial Court Act, Cap 234B, Laws of Kenya.
- iv. The Court of Appeal delved into matters of fact when it ought to have restricted itself to matters of law only.
- v. The Court of Appeal's judgment restricted the application of Application of Article 10 of the Constitution.
- vi. The Court failed to consider Article 41 of the Constitution meaningfully.
- vii. It was an error for the Court of Appeal to interfere with the discretion of the trial Judge to order reinstatement despite the appellate court having found that there was no lawful basis for the redundancy.
- viii. The Court of Appeal had no jurisdiction to assess damages and award compensation under Section 49 (1) (c) of the Employment Act.
- ix. It was an error to find that the redundancy was justified purely because Kenya Airways appears to be in a precarious financial position.
- x. The Court of Appeal failed to promote conciliation pursuant to the requirement for fair labour practices under Article 41 of the Constitution.
- xi. The Court failed to pronounce itself on the issue of back pay after finding that Kenya Airways had not satisfied the conditions under Section 40 of the Employment Act.
- xii. The Court of Appeal should have awarded the maximum compensation available owing to the gross violation of the law and fundamental rights.

- xiii. The Court of Appeal failed to uphold the principle of *last in-first out* as a principle that employers in Kenya must consider in addition to the criteria for redundancy provided under Section 40 of the Employment Act, 2007.

This appeal was still pending before the Supreme Court.

7. Foreign Nationals Working for Kenya Airways

Kenya Airways has in its employment 517 foreign nationals who comprise 13% of the workforce. The Director of Immigration Services, in the Ministry of Interior provided information as to 17 foreign nationals for whom work permits had been applied for by Kenya Airways and issued by the Director.

Section 45(2) of the Kenya Citizens and Immigration Act Cap. 172 provides that *"It shall be the duty of every employer to apply for and obtain a work permit or a pass conferring upon a foreign national the right to engage in employment before granting him employment and it shall be presumed that the employer knew at the time of the employment that such person was among those referred to in subsection (1)"*.

Regulation 20(1) and (2) of the Kenya Citizenship and Immigration Regulations provides-

(1) An application for a residence or work permit shall be made to the Director in Form 25 set out in the First Schedule.

(2) The Director shall, after considering an application made under paragraph (1), issue a residence or work permit, in any of the classes specified in the Seventh Schedule, in Form 26 set out in the First Schedule, upon the payment of the applicable fees prescribed in the Ninth Schedule.

The Seventh Schedule to the Kenya Citizenship And Immigration Regulations, 2012 provides for a class D work permit in the following terms *A person who is offered specific employment by a specific employer, the government of Kenya or any other person or authority under the control of the Government or an approved technical aid scheme under the United Nations Organization or some other approved Agency (not being an exempted person under section 34(3), **who is in possession of skills or qualifications that are not available in Kenya and whose engagement in that employment will be of benefit to Kenya.***

Vide a letter, dated 8th October, 2015, the Director of Immigration Services outlined the 17 persons to whom Kenya Airways had applied for and obtained work permits for. The work permits related to the following positions-

- (a) CEO of JamboJet Limited;
- (b) Commercial Director;
- (c) Captain;
- (d) Team leader, Boeing Field Service;
- (e) Ground Services Director;
- (f) Field service representative;
- (g) Head of Network and Alliances;
- (h) Fleet Development Director;
- (i) Quality Manager, JamboJet limited;
- (j) In-flight attendants; and
- (k) Simulator Instructor

The reasons advanced by the airline and summarized in the letter by the Director Immigration Services include-

- (a) the unique and wealth of experience in managing aspects of the airline industry that the employees to whom the work permits related to held;
- (b) pilot shortage due to growth and expansion;
- (c) secondment by companies that transacted business with the airline such as Boeing, Embraer and KLM; and
- (d) rapid fleet expansion

8. Acquisition of Aircrafts

Under the pre-delivery payments, a purchase agreement prior to delivery is made. The airline is required to pay the manufacturer a certain deposit by way of progress payment known as pre-delivery payments or PDPs. The deposit is ordinarily for up to 35% of the purchase price or as may be agreed with the manufacturer. The deposit may be paid from the airline's own cash resources or from a commercial lender. The lender, through the SPV that is set up, obtains a right to purchase the aircraft on the terms and conditions.

Pre-delivery payments are paid off at delivery of an aircraft. In order to expound on how this system works, Amboseli Limited which held the title

to the Embreair E190s before delivery under PDP financing, passed the title to Samburu Limited, the SPV under the long term delivery finance. Now that all the ten E190s have been delivered, Amboseli was in the process of being wound up. The SPVs hold title to the aircrafts until all loans borrowed are paid.

The following is a breakdown of aircrafts acquired by Kenya Airways-

Plane	Quantity	Financier	Special Vehicle(SPV)	Purpose	Status
B737-300	4	• Export Import Financing Bank of the United States of America	Simba Limited	Finance	Loan has been fully repaid. Title to the aircraft has been transferred from Simba Limited to Kenya Airways
777-200	4	• Exim Bank, Barclays Bank, the Security Trustee known as Wells Fargo Bank Northwest, National Association	Ndovu Financing Nyati Financing Kifaru Financing Chui Financing	Aircraft Aircraft Aircraft Aircraft	Kenya Airways has not yet completed the repayments. The aircrafts are still owned by the SPVs.
Embraer ERJ-190 Aircraft (E190s)	10	• Standard Chartered Bank • African Export Import Bank; and • Other lenders	Amboseli Limited (for pre-delivery financing) Samburu Limited (for delivery financing)	Limited Limited	Kenya Airways has not yet completed the repayments. The aircrafts are still owned by the SPVs.
787-8	6	• JP Morgan Citibank NA • African Export	Aberdare Limited (for pre-delivery financing)	Limited	Upon delivery of the B787s and B777, Kenya airways paid off
777-300	1				

		Import Bank	Tsavo Aircraft financing LLC (for delivery financing)	the outstanding pre-delivery payments and title to the respective aircrafts has passed to the SPVs
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Kenya Airways has entered into the following lease agreements-

- (i) Eight Year Aircraft lease with Inishcrean Leasing Limited expiring on 8th August, 2016 for a B737-800, registration No. 5Y-KYD;
- (ii) Eight Year Aircraft Lease with Wells Fargo Bank Northwest National Association expiring on 13th January, 2017 for a B737-800, registration No. 5Y-KYE;
- (iii) Eight Year Aircraft Lease with Celestial EX-IM Trading Limited expiring on 11th February, 2017 for a B737-800, registration No. 5Y-KQF;
- (iv) Fourteen Year Aircraft Lease with GECAS Sverige Aircraft Leasing Worldwide AB expiring on 30th May, 2016 for a B737-700, registration No. 5Y-KQF;
- (v) Eight Year Aircraft Lease with JAG XVI LLC expiring on 17th December, 2018 for a E190AR, registration No. 5Y-KYP;
- (vi) Eight Year Aircraft Lease with JAG XVII LLC expiring on 30th May, 2019 for a E190AR, registration No. 5Y-KYQ;
- (vii) Eight Year Aircraft ALC E190 468 LLC expiring on 9th September, 2019 for a E190AR, registration No. 5Y-KYR;
- (viii) Eight Year Aircraft Lease with ALC E190 478 LLC expiring on 29th September, 2019 for a E190AR, registration No. 5Y-KYS ; and
- (ix) Eight Year Aircraft Lease with Celestial Aviation Trading 16 Limited expiring on 31st July, 2016 for a E170LR, registration No. 5Y-KYH.

9. Fuel Hedging

- 1) A hedge is a risk management policy to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract. In other words a hedge is used to reduce any substantial losses/gain suffered by an individual or an organization that may arise from volatility of prices.
- 2) Hedge policies are majorly used on financial instruments that are subject to erratic price changes such on loans from international markets and fuel for airlines.

- 3) Fuel Hedging is a contractual tool some large fuel consuming companies, such as airlines, use to reduce their exposure to volatile and potentially rising fuel costs. A fuel hedge contract allows a fuel-consuming company to establish a fixed or capped cost, via a commodity swap or option. The companies enter into hedging contracts to mitigate their exposure to future fuel prices that may be higher than current prices and/or to establish a known fuel cost for budgeting purposes.

Global practice:

- 1) Airlines typically hedge some of their fuel needs - or buy fuel in advance at pre-determined prices - to reduce the impact on earnings from wide swings in the market. However, it is not guaranteed that the fuel prices would work in favor of the company; it is but a gamble.
- 2) Since 2008 when the price of fuel suddenly declined from \$100 to \$40 per barrel after most airlines had rushed to hedge their fuel, the resultant loss made many airlines to be prudent in their hedging policies.
- 3) Other airlines such as KLM, Air France, and Lufthansa also practice fuel hedging as a risk management practice; they operate a more cautious policy (operating at 3 to 6 months at 60%).

Hedging practice in Kenya airways

1. As a risk management strategy to mitigate on the adverse price and exchange rate volatility, Kenya Airways has been operating a fuel hedging policy over time.
2. Kenya airways' use of fuel hedge derivatives to protect it against sudden increases in prices is not new. Though there have been reviews in terms of the policy affecting the percentages of fuel subjected to hedging and the effective timelines.
3. At point of inquiry, fuel hedge policy in use allows up to 80% of fuel for the first 12 months rolling and 50% for the next 12 months rolling (submission by KQ Management). This has been in use since the financial year ending March 2013 and has been reportedly adhered to.

4. Over the contract period, this fuel hedge policy contract locks the future purchasing price of fuel for KQ at \$80(approximately Kshs.8, 000) per barrel. Given the decline of fuel price(largely in Mid 2014) in the international market arising from an increase in the supply of oil by the United States of America (USA) and the decrease in demand as a result of the contraction of Chinese economy , the contractual \$80 per barrel is about a quarter over the prevailing market price(\$60).
5. This implies that for every barrel of fuel purchased at the \$80 under the hedge contracts, as per the IAS 39, KQ recognizes a loss of \$20 which resulted into a whopping loss of Ksh.8.4 billion on hedge contracts in FY ending March 2015 (Audited Financial Statements).
6. Financial statements show that KQ has in the past (2011-2014) made profits from fuel hedges with a significant profit of Kshs.2.5 billion arising from fuel hedging.

10. Financial Statements and Management Letters

The Government of Kenya believed that International Finance Corporation (IFC) (private financing/lending arm of the World Bank Group) had the requisite combination of technical expertise, political sensitivity, and credibility required for the difficult environment surrounding the privatization of Kenya Airways. Consequently, in April 1994, the Government hired IFC to prepare “a strategic review and options report” and to develop and implement a privatization action plan. IFC’s undertakings included the following:

- a) Conducting a strategic review of the airline’s operations and financial condition.
- b) Producing a detailed action plan to reconcile the Government’s objectives and practical constraints with the commercial realities of the industry.
- c) Identifying the characteristics of potential investors.
- d) Determining financing needs as well as legal and regulatory requirements.

- e) Designing an equity structure.
- f) Evaluating the bids and negotiating with prospective partners.
- g) Recommending a preferred partner.
- h) Designing the public offer.

In 1995, IFC successfully advised and guided the Government of Kenya on the privatization of Kenya Airways. After selling 26 percent of the airline to a strategic partner, the frequency of the airline's flights grew by 61 percent in six years. The sale was completed in December 1995 and the Initial Public offering (IPO) undertaken in April 1996.

KLM Royal Dutch Airlines purchased 26 percent of the equity and the Kenya Government through National Treasury received over US\$70 million from the sale. Over 113,000 Kenyans were able to buy 22 percent of the shares in the airline (the vast majority bought the equivalent of about US\$200 worth). Kenyan financial institutions bought 12 percent, international financial investors 14 percent, and employees of the airline acquired 3 percent.

The completion of privatization of Kenya Airways, coupled with strong management and partnership with KLM, led the Airline back to the profitability path. The cooperation between the two airlines was geared towards pooling of their strengths thereby achieving economies of scale through sharing resources, combining route networks, and assessing new markets in Sub-Saharan Africa. The success of this joint venture led to the doubling of passenger traffic and cargo between 1995 and 2003 and a boost to tourism.

11. Financial Loss-Making trend by Kenya Airways Limited

Table 1.0 presents Kenya Airways Group Limited 5 years consolidated income statement for the periods ending 31st March 2010 to 31st March 2015.

5 Years Consolidated Income Statement for Kenya Airway Group Limited in Kshs. Millions

Description	Full Year 31-3-2015	Full Year 31-3-2014	Full Year 31-3-2013	Full Year 31-3-2012	Full Year 31-3-2011	Full Year 31-3-2010
Revenue	110,161	106,009	98,860	107,897	85,836	70,743
Direct Cost	(76,059)	(75,268)	(77,225)	(77,217)	(53,419)	(44,376)
Fleet Ownership Cost	(25,932)	(12,490)	(11,178)	(9,970)	(9,622)	(9,102)
Overheads	(24,503)	(20,972)	(18,643)	(19,404)	(16,980)	(15,426)
Restructuring Cost	-	-	(826)	-	-	-
Total Cost	(126,494)	(108,730)	(107,872)	(106,591)	(80,021)	(68,904)
Operating Loss/Profit	(16,333)	(2,721)	(9,012)	1,306	5,815	1,839
Operating Margin (%)	(14.83)	(2.57)	(9.12)	1.21	6.77	2.60
Finance Cost	(4,734)	(2,424)	(1,907)	(1,341)	(1,379)	(1,485)
Finance Income	153	823	1,421	244	172	372
Realized Gain on fuel derivatives	(1,676)	972	602	2,508	298	(3,771)
Fair value (losses)/gains on fuel derivatives	(5,776)	-	-	(41)	30	6,140
Other Costs/losses	(1,346)	(1,511)	(1,700)	(1,019)	254	(501)
Share of results of associate, net of tax	-	-	(230)	238	(188)	77
Gain on deemed partial disposal of interest in associate	-	-	-	251	-	-
Profit/(loss) before income tax	(29,712)	(4,861)	(10,826)	2,146	5,002	2,671
Income Tax Credit/Expense	3,969	1,479	2,962	(486)	(1,464)	(636)
Profit/ (Loss) for the year	(25,743)	(3,382)	(7,864)	1,660	3,538	2,035
Net Profit Margin (%)	(23.37)	(3.19)	(7.95)	1.54	4.12	2.88

Data Source: Kenya Airways Group Ltd¹

As shown in table 1.0, the total revenue for the group went up slightly in 2014/2015 financial year to Kshs. 110.16 billion representing a growth of 3.9% compared to 2013/2014 financial year. From the 2014/2015 financial year audited financial statements, the number of passengers

¹ Audited Financial Statements for the financial Years ended 31st March 2010 to 31st March 2015

carried also went up from 3,719,590 in 2013/2014 financial year to 4,179,046 in 2014/2015. However, the airline made a huge operating loss of Kshs. 16.33 billion in 2014/2015 compared to an operating loss of Kshs. 2.72 billion in 2013/2014.

The huge financial-loss making trend dates back to 2012/2013 financial year when the airline made an operating loss of Kshs. 9.012 billion. Incidentally, 2012/2013 coincides with the initial years of the execution of the 10 year strategic plan of the airline dubbed "project Mawingu".

The company under the "Project Mawingu" is undertaking an expansive flight modernization programme which led to expensive and huge borrowings to fund acquisitions aircraft, aircraft spare engines and pre-delivery payments for ordered aircrafts. **The total borrowing by the Company rose by approximately 108 percent from Kshs. 50.12 billion as at 31st March 2014 to Kshs. 104.175 billion as at 31st March 2015.**

The new aircrafts being purchased by the Company under the plan are not registered in the name of the company but are registered in the name of SPVs whose equity is held by the security trustees on behalf of the respective financiers. The entities which have been registered by Kenya Airways Group Limited for this arrangement are:

- (i) Swara Aircraft Financing Limited
- (ii) Ndovu Aircraft Financing Limited
- (iii) Nyati Aircraft Financing Limited
- (iv) Kifaru Aircraft Financing Limited
- (v) Chui Aircraft Financing Limited
- (vi) Tsavo Financing LLC
- (vii) Samburu Limited
- (viii) Aberdare Limited
- (ix) Amboseli Limited

The Directors and the faces behind these special purpose vehicles (companies) are not known to the investors and to the general public.

12. Shareholders Analysis

Table 2 shows the largest shareholding in Kenya Airways and the respective number of shares held as at 31st March 2014.

Table 2: Kenya Airways shareholders as at 31st March 2014

Name	No of Shares	%
1. Cabinet Secretary to the National Treasury	445,920,556	29.80
2. KLM - Koninklijke Luchtvaart Maatschappij	400,020,026	26.73
3. Standard Chartered Nominees Ltd Non Resident a/c KE11752	143,000,000	9.56
4. Standard Chartered Nominees Ltd Non Resident a/c 9057	71,116,080	4.75
5. Standard Chartered Nominees Ltd A/c 9187	25,536,865	1.71
6. Standard Chartered Nominees Ltd a/c 9230	20,630,773	1.38
8. Standard Chartered Nominees Ltd A/c 9197	10,369,230	0.69
8. Vijay Kumar Ratilal Shah	9,029,660	0.60
9. Standard Chartered Nominees Ltd KE 14353	8,232,417	0.55
10. Mike Maina Kamau	8,003,940	0.53
Other shareholders	354,609,487	23.70
Total	1,496,469,034	100.00

Data Source: Kenya Airways²

As shown in table 2, the largest shareholder as at 31st March 2014 was the Government of Kenya (through Cabinet Secretary to the National Treasury) with 29.8 percent shareholding followed by KLM Airline with 26.7 percent shareholding; other shareholders at 23.7 percent shareholding; and Standard Chartered nominee non residents at 9.56 percent.

² 2013-2014 Financial Year Audited Financial Statements

Mike Maina Kamau was the largest local individual shareholder as at 31st March 2014 with 8 million shares representing approximately 0.53 percent shareholding of the company while the total Standard Chartered Nominees Ltd shareholding for various groups both non-resident and local was approximately 18.64 percent shareholding as at the same date.

Table 3.0 show the distribution of Kenya Airways shares among foreigners and locals residents as at 31st March 2014.

Table 3.0: Distribution of Shareholders by Region as at 31st			
	No. shareholders	No of Shares	%
Foreign	21	633,292,257	42.32
Foreign Individuals	534	8,138,841	0.54
Local Institutions	3,266	648,151,642	43.31
Local Individuals	74,016	206,886,295	13.82
Total	77,837	1,496,469,035	100

Data Source: Kenya Airways³

As shown in table 2, 42.86 percent of Kenya Airways was owned by foreigners as at 31st March 2014. This comprised of 21 foreign institutions which owned 42.32 percent and 534 foreign individuals who owned 0.54 percent. The local ownership of the institution stood at 57.14 percent comprising of 3,266 local institutions who owns 43.31 percent and 74,016 local individuals who owns a paltry 13.82 percent.

The number of local individual shareholders has reduced from over 113,000 in 1st April 1996 when the airline underwent public listing to 74,016 at as 31st March 2014. The shareholding strength of local individuals have also reduced from a high of 22 percent in 1996 to 13.82 percent as at 31st March 2014.

³ 2013-2014 Financial Year Audited Financial Statements

CHAPTER FIVE: OBSERVATIONS AND RECOMMENDATIONS

Observations

The Board and Management of Kenya Airways

1. The committee was not persuaded that the Kenya Airways management understood the environment and market they were operating in so as to maintain a competitive edge, make strategic decisions in key areas that required constant vigilance in studying global and regional markets and destinations, the vagaries or ups and downs in the oil industry, planning of routes and networks, leverage partnerships with KLM and the Sky team, sale of tickets, capitalizing the potential and dynamic of its own local and regional base where it had inherent hegemony in Kenya and Africa
2. The Government of Kenya is represented in the Board of Directors by the Principal Secretary, National Treasury and the Principal Secretary, Ministry of Transport and Infrastructure. The Government is under an obligation to ensure that public funds are employed lawfully and efficiently, hence the need to have the representatives in the Board. The Committee however noted that the two representatives were not constant in the attendance of Board meetings, therefore reneging on the responsibility assigned to them.
3. The Management of Kenya Airways is over represented in the Board, consequently undermining the Board's control and oversight. The committee was unable to tell the skills the members offered to the Board.

Qualifications of the Chief Executive Officer

4. The current Group Managing Director and Chief Executive Officer, Mr. Mbuvi Ngunze was the former Chief Operating Officer of Kenya Airways for three years. The Committee observed that at the point of being recruited to the position of chief operating officer, Mr. Ngunze was not qualified for that position as outlined in the Kenya Airways operations manual (**Appendix 1 page 31 of 118**).
5. The Board of Kenya Airways submitted to the Committee that it exercised its discretion to waive the requirement for 8-10 years' experience which allowed the current Group Director and Chief Executive Officer to be recruited as Chief Operating Officer before the current appointment to Group Managing Director and Chief Executive Officer. The Committee questioned how the Board could exercise

discretion on a matter clearly laid down in a procedural document. The Board's discretion was over stretched resulting in the employment of an unqualified person to a critical office assigned key responsibilities in the airline's operations.

6. The Board of Kenya Airways does not have the latitude to waive employment qualifications which form part of its own labour requirements. Professional qualification and minimum level of experience and the genre of work experience for accountable managers and technical staff must always prevail against the discretion of the Board however well founded.

Outsourcing of Staff

7. The data submitted to the Committee by Kenya Airways on the savings made on operational costs were uninformative to enable the Committee to draw any conclusions as to whether the airline actually saved on costs.

8. The outsourcing model embraced by Kenya Airways exposes employees performing the same tasks to varied remuneration. Kenya Airways submitted a document with employee cost comparison between employees performing the same duties directly employed by Kenya Airways and those employed through Career Directions Limited. This raises questions of fair labour practices. Article 41(1) and 41(2) of the Constitution provides as follows-

(1) *Every person has the right to fair labour practices.*

(2) *Every worker has the right—*

(a) to fair remuneration;

(b) to reasonable working conditions;

(c) to form, join or participate in the activities and programmes of a trade union; and

(d) To go on strike.

One of the tenets of fair labour practices is equal pay for equal work. Fair labour practices lead to increased productivity, staff retention and improved customer satisfaction. **While the staff recruited by Kenya Airways enjoy the benefits attendant to belonging to a union, the staff recruited under Career Directions and Insight Limited do not.**

Accountability of Funds

9. Kenya Airways has severally received funds in the form of cash bail outs from the government. The most recent of this bail out was an

amount of KShs.4.2 Billion approved by the National Assembly in May, 2015. It only follows therefore that the principles of public finance contained at Article 201 of the Constitution and especially the principle of openness and accountability must be adhered to. Further, Article 229 (5) & 229 (6) of the Constitution provides that-

(5) The Auditor-General may audit and report on the accounts of any entity that is funded from public funds.

(6) An audit report shall confirm whether or not public money has been applied lawfully and in an effective way.

The Committee observed that Article 229 as stated above provides enabling provision to cause the Auditor General to audit Kenya Airways and any other non-public entity that benefits from public funds.

Human Resource Issues

10. The labour disputes at Kenya Airways have a huge impact on service delivery and the morale of pilots, crew and other staff. The disputes have been the subject of protracted litigation and the proceedings are still pending before various courts. The prolonged litigation in court impacts negatively on the operations of the airline in terms of costs and man hours.

Employment of Foreign Nationals

11. The Kenya Citizenship and Immigration Regulations, 2012 provides at Regulation 20(2) and in the Seventh Schedule provides that a Class D permit shall be issued once it has been demonstrated that the person in favour of whom the permit relates possesses a skill that is unavailable in Kenya and further that the person would be of benefit to Kenya. The Regulation provides as follows-
 20. *Residence or work permit*
 - (1) *An application for a residence or work permit shall be made to the Director in Form 25 set out in the First Schedule.*
 - (2) *The Director shall, after considering an application made under paragraph (1), issue a residence or work permit, in any of the classes specified in the Seventh Schedule, in Form 26 set out in the First Schedule, upon the payment of the applicable fees prescribed in the Ninth Schedule.*
13. The Director of Immigration Services, to whom applications for Class D work permits are made, should require an employer to demonstrate that the skill possessed by the person to whom an application for a work permit relates is unavailable in Kenya. The

201 of the Constitution and especially the principle of openness and accountability must be adhered to. Further, Article 229 (5) & 229 (6) of the Constitution provides that-

(5) The Auditor-General may audit and report on the accounts of any entity that is funded from public funds.

(6) An audit report shall confirm whether or not public money has been applied lawfully and in an effective way.

The Committee observed that Article 229 as stated above provides enabling provision to cause the Auditor General to audit Kenya Airways and any other non-public entity that benefits from public funds.

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13. The Director of Immigration Services, to whom applications for Class D work permits are made, should require an employer to demonstrate that the skill possessed by the person to whom an application for a work permit relates is unavailable in Kenya. The Committee observed that the Director of Immigration did not exercise due diligence before issuing the

work permits as requested by Kenya Airways. Further, there was a disparity between the list of foreign employees with work permits made available by the management of Kenya Airways and the list submitted by the Director of Immigration Services

14. Kenya Airways applied for work permits for Captains in order to meet a shortage of pilots and get pilots who could fly certain types of aircrafts. However, the airline has an *ab initio* training programme where Kenya Airways trains first officers and then recruits them after successful completion of the training. It would have been prudent to ensure that the *ab initio* programme was designed along the expansion plans of the airline to ensure that pilots are trained in operating the aircrafts that were likely to be purchased under the expansion plan. A shortage of pilots due to the airline's expansion plan is one of the indicators that the ambitious expansion plan was not accompanied by actual growth in the airline including building the capacity of existing employees.

Financing Arrangements

15. The documentation provided by the Management of Kenya Airways for purchase of aircrafts was not sufficient in terms of the amount of money spent on each aircraft. Issues of transparency and accountability arises in such a case, as it would be important to know the amount of money spent on these aircrafts in order to make a comparison of prices and assess whether there was good value for money and compare the prices with prevailing market prices. The competitiveness of the funding structure could also not be ascertained. Owing to the public interest in the affairs of Kenya Airways, there was need for more transparency and accountability.
16. It was observed that operating costs were so high and was posing liquidity problems to the Company. The high costs on many occasions stifled the achievement of some financial agreements as pointed out in the Embraers' credit facility. Kenya Airways recorded a loss of Kshs 25.7 billion in the Financial Year ending 31st March 2015. The loss has been attributed to the increase in the operational costs of the company. However, the management presented to the Committee that the heavy losses were as a result of various factors including the Ebola outbreak, insecurity and unfair competition. The Committee however noted that these factors were not unique to Kenya airways as other airlines operated profitably in the same region.
17. The Committee observed that the IFC had committed itself to provide managerial and technical support to KQ on rolling out project

"Mawingo". The IFC went further to give accolades to the project, showering praises and showing tremendous confidence in achieving its goals and objectives. The Committee invited the IFC to discuss this project without success. The IFC pointed out that it had immunity protecting it from appearing before the committee. The Committee sent questions to the IFC so as to receive written clarification on certain key issues pertaining to the project. The IFC responded to one question whose answer was in the public domain.

18. In various years, variances were observed in inventory where physical counts were less than the recorded balances in OASES (2012). This is also manifested in Fixed Asset registers (2011). Notably, the incidences were in overstatement/overvaluation of assets. This could be a case of creative accounting.

19. The basis on which KQ makes profits is partially based on revaluation of assets. A case in point is in 2012/13, the computational basis of leave accrued (account payables) was changed from a 22 to 30 working days a month, which led to understating of a provision for the leave accrual by Ksh.263 million. There was also a revaluation of Property, Plant and Equipment that led to a surplus of Kshs.4.957 billion. Though this could have been done procedurally and as provided for by the Company's policy, the impact of this is that instantaneously it may portray a healthy asset base.

20. **Accuracy of reported revenue**

The delayed reconciliation for subsequent revenue/costs sharing in the KQ/KLM joint venture has been noted (year ending 31st March, 2014). This long outstanding unmatched receipts and non-compliance with company's policy on tickets reissue also indicate that timely recognition of revenue could be realized hence the airline incurring losses. At the point of enquiry, there was no effort to rectify this mismatch within the framework of the joint venture.

21. **Weak information systems controls**

The Committee observed that some ex-employees still had their accounts active in various systems and therefore still had access to the systems (year ending 31st March, 2012). It was also noted that Database password parameters were not appropriately set (year ending 31st March, 2013). The system access rights were also noted to have been granted to many employees more so in requisition of technical spare parts. This exposes the company to

fraud and subsequent loss of the assets. Issues of weak information system have been recurring over the period under review.

22. **Ticket Overpricing and Competition**

Although ticketing is a core revenue earner for an airline, the Committee observed that KQ has overpriced its tickets and has lost many potential passengers institutionally and individually to other airlines particularly Ethiopian Airline.

23. **Tax Burden**

The taxation Burden incurred by the Airline contributed to a massive loss. In May 2014, the VAT (Amendment) Act 2014 was implemented. This had an impact on the planes that had earlier on been exempted from VAT. The amendment as well provided for VAT on spare engines of the aircrafts. This substantially increased the costs of importing the aircrafts. In addition, the burden was likely passed to the passengers in form of pricier airline tickets. The Committee observed that Tax issues have been recurring prompting KQ to seek waivers over tax penalties and interest charges.

24. **Unsustainable Debt Levels**

It was observed that during the year ending 31st March 2013, the Company acquired 3 borrowing facilities to finance the purchase of 10 Embraer aircrafts and pay for the pre delivery deposits for Embraer's and 9 Boeing 787 Dreamliner aircraft. These credit facilities were part of a larger \$2 billion syndicated aircraft purchase facility with African Export –Import Bank (Afrexim) being the lead arranger (the facility to be provided by a consortium of financiers). The Afrexim-Aircraft loans was reported to be Kshs.37.594 billion which was to accrue an average interest rate of 5.39% for period 2012-2025. The Committee noted that given the current revenue base of KQ, these debt levels are unsustainable.

25. During the planning, development and execution of the “*mawingu*” project the management did not consider risks that could jeopardize the successful implementation of the project. The Committee observed that this was an indication of managerial incompetence.

26. The Committee observed that the success of Kenya Airways as a national airline is intertwined with the broader national goal of creating a regional hub in Nairobi. Therefore, there was need for Kenya Airways, the Kenya Airports Authority and the Kenya Civil Aviation Authority to pool synergies in order to achieve the vision of the aviation industry of building Nairobi as a regional hub.

27. Having gone through the above, the Committee observed that in order to solve the current fiscal crisis in Kenya Airways, there can only be three options for Kenya Airways-

- a) Dissolution of the Company;
- b) Recapitalization of the Company through a rights issue or bringing on board additional stakeholders; or
- c) Sale of the Government's 29% share.

28. The Committee observed that KQ as at 20th November, 2015 had appointed Mckinsey and Company as lead Consultants to ensure the turnaround of the Company within the next 18 months.

Recommendations

1. Given the importance of the KQ to the Kenyan economy, the Committee recommends that the shareholders inject new capital into the airline to facilitate the turnaround of the airline
2. The shareholders should provide a financial bailout in form of equity under the following conditions-
 - a. A reconstitution of the Board of Management by the major shareholders,
 - b. Restructuring and putting into place a management team with sufficient skills and experience in the aviation industry, with an ability to turn around and build the company.
 - c. Hire a new marketing director with proven international experience to turn around its ticketing system and ensure proper accounting of revenue from market sales.

Infusion of capital can only be made upon meeting the conditions stated above. The committee does not recommend any bailout that does not take into full account the above conditions.

3. The shareholders should review and restructure the Board of Directors composition since in the current composition the management team is over represented; this overrepresentation undermines the Board's advisory role.
6. The Auditor General should audit the Accounts of the Airline to ensure that the public funds injected into the airline are prudently used.
7. The Committee recommends that Parliament should review the IFC Act in conjunction with any other relevant international law to establish whether or not the IFC position is tenable, especially in the context where it is currently asking for a position as a member of the Board of Directors of Kenya Airways. The Committee further recommends a review to the Country's engagement with the IFC in view of the fact that they are not accountable to Kenya.
8. National Treasury should initiate the process of providing a favourable tax regime; possible tax breaks for the Kenya Airways as its success is vital to the realization of creation of Nairobi aviation hub.

9. The Committee further recommends that the management team should:
- i) Initiate arbitration alternatives with employees and their unions with the aim of ending the long standing litigation.
 - ii) Apply prudence outsourcing of services without compromising the morale and efficiency of the existing employees.
 - iii) Apply prudence in hedging so as to avoid incurring unnecessary losses.
 - iv) Install a new Management Information System (MIS) in accounting, ticketing, procurement and operations based on latest technology and global best practice.
10. The planning, negotiations and execution of Special Purpose Vehicles (SPVs) should be guided by the principles of transparency, and accountability to ensure that the company gets value for money.
11. Review the Joint Venture with KLM especially on the provisions of code sharing, revenue management and sales tracking to ensure equity in revenue sharing.
12. Whenever it is necessary to foreign workers, Kenya Airways should negotiate with Governments whose nationals are hired to work for KQ. Further KQ should seek exchange programmes from those airlines to benefit from shared experiences and passengers access.
13. The Committee welcomed the Mckinsey initiative and emphasized the importance of taking into account this Report, its observations and recommendations.

