CORPORATE & COMMERCIAL ALERT

2 MARCH 2022

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

FOR MORE INSIGHT INTO OUR EXPERTISE AND SERVICES

IN THIS ISSUE

KENYA

Changing perspective on central bank digital currencies in Kenya

The Central Bank of Kenya (CBK) recently published a discussion paper on the feasibility of a central bank digital currency (CBDC). The CBDC is intended to be a sovereign electronic currency that serves as legal tender and is exchangeable on a one-to-one basis with physical currency. It would essentially be a universally available payment method that appears on the CBK's balance sheet and is an asset to a user who holds it.

The publication of this discussion paper signifies a notable shift in the CBK's approach towards fintech. Only four years ago, in 2018, the CBK cautioned against the use of virtual currency as legal tender and issued a notice to this effect, reasoning that transactions involving virtual currencies were largely untraceable, had highly speculative values, and lacked proper regulation – all of which exposed users to potential risks that the CBK could not prevent.

The effect of this cautionary notice led commercial banks to dissuade customers from buying, trading, and holding virtual currency and, in some instances, led to threats of account closures for customers who created accounts to trade in virtual currency.

A WELCOME SHIFT

The current discussion about a potential CBDC therefore represents a welcome shift in the CBK's perspective and is seen as a positive step towards exploring and addressing the financial needs of an increasingly digital economy. According to the CBK MSME Access to Bank Credit Report (2021), financial inclusion in Kenya was at 83% in 2021, whereas the mobile penetration rate was at 129,1% in 2020, according to the CBK Bank Supervision Annual Report (2020). Additionally, during the COVID-19 pandemic, digital payments in Kenya increased from 55,7% to 79,6% of the share of all financial transactions, and accounted for 81,5% of the value of all financial transactions. As stated in the discussion paper, "*digital platforms have emerged as important financial inclusion tools in Kenya. Considering a CBDC is therefore critical, given that policy choices among central banks should reflect the specific jurisdiction requirements and circumstances at that point in time.*"

Notably, these recent discussions position the CBK alongside the 86% of global central banks that are actively researching the potential for centralised digital currencies. Jurisdictions such as Sweden, Singapore, England, Canada and the Bahamas are currently considering the opportunities and approaches to take in implementing a digital

KENYA

Changing perspective on central bank digital currencies in Kenya

CONTINUED

currency. In Nigeria, the central bank successfully launched a CBDC called eNaira in October 2021. Importantly, Nigeria took four years to implement its currency to ensure that the correct infrastructure and regulation were in place across the entire country prior to the adoption of the CBDC. In its discussion paper, the CBK highlighted the cost of infrastructure and the need for a legal and regulatory framework as some of the challenges involved in implementing a Kenyan CBDC. Given that an effective CBDC will need to be universally accessible, easy to use, and highly inclusive, the CBK is aware that it will need to resolve these challenges to ensure equal access across Kenya. It is arguable and foreseeable that significant investment in Kenya's infrastructure will be required before the CBK can effectively implement a CBDC. Nevertheless, a CBDC provides many opportunities for Kenya in terms of financial stability, payments resilience, enhanced cross-border payments and greater financial inclusion.

The publication of the discussion paper indicates that the CBK is aware of the need to keep up with evolving global digital transformation. Physical currency is becoming less viable and less desirable in a COVID-19 world. In particular, the rise of mobile money payments demonstrates that the *"technology and innovation wave has brought about a paradigm shift in the way money is handled"*. Moreover, the uptake of virtual currencies in Kenya, despite the CBK cautionary notice, indicates that there is an interest in the use of virtual currencies, which the CBK can leverage and cultivate by providing a more accessible and inclusive virtual currency in Kenya. The CBK has invited public discussion on the applicability of a CBDC in Kenya's payments landscape, and provided a list of 12 guidance questions to aid this discussion. To participate in this discussion and review the questions, refer to pages 21 and 22 on the link below:

https://www.centralbank.go.ke/uploads/discussion_papers/CentralBankDigitalCurrency.pdf

NJERI WAGACHA AND
TYLER HAWI AYAH

SOUTH AFRICA

Earn-out to earn big: Understanding earn-out mechanisms

What is an earn-out mechanism?

An "*earn-out*" or "*agterskot*" is a contractual mechanism frequently used in acquisitions where the purchaser and seller agree that a fixed portion of the purchase consideration is payable on the closing of a transaction and a further portion (i.e. the "*earn-out*" amount) is only payable in the future when certain agreed conditions or financial performance thresholds are met.

Earn-outs are commonly used in private equity transactions, to retain and incentivise the management shareholder, and after the closing of a transaction, to ensure that the target continues to be profitable and meets the agreed performance thresholds. In return for meeting the thresholds, the management shareholders are incentivised and "earn" the payment of the deferred consideration. Normally, the parties agree that the better the financial performance or the target, the larger the deferred consideration the seller will receive.

DURATION OF AN EARN-OUT MECHANISM

Earn-outs are mostly dependent on the future performance of the target and the duration varies from transaction to transaction. There are many variables that are considered, such as the complexity of the transaction, the nature of the target's business, or the regulatory environment in which it operates, but ultimately the duration of an earn-out mechanism is dependent on the outcome of the purchaser's risk assessment of the target's financial performance. Generally, the duration of earn-outs range between one and three years. From a purchaser's perspective, if there is uncertainty regarding factors that may negatively impact the future financial performance of the target, the purchaser would try and negotiate a longer earn-out period and vice versa.

CALCULATION OF THE EARN-OUT

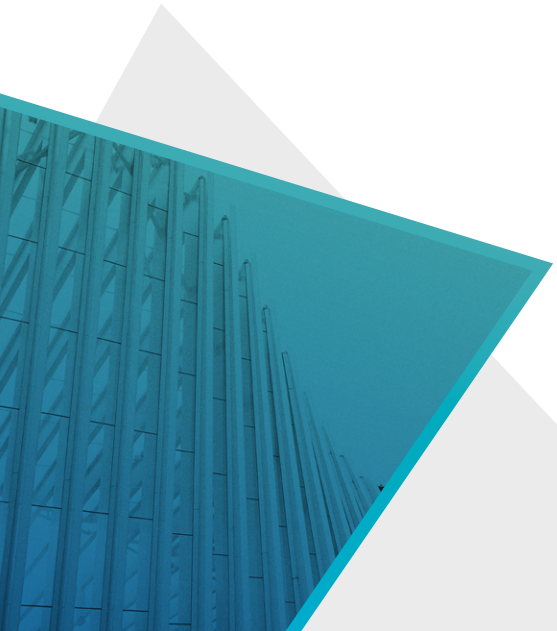
The calculation of the purchase consideration by way of an earn-out mechanism benefits the purchaser, and in most cases, also the seller, as it allows the parties to purchase and sell the target for its true worth. This prevents parties from being overcharged or undercut by one another.

The earn-out will usually be calculated with reference to financial metrics such as the profits, sales, or net asset value of the target. It is critical that these provisions be set out in the sale agreement in sufficient detail, to avoid disputes regarding

SOUTH AFRICA

Earn-out to earn big: Understanding earn-out mechanisms

CONTINUED



the calculation of the earn-out. The parties will typically agree to appoint an auditor or accountant to calculate the earn-out. If, for example, the buyer's auditor calculates and certifies the earn-out, then the seller should be given the opportunity to review the calculation. Where parties fail to agree on the calculation of the deferred consideration, the sale agreement should make provision for such disputes to be referred to an independent expert who will make a fair determination.

ADVANTAGES V DISADVANTAGES OF EARN-OUT MECHANISMS

ADVANTAGES	DISADVANTAGES
The purchaser is effectively transferring the risk of uncertainty associated with the target's future performance, and by doing so, hedging against the risk of overpaying. The seller is similarly avoiding an undervaluation of the target.	It places a burden of risk on the seller to meet performance targets, and a failure to meet these targets can result in the seller not obtaining its desired purchase price.
The purchaser can protect itself against any misrepresentations made by the seller in respect of the projected performance of the target. similarly avoiding an undervaluation of the target.	Earn-outs can be complex in nature and if the parameters of the earn-out are not properly defined in the sale agreement, disputes may occur, which can delay the transaction.
It facilitates and incentivises the retention of the management shareholder and allows the purchaser and seller to partner with each other to improve profitability and performance targets.	It creates an obligation for a seller, who wishes to exit the target, to stay longer to receive the deferred consideration.

DEEPESH DESAI AND TESSA BREWIS

SOUTH AFRICA

A board's discretion to call meetings of shareholders

Under section 61 of the Companies Act 71 of 2008 (Companies Act), only the board of a company, or any other person specified in the company's Memorandum of Incorporation (MOI) or rules, has the power to call a shareholders' meeting. In order to grant shareholders and other stakeholders some power to be able to dictate when a meeting must be held, there are certain circumstances, listed in subsections (2) and (3), under which the board is obligated to hold a meeting. Yet, on closer inspection, this power seems to be somewhat diminished by the lack of wording setting time periods in section 61(3), which enables a board to ignore the call for a meeting from its shareholders. The potential consequences of this drafting loophole are discussed in this article.

Under section 61(2), a company must hold a shareholders' meeting at any time that the board is required (i) by the Companies Act or the MOI to refer a matter to shareholders for decision, (ii) in terms of section 70(3) to fill a vacancy on the board, and (iii) otherwise, in terms of subsection (3) or (7), or by the company's MOI. Subsection (7) speaks to public companies and when the board must convene an annual general meeting of its shareholders, and is irrelevant for this discussion.

Under section 61(3), the board of a company "*must*" call a shareholders' meeting if one or more written and signed demands for such a meeting are delivered to the company. In order to be in the prescribed form, the demand must describe the specific purpose for which the meeting is proposed and in aggregate, demands for substantially the same purpose must be made and signed by the holders of at least 10% of the voting rights entitled to be exercised in relation to the proposed matter to be discussed at the meeting. The exceptions for when a board is not obligated to call a meeting are contained in subsection (5) and (6). These are (i) when the company or any shareholder applies to a court for an order setting aside a demand on certain grounds or (ii) when a shareholder(s) withdraws a demand.

NO TIME FRAME

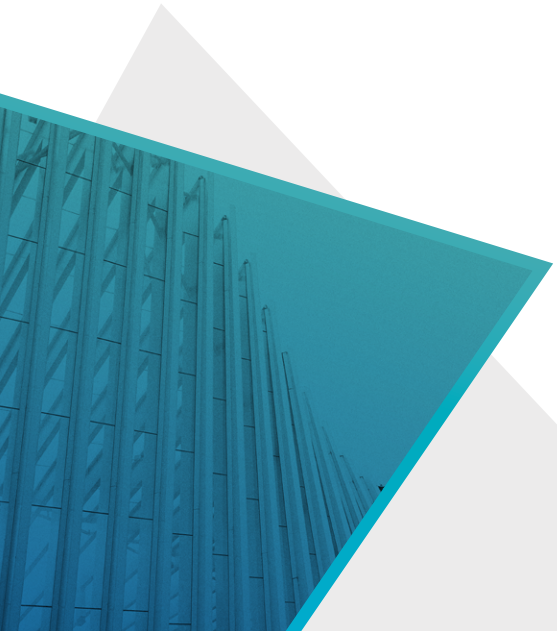
The missing piece in section 61(3) is that the subsection does not prescribe a time period by which a board, which has received a notice in the prescribed form, must call the meeting. In essence, this enables the board, at least for a time, to simply ignore the call for a meeting, and it might be anticipated that the circumstances in which shareholders are requisitioning the board to call a meeting are time-sensitive. In addition, there has been no case law dictating a time by which a board must hold a shareholders' meeting after receiving a requisition notice in the prescribed form.

However, subsection (12) does provide recourse to shareholders by enabling them to approach a court to order the board to call the meeting, which is the only form of relief available to the shareholders if a board does not respond. Unfortunately for anxious shareholders in such circumstances, recent case law and the general common law trend indicates that shareholders will not easily receive any relief from the courts, as courts are loath to interfere in the running of a company. The case of *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) (confirmed on appeal in the Supreme Court of Appeal – 2019 ZASCA 53 (SCA)), highlights the courts' most recent views on this subject. Judge van der Linde opined that the power, conferred on the courts in terms of section 61(12), to direct that a board calls a meeting, is company law contra-intuitive, as the courts generally decline to interfere in the management of company affairs. The judge went further to state that it

SOUTH AFRICA

A board's discretion to call meetings of shareholders

CONTINUED



could hardly have been the intention of the legislature for the court to act as a mere "rubber stamp" and direct a meeting in circumstances where the shareholder has only met the basic requirements for the statutory demand for the meeting. Rather, the intention must thus have been to invoke the oversight role of the court. The judge stated that a court would generally, unless special circumstances required otherwise, have to be satisfied that calling a members' meeting was bona fide intended, with a legitimate purpose, and in the best interests of the company and an applicant for relief would have to put facts before the court that would justify the inference that such thresholds have been met.

A HIGH BAR FOR SHAREHOLDERS

It is obviously problematic for shareholders to go to the effort and cost of engaging in litigation against the board to call a shareholders' meeting. The case law also leaves the board with counterarguments that the shareholders have not exercised their power to requisition a meeting reasonably, in a bona fide manner or in the best interests of the company. While this makes sense in circumstances where shareholders are invoking the requisitioning power improperly to harass the company, it does create a high bar for shareholders to meet, just to hold a meeting.

Perhaps what we can take from section 61 is that the legislature is actually trying to provide maximum flexibility to the board in order for it to run the company in the way and manner it deems fit. After all, in accordance with section 66(1), the business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that the Companies Act or the MOI provides otherwise. The directors are also subject to strict fiduciary duties to conduct themselves in the best interests of the company. In this context, the board is left with broad discretion regarding the timing of the calling of a shareholders' meeting and unless the board is acting obviously irrationally, in bad faith or contrary to the best interests of the company in failing to call the meeting, shareholders will be unlikely to receive any support or intervention from the courts.

DAVID PINNOCK AND
NICOLA STIPINOVICH

OUR TEAM

For more information about our Corporate & Commercial practice and services in South Africa and Kenya, please contact:

Willem Jacobs
Practice Head
Director
Corporate & Commercial
T +27 (0)11 562 1555
M +27 (0)83 326 8971
E willem.jacobs@cdhlegal.com

David Thompson
Deputy Practice Head
Director
Corporate & Commercial
T +27 (0)21 481 6335
M +27 (0)82 882 5655
E david.thompson@cdhlegal.com

Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Roelof Bonnet
Director
T +27 (0)11 562 1226
M +27 (0)83 325 2185
E roelof.bonnet@cdhlegal.com

Tessa Brewis
Director
T +27 (0)21 481 6324
M +27 (0)83 717 9360
E tessa.brewis@cdhlegal.com

Etta Chang
Director
T +27 (0)11 562 1432
M +27 (0)72 879 1281
E etta.chang@cdhlegal.com

Vivien Chaplin
Director
T +27 (0)11 562 1556
M +27 (0)82 411 1305
E vivien.chaplin@cdhlegal.com

Clem Daniel
Director
T +27 (0)11 562 1073
M +27 (0)82 418 5924
E clem.daniel@cdhlegal.com

Jenni Darling
Director
T +27 (0)11 562 1878
M +27 (0)82 826 9055
E jenni.darling@cdhlegal.com

André de Lange
Sector head
Director
Agriculture, Aquaculture
& Fishing Sector
T +27 (0)21 405 6165
M +27 (0)82 781 5858
E andre.delange@cdhlegal.com

John Gillmer
Joint Sector head
Director
Private Equity
T +27 (0)21 405 6004
M +27 (0)82 330 4902
E john.gillmer@cdhlegal.com

Johan Green
Director
T +27 (0)21 405 6200
M +27 (0)73 304 6663
E johan.green@cdhlegal.com

Ian Hayes
Director
T +27 (0)11 562 1593
M +27 (0)83 326 4826
E ian.hayes@cdhlegal.com

Peter Hesseling
Director
T +27 (0)21 405 6009
M +27 (0)82 883 3131
E peter.hesseling@cdhlegal.com

Quintin Honey
Director
T +27 (0)11 562 1166
M +27 (0)83 652 0151
E quintin.honey@cdhlegal.com

Brian Jennings
Director
T +27 (0)11 562 1866
M +27 (0)82 787 9497
E brian.jennings@cdhlegal.com

Rachel Kelly
Director
T +27 (0)11 562 1165
M +27 (0)82 788 0367
E rachel.kelly@cdhlegal.com

Yaniv Kleitman
Director
T +27 (0)11 562 1219
M +27 (0)72 279 1260
E yaniv.kleitman@cdhlegal.com

Justine Krige
Director
T +27 (0)21 481 6379
M +27 (0)82 479 8552
E justine.krige@cdhlegal.com

Johan Latsky
Executive Consultant
T +27 (0)11 562 1149
M +27 (0)82 554 1003
E johan.latsky@cdhlegal.com

Nkcubeko Mbambisa
Director
T +27 (0)21 481 6352
M +27 (0)82 058 4268
E nkcubeko.mbambisa@cdhlegal.com

Nonhla Mchunu
Director
T +27 (0)11 562 1228
M +27 (0)82 314 4297
E nonhla.mchunu@cdhlegal.com

William Midgley
Director
T +27 (0)11 562 1390
M +27 (0)82 904 1772
E william.midgley@cdhlegal.com

Tessmerica Moodley
Director
T +27 (0)21 481 6397
M +27 (0)73 401 2488
E tessmerica.moodley@cdhlegal.com

Anita Moolman
Director
T +27 (0)11 562 1376
M +27 (0)72 252 1079
E anita.moolman@cdhlegal.com

Francis Newham
Executive Consultant
T +27 (0)21 481 6326
M +27 (0)82 458 7728
E francis.newham@cdhlegal.com

OUR TEAM

For more information about our Corporate & Commercial practice and services in South Africa and Kenya, please contact:

Gasant Orrie
Cape Managing Partner
Director
T +27 (0)21 405 6044
M +27 (0)83 282 4550
E gasant.orrie@cdhlegal.com

Verushca Pillay
Director
T +27 (0)11 562 1800
M +27 (0)82 579 5678
E verushca.pillay@cdhlegal.com

David Pinnock
Joint Sector head
Director
Private Equity
T +27 (0)11 562 1400
M +27 (0)83 675 2110
E david.pinnock@cdhlegal.com

Allan Reid
Joint Sector Head
Director
Mining & Minerals
T +27 (0)11 562 1222
M +27 (0)82 854 9687
E allan.reid@cdhlegal.com

Megan Rodgers
Sector Head
Director
Oil & Gas
T +27 (0)21 481 6429
M +27 (0)79 877 8870
E megan.rodgers@cdhlegal.com

Ludwig Smith
Director
T +27 (0)11 562 1500
M +27 (0)79 877 2891
E ludwig.smith@cdhlegal.com

Tamarin Tosen
Director
T +27 (0)11 562 1310
M +27 (0)72 026 3806
E tamarin.tosen@cdhlegal.com

Roxanna Valayathum
Director
T +27 (0)11 562 1122
M +27 (0)72 464 0515
E roxanna.valayathum@cdhlegal.com

Roux van der Merwe
Director
T +27 (0)11 562 1199
M +27 (0)82 559 6406
E roux.vandermerwe@cdhlegal.com

Andrew van Niekerk
Head of Projects & Infrastructure
Director
T +27 (0)21 481 6491
M +27 (0)76 371 3462
E andrew.vanniekerk@cdhlegal.com

Charl Williams
Director
T +27 (0)21 405 6037
M +27 (0)82 829 4175
E charl.williams@cdhlegal.com

Njeri Wagacha
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E njeri.wagacha@cdhlegal.com

Emma Hewitt
Practice Development Director
T +27 (0)11 562 1635
E emma.hewitt@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE
This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196.
Private Bag X40, Benmore, 2010, South Africa.
Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111
E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001.
PO Box 695, Cape Town, 8000, South Africa.
Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388
E ctn@cdhlegal.com

NAIROBI
Merchant Square, 3rd floor, Block D,
Riverside Drive, Nairobi, Kenya.
P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 |
+254 710 560 114
E cdhkenya@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central,
Stellenbosch, 7600.
T +27 (0)21 481 6400
E cdhstellenbosch@cdhlegal.com

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA