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Anticipating and mitigating the legal risks resulting from default on external debt from China.

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Declaration

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by any other person except where due reference is made in the thesis itself.

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Abstract

In the absence of legal provisions anticipating and protecting against the legal risks of default on external debt from China (a non-Paris Club creditor), Kenya remains exposed to insolvency or debt restructuring procedures that are unclear and not standardized. Even though the government is on a strategic move to cover the infrastructure gap in the country, the people of Kenya shall remain constantly confronted with longstanding legal and economic consequences owing to the absence of a regulatory framework that would inform sustainable debt strategies. The following study therefore investigates the legal risks incidental to such debt that Kenya has been procuring through bilateral loans with China despite alternative low-cost concessional finance for the development of critical infrastructure in the country. As such, the study seeks to delineate the parameters and metrics that would inform a legal framework that anticipates and guards against the detrimental effects of such risks, drawing from the principles of traditional lending and debt restructuring under the Paris Club. This is based on analysing the legal risks and weighing them against conventional principles of sovereign debt to examine the magnitude of the risks and possible mitigation through legislative and policy interventions.

Key words: *non-Paris Club creditors, external debt, default, debt restructuring, China debt*

Table of Contents

List of Abbreviations

BRI	Belt and Road Initiative
DSA	Debt Sustainability Analysis
DSSI	Debt Service Suspension Initiative
ECA	Export Credit Agency
HIPC	Highly Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
MDI	Multilateral Debt Initiative
ODA	Official Development Assistance

List of Cases

Alcom Limited v Republic of Columbia [1984] AC 580.

Holland v Lampen Wolfe [2000] 1 WLR 1573, HL.

Isack M'Inanga Kiebia v Isaya Theuri M'Lintari & another [2015] eKLR

Jack Mukhongo Munialo & 12 others v Attorney General & 2 others [2017] eKLR

Njuguna S. Ndungu vs Ethics Anti-Corruption Commission & 3 Others Petition No. 73 of 2014

NML Capital Limited v Republic of Argentina [2011] UKSC 31.

Okiya Omtatah Okoiti & 2 others v Attorney General & 3 others [2014] eKLR

Trendex Trading Corporation v Central Bank of Nigeria [1977] QB 529

List of Statutes

Access to Information Act, 2016

Constitution of Kenya, 2010

Foreign Sovereign Immunity Act, 1976 (United States of America)

Public Finance Management Act, 2012

Public Procurement and Asset Disposal Act, No. 33 of 2015

Sovereign Immunity Act, 1978 (United Kingdom)

Vienna Convention on Succession of States in respect of State Property, Archives and Debts, 1983

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Chapter 1: introduction

1.1 Background to the Study

External debt financing by a state can either be classified by the source of the debt financing or by the type of creditor. Hence, with regard to the source of debt financing, external debt can either be multilateral debt or bilateral debt. Multilateral debt is such debt that is lent to one country by multilateral agencies such as the International monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) among others.[1] Bilateral debt on the other hand, also referred to as official debt, is debt contracted by one sovereign state from another in a manner that directly emanates from inter-governmental credit.[2] This part introduces the factual background and lays the foundation for the entire dissertation. It first introduces the legal power of the state to borrow from external sources, and then provides a snapshot of Kenya's debt situation in light of the growing influence of China's lending to Kenya. Thereafter, it analyses the problem with borrowing from China before providing a brief overview of the current legal framework governing borrowing by the government of Kenya.

1.1.1 The Legal Power of the State to Borrow and Lend

A state enjoys inherent powers to borrow that are subject to constitutional limits. The role of enabling legislation is to establish limits upon which the state may borrow or restrain the purposes for which the state can borrow.[3] It is important to understand that the general conditions and warranties in a loan agreement with a state do not require the state to make warranties as to its financial condition.[4] As such, the state – without appropriate legislative or executive sanctions – is likely to get itself into aggressive borrowing even when it may lack the capacity to sustain debt. Further, it is part of conventional practice that a state would normally include a warranty in a loan agreement confirming that such borrowing is a commercial act of the state. This implies that it foregoes its state immunity with respect to such transaction.[5] This is drawn from the development

[1] Mugasha A, 'Solutions for developing-country external debt: Insolvency or forgiveness' 13(4) *Law and Business Review of the Americas,* 2007.
[2] Paul C. and Montagu, *G. Banking and capital markets companion*, 6th ed, Bloomsbury Professional Limited, 2014, 506.
[3] Paul and Montagu, *Banking and capital markets companion*, 495.
[4] Paul and Montagu, *Banking and capital markets companion*, 496.
[5] Paul and Montagu, *Banking and capital markets companion*, 496.

of a restrictive theory to counter the absolute theory applicable to state immunity prior to the 20th century.[6] This implies – according to the United Kingdom's Sovereign Immunity Act of 1978 - that with respect to its commercial acts, the state neither enjoys immunity from jurisdiction nor immunity from enforcement.[7] In order to protect themselves from the intricacies of domestic laws, the lenders would often prefer foreign governing law as well as foreign jurisdiction with the clauses that relate to the same in the agreement. Hence, the state (borrower) can be sued in foreign courts and the judgment entered against it can be enforced by execution against its property if the state has consented to such enforcement and the asset involved comprises of commercial property that is not used for administration functions of the state.[8]

It is with this warranty that comes the legal risk that the state may not be in a position to sufficiently protects its national assets and natural resources especially if they are the subject of a loan agreement as security. It is also normal for states procuring foreign currency debt to execute negative pledge clauses in respect of their ability to create collateral over the assets that justify its indebtedness.[9] Such an undertaking bears the implication that the state itself or the future generation that shoulders the debt may not benefit from the leverage of its national assets (to procure more debt) before the said debt upon which a negative pledge clause was executed is fully satisfied.

On the other hand, lenders in the global economy have, over time, been classified as the traditional bilateral creditors also known as the Paris Club[10] as well as the emerging non-traditional bilateral creditors who are not members of the Paris Club such as China, the Slovak Republic, South Korea and South Africa, among others. The Paris Club refers to a comprehensive set of rules and procedures that are applied by debtor states and bilateral creditors to defer the former's payment of its external debt obligations that they are unable to meet at the time.[11] These procedures were established with a view to resolving the international debt crisis that shattered confidence in the

[6] *Trendex Trading Corporation v Central Bank of Nigeria [1977] QB 529; Holland v Lampen Wolfe [2000] 1 WLR 1573, HL.*
[7] Paul and Montagu, *Banking and capital markets companion*, 502.
[8] Paul and Montagu, *Banking and capital markets companion*, 499 & 502; *NML Capital Limited v Republic of Argentina* (2011), The United Kingdom Supreme Court.
[9] Paul and Montagu, *Banking and capital markets companion*, 496.
[10] African Legal Support Facility, *Understanding Sovereign Debt Options and Opportunities for Africa,* Africa Legal Support Facility, 2019.
[11] Rieffel, A. 'The role of the Paris Club in managing debt problems,' 1985 *Essays in International Finance* No. 161, 3. -https://ies.princeton.edu/pdf/E161.pdf >- on July 19, 2022.

international financial system in the years between 1978 and 1984.[12] As such, it procedures involve debtor governments negotiating with creditor governments to relieve the debtor governments of the burden of serving outstanding debts in addition to obtaining additional financing.[13] The main participants in the Paris Club and traditional bilateral creditors of the major industrial countries of the West such as the United States, France, Germany, and the United Kingdom among others.[14]

The philosophy of the Paris Club has been centred on long-term debt sustainability of their debtors while keeping an eye on macroeconomic linkages while lending on concessional terms. On the other hand, the non-traditional bilateral creditors take a different approach and philosophy when it comes to lending. Their practice is characterized as follows. First, they are inclined towards providing both concessional and non-concessional financing to borrowers. Second, unlike the traditional bilateral creditors, their focal point is on microeconomic sustainability of individual projects as opposed to the borrower's macro economy. As such, instead of providing the debtor government with direct budget support, these creditors are inclined to lending to certain sectors of the economy, most preferably the infrastructure sector. Third, they take a totally different approach when it comes to conditionality as they prefer upholding the principles of non-interference in the internal affairs of the debtor country.[15]

1.1.2 The Debt Situation in Kenya and the Growing Influence of China's lending to Kenya

Kenya's external debt is cumulatively composed of multilateral debt, bilateral debt (Paris Club and non-Paris Club) as well as private debt. Such debt financing is largely used for infrastructure development while the rest is deployed to social spending, budget financing, as well as potential debt management operations.[16] According to the Central Bank of Kenya, as of June 2021, the composition of the country's external debt has been distributed between 41% being multilateral debt, 28% bilateral debt while 30% accounts for commercial debt.[17] The IMF in 2021 reported that

[12] Rieffel, A. 'The role of the Paris Club,' 1.
[13] Gueye, C. F., Vaugeois, M., Martin, M. & Johnson, A. Negotiating debt reduction in the HIPC initiative and beyond, (Debt Relief International, 2007).
[14] Gueye, C. F., Vaugeois, M., Martin, M. & Johnson, A. Negotiating debt reduction.
[15] African Legal Support Facility, *Understanding sovereign debt*, 2019.
[16] IMF, *Republic of Kenya, Requests for disbursement under the Rapid Credit Facility – Press release; Staff report; and statement by the executive director for the Republic of Kenya*, 2021, 6.
[17] Njoroge, P. 'Kenya's public debt status presentation to the Senate Committee on Finance and Budget' Central Bank of Kenya, September 2021 – <https://www.centralbank.go.ke/uploads/presentations/1505218058_Presentation%20to%20the%20Senate%20Committee%20on%20Kenya's%20Public%20Debt.pdf > on 28 January 2022.

Kenya's external debt as it stands is deemed to be sustainable in addition to the averment that the country's standard of debt transparency ranks decently high. [18] However, since May, 2020[19] the IMF still warns that the country is still at a high risk of external debt distress as well as a high overall risk of debt distress.[20] A Debt Sustainability Analysis (DSA) conducted by the IMF in 2020 suggests that the seemingly reasonable impression of Kenya's debt outlook remains susceptible to export as well as exchange rate shocks besides other forms of protracted shocks in the economy.[21]

So far, Kenya's gross public debt is reported to have grown from 48.6% of the GDP to approximately 69.7% as of March 2022.[22] This spike in public debt is attributable by the efforts to narrow the infrastructure gap in the country through big infrastructure projects in addition to the effects of the Covid-19 pandemic on the national economy.[23] Since October, 2020, Kenya's debt carrying capacity has been reduced from strong to medium. However, considering that the country continues to maintain its membership in the IMF in good standing and is yet to fall out of the IMF indicates that the country is not in serious economic problems yet. However, this is not a guarantee that such consistent practices might not land the state in crises occasioned by default to external debt procured from non-Paris Club members.

Among other official lenders, China passes as an attractive development partner with governments in developing countries by operating in a manner that sharply contrasts with conventional development partners.[24] This emanates from the observation that financial assistance from China is found to be much faster, more aligned to the needs of the political elite, and are tied to fewer conditions.[25] For instance, compared to the United States of America, China's centralized political system makes it easier to make decisions which are not fettered by a lot of social and political considerations.[26] In the same vein, African leaders also seem to welcome Chinese dent considering

[18] IMF, 'Kenya requests for an extended arrangement under the Extended Credit Facility – Debt sustainability analysis' IMF, 19 March 2021 - < https://www.imf.org/-/media/Files/DSA/external/pubs/ft/dsa/pdf/2021/dsacr2172.ashx > on 28 January 2022.
[19] IMF, *Request for disbursement*.
[20] IMF, 'Kenya requests for an extended Arrangement'.
[21] IMF, 'Kenya requests for an extended Arrangement'.
[22] Benson, E. A. '20 Countries with the highest debt-to GDP ratio in Africa,' March 21, 2022 *Business Insider Africa* -< https://africa.businessinsider.com/local/markets/20-countries-with-the-highest-debt-to-gdp-ratio-in-africa/8qdmrsq > - on July, 19.
[23] IMF, 'Kenya requests for an extended Arrangement'.
[24] Rajah R, Dayant A, and Pryke J, 'Ocean of debt? Belt and Road and debt diplomacy in the Pacific.' *Lowy Institute for International Policy* 2019.
[25] Rajah R, *Ocean of debt,* 2019.
[26] Muekalia, D. J. 'Africa and China's strategic partnership,' 2010 *African Security Studies* Vol. 13(1), 11.

that it is not attached to political conditions or requirements of transparency that are often attached to loans by conventional lenders from the West.[27] Further, the establishment of economic partnerships through Chinese State-Owned Enterprises makes it easier for the government of the People's Republic of China to undertake these commercial arrangements without being set back by standard bureaucracies.[28] According to Central Bank of Kenya data in 2010, China turns out to have overtaken Japan as the leading bilateral lender in Kenya between the year 2011 and 2020. As of June 2020, 67% of the composition of Kenya's bilateral debt was procured from China which is up from 13% in June 2011.[29] Japan's share has therefore dropped from 44% in 2011 to 14% in 2020 and the case has been the same for other bilateral lenders to Kenya such as France. This implies that China has more than triple its share of debt to Kenya within a period that spans less than ten years. As a result, China ranks as the nation's biggest foreign creditor after the World Bank with a greater portion of the debt being invested in the transport sector.[30]

1.1.3 The Problem with Borrowing from China

A study on how China lends indicated that all Chinese sovereign debt contracts from China Exim Bank entered into after 2014 are implemented with binding and unusual confidentiality undertakings that are imposed on the borrower. This requires borrowers to keep all terms, conditions and standards of fees connected to the agreement confidential where disclosure of such information connected to the agreement to any third party shall only be subject to the written consent of the lender.[31] This explains the government of Kenya's refusal to make public the loan contracts surrounding the construction of the Standard Gauge Railway citing non-disclosure clauses in the agreements.[32] In an affidavit sworn by the Principal Secretary for Public Works, Mr.

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[27] Muekalia, D. J. 'Africa and China's strategic partnership,' 11.
[28] Brautigam, D. 'The dragon's gift: The real story of China in Africa,' 2010 *Journal of the Washington Institute of China Studies* Vol. 5(1), 65.
[29]Njoroge P, 'Kenya's public debt status: Presentation to the Senate Committee on Finance and Budget' Central Bank of Kenya, 15 September 2021 - <https://www.centralbank.go.ke/uploads/presentations/1505218058_Presentation%20to%20the%20Senate%20Committee%20on%20Kenya's%20Public%20Debt.pdf > on 15 February 2022, 8.
[30] [30] Faria J, 'Value of Chinese loans to Kenya, by sector 2000-2019,' 19 August 2021 - < https://www.statista.com/statistics/1222346/value-of-chinese-loans-to-kenya-by-sector/> on 3 February 2022.
[31] Gelpern A, *How China Lends*, 24.
[32] Mureithi C. 'Secret contracts show how China structures loans to become Africa's "preferred" lender' Quartz Africa, 9 April 2021 - https://qz.com/africa/1993342/how-china-structures-loans-to-become-africas-preferred-lender/ > on 15 February 2022.

Solomon Kitungu stated that publishing the contents of the contracts were detrimental to an extent that would undermine Kenya's national security and foreign relations with China.[33]

Regarding seniority and security, it is reported that 75% of sovereign debt contracts entered into by China Development Bank as well as 22% of those entered into by China Exim Bank are characterized by security arrangements. This includes minimizing repayment risk by relying on future income as security where all revenues from the associated project are to be deposited in an escrow account.[34] These operate as lender-controlled revenue accounts that Chinese official creditors maintain in order to guarantee repayment of debt. Other contractual arrangements also include restrictions against the debtor from withdrawing funds from specified revenue accounts in the agreement.[35] In addition to lender-controlled revenue accounts, China is also known for practicing collateralized lending through natural resource exports or financing the development of resource-secured infrastructure.[36] In this regard, repayment is not secured through existing assets but through future receivables such as oil, copper, and tobacco among other export revenues.[37]

A significant problem attributable to China's official bilateral loans and one that is at the center of this study is that these contracts are implemented conditional on the 'No Paris Club' clause. With which. Save for a selected few, the loan agreements are reported to commit debtor states to excluding the debt extended to them from any multilateral restructuring processes such as those undertaken by official bilateral creditors in the Paris Club. The aim is to give China more bargaining power in the event of a crisis occasioned by defaults.[38] The 'no-Paris' clauses also bar the borrower from seeking from the lender any comparable terms and conditions that might be available in other agreements with other creditors such as the Paris Club creditors. In contrast, other official creditors do not as a matter of practice include such clauses that bar collective restructuring negotiations in their loan agreements.[39] Finally, with regard to lender discretion,

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[33] Mureithi C, 'Kenya is refusing to releasee the loan contracts for its Chinese-built railway' Quartz Africa, 20 January 2022 - https://qz.com/africa/2115070/kenya-refuses-to-release-contracts-for-china-debt/ > on 15 February 2022.
[34] Gelpern A, *How China Lends*, 26.
[35] Gelpern A, *How China Lends*, 27.
[36] Brautigam, D., Huang, Y. & Acker, K. 'Risky business: New data on Chinese loans and Africa's debt problem,' 2020 *China Africa Research Initiative* Briefing Paper No. 3. - < https://www.econstor.eu/bitstream/10419/248244/1/sais-cari-bp03.pdf > - on July 20, 2022.
[37]Minassian, T. 'Assessing public sector borrowing collateralized on future flow of receivables,' June 11 2003 *International Monetary Fund* -< https://www.imf.org/external/np/fad/2003/061103.pdf> - on July 19, 2020.
[38] Gelpern A, *How China Lends*, 34.
[39] Gelpern A, *How China Lends*, 36.

China – in official bilateral debt agreements from China Development Bank and China Exim Bank retain the right to terminate the loan agreement and seek immediate repayment following political and economic developments directly affecting the lending relationship between China and the debtor country.[40] This is critical because such termination is activated under terms such as the enactment of legislation or policy and regulations that negatively affect China's interests in the debtor country even when the affected interest do not directly relate to the terminated contract.[41]

As a result of not being a member of the Paris Club, lawyers and geostrategic analysists are concerned about China's processes and procedures that follow events of default and renegotiation that remain unclear and without known standards. However, evidence of such procedures may be gathered from the example of the Hambantota Port in Sri Lanka where China's State-Owned-Enterprise (SOE) acquired majority of equity stake of the port after default by the country is already a cause for alarm.[42] In a similar approach, Chinese SOE COSCO Shipping Lines ended up acquiring a majority of stake in the Port of Piraeus amidst Greece's sovereign debt crisis.[43] As such, while the size of bilateral debt from China has been growing in Kenya over the years, the country is faced by a big problem that stems from the oblivion on how the debt would be restructured while the agreements of which the debt is subject limit the country's options for crisis management with effect to complicating debt renegotiation as well.

As such, the distinct approach taken by the non-traditional bilateral creditors such as China raises concerns as regards the resolution of the sovereign debt problem. For instance, China's resistance to the principle of comparability of treatment in the event of default implies that it prefers to address payment difficulties at a bilateral level. This implies that the defaulting debtor country is not likely to benefit from the collective approach that they have conventionally benefited from when dealing with conventional bilateral creditors that are ascribed to a different philosophy within the Paris Club. Although some of the non-traditional lenders are known to participate in the Paris Club on an ad hoc basis, it is reported that they behave differently from the members of the club when it comes to the process of restructuring.

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[40] Gelpern A, *How China Lends*, 37.
[41] Gelpern A, *How China Lends*, 37.
[42] Gelpern A, *How China Lends*, 37.
[43] Brattberg, E., Le Corre, P., Stronski, P. & Waal, T. 'China's influences in Southeastern, Central and Eastern Europe,' 2021 *Varnegie Endowment for International Peace* -< https://carnegieendowment.org/files/202110-Brattberg_et_al_EuropeChina_final.pdf > - on July 19, 2022.

1.1.4 The Current Legal Framework Governing Borrowing by the Government of Kenya

The prevailing legal framework with respect to public finance and the procurement of external debt plays a limited role in anticipating and mitigating risks associated with borrowing from non-traditional official bilateral creditors such as China. Borrowing in Kenya is guided by the principles of public finance enshrined under the Constitution of Kenya, 2010. On the one hand, the constitutional dispensation provides that there shall be openness, accountability and participation in all aspects of public Finance.[44] This is coupled with the provision for the intergenerational equity in the distribution of the burdens and benefits incidental to public borrowing.[45] On the other hand, the Public Finance Management Act, 2012 also makes similar generic provisions as the Constitution when establishing the Public Debt Management Office that sets among other objectives the obligation of the office to minimize the cost of managing public debt while taking risks to account when borrowing over the long-term.[46]

While the Public Finance Management Act also reiterates the constitutional provisions on accountability and transparency in the management of public finances, the Public Procurement and Asset Disposal Act gives prominence to international obligations in such agreements where the provisions of the Act conflict with the country's international obligations including provisions on transparency.[47] As such, the regime does not make anticipate or make specific provisions that anticipate and avert risks incidental to debt procured under peculiar terms (such as strict confidentiality, collateralization, and acceleration clauses with policy influence, among others as seen above) by non-Paris Club members such as China from whose practices and procedures of renegotiation are not standard.

1.2 Statement of the Problem

The extent to which loan agreements for the procurement of external official debt do not require warranties as to the financial position of the borrower country leaves the Government of Kenya at liberty to borrow even when the country may not be in a financial position to do so. Further, the non-disclosure clauses in the debt contracts remove the National Parliament of Kenya and other relevant institutions such as IMF from the realm of oversight over government lending. This

[44] Article 201(a), *Constitution of Kenya, 2010.*
[45] Article 201(c), *Constitution of Kenya, 2010*.
[46] Section 62(3)(a), *Public Finance Management Act,* (Act No. 18 of 2012).
[47] Section 6(1), *Public Procurement and Asset Disposal Act,* (No. 33 of 2015).

exposes the country to the accumulation of unsustainable debt. In the absence of the privilege of state immunity coupled with the absence of the benefit of collective debt restructuring under the Paris Club, the procurement of external official debt from China (a non-Paris Club lender) leaves the country at the risk of being subjected to foreign jurisdiction law of the lenders during enforcement of such debt in the event of default. This leaves Chinese official creditors at liberty to enforce against the Kenya's national and strategic assets as well as resources within and outside the country. The provisions of the Public Procurement and Asset Disposal Act[48] provide that obligations of the state arising from such international agreements shall prevail over the provisions of the domestic law that are inconsistent with such obligations.[49]

Unlike the United Kingdom, Kenya's legal regime does not make legislative provisions with effect to limiting the enforcement of debt over the country's national assets and resources to the written consent of the state. This further exposes the country to legal risks and public debt vulnerabilities incidental to the unpredictable responses by Chinese official creditors to Kenya's default on official loans. The following study, therefore, evaluates the legal risks that can be anticipated from default on the debt contracts involved in procuring external official debt from Chinse official creditors. The study also investigates the role of the current legal framework in anticipating these risks while recommending legislative and policy interventions towards mitigating the said risks while averting their future recurrence.

1.3 Research Objectives

The overall research objective is to establish the impact of legal risks and public debt vulnerabilities facing the government of Kenya in the event of default on external debt from China. This objective shall be realized through the following minor objectives;

a) To investigate the legal risks that may follow possible default in external debt from China
b) To examine the role of the Kenyan legal framework anticipating and mitigating against the legal risks of default on external debt.
c) To establish the utility of conventional principles of sovereign debt in mitigating the legal risks of default on Chinese bilateral debt to Kenya.

[48] Public Procurement and Asset Disposal Act, No. 33 of 2015.
[49] Section 6, *Public Procurement and Asset Disposal Act* (2015).

1.4 Research Question

The following study shall answer the following research question; what legal risks and public debt vulnerabilities do the government of Kenya face in the event of default in external debt from China? This shall be answered by responding to the following minor research questions;

a) What are the legal risks that may follow possible default in external debt from China?
b) What is the role of the Kenyan legal framework anticipating and mitigating against the legal risks of default on external debt?
c) What is the utility of the conventional principles of sovereign debt in mitigating the legal risks of default on Chinese bilateral debt to Kenya?

1.5 Hypothesis

The following study proceeds on this proposition; that the potential default in the burgeoning official bilateral debt from China exposes Kenya to legal risks that the current legal framework neither anticipates nor sufficiently mitigates against.

1.6 Significance and Justification

For any such kind of bilateral loan where, in its representations and warranties, the state must not issue any warranties as to its financial position, it is important that there is a transparent legal framework that acts as a restrictive legislative sanction regulating the conduct of the state when pursuing external debt especially from non-Paris Club lenders. Borrowing under traditional terms within the Paris Club was more transparent where default led to restructuring. However, under non-traditional terms, there is no mechanism of restructuring (less transparent) rather, there is a pattern of capture of national assets and other legal risks. The current legal regime does not anticipate risks incidental to default on external debt procured under non-traditional terms and does not provide mechanism of protecting its national assets from such risks. This study investigates into them to establish the parameters of anticipating and managing such risks. The study is therefore, of great utility for Academics scholars especially those studying debt restructuring. The findings of this studies shall also be essential to legislators and policy makers in the course of developing or ameliorating the prevailing legal framework and financial policies.

1.7 Theoretical Framework

1.7.1 Utilitarian Legal Theory

The utilitarian legal theory is anchored on the proposition that the law ought to be made with the aim of conforming to its most useful social purpose.[50] In this regard, utility with respect to the law is defined in light of the ability of the law to increase and maximize happiness, wealth or justice within the society.[51] According to the utilitarian approach to justice, the value of the law lies with its ability to maximize the average welfare in a society.[52] The main proponents of this theory of the law were Jeremy Bentham and John Stuart Mill. The two advanced this approach as a consequentialist theory by testing justice and the value of the law with reference to its consequences.[53] Hence the expression that the ideal value of the law is to achieve 'the greatest happiness for the greatest number'.[54] As such, there are two variations of the theory. The first variation weighs on whether a proposed action is likely to result in increasing the average welfare in the society. This is referred to as act utilitarianism.[55] On the other hand, the second approach inquiries into what rule is best suited to increase the average welfare in the society. This is referred to as rule utilitarianism.[56] As such, according to the proponents of this theory, it is not enough to look into what is the right act to do or the right rule to follow. Rather, it is better to undertake an act or follow a rule because the resulting consequences are perceived to maximize the average welfare of the society and produce the greatest happiness within a significant portion of the population.

Various scholars have advanced different weaknesses attributable to utilitarianism that expose its weaknesses as a theoretical framework relied on to understand what the law is and its purpose. For instance, utilitarianism has been painted as an inhumane theory for reasons that it encourages the sacrifice of minorities.[57] In other extremes, it has been argued that it has promoted the killing of the innocent and characterized as a mechanism that reduces the value of human life into simplistic

[50] Veitch, S., Christoddoulidis, E. & Goldoni, M. Jurisprudence: Themes and Concepts. 3rd ed. (Routledge, 2018), 230.
[51] Veitch, S., Christoddoulidis, E. & Goldoni, M. Jurisprudence, 231.
[52] Coleman, J. L., Himma, K. E. & Shapiro, S. J. The Oxford handbook of jurisprudence and philosophy of law. (Oxford University Press, 2004).
[53] Zhai, X. & Quinn, M. Bentham's theory of law and public opinion. (Cambridge University Press, 2014).
[54] Zhai, X. & Quinn, M. Bentham's theory of law.
[55] Bales, R. E. Act vs rule utilirarianism. (Standford University, 1968).
[56] Bales, R. E. Act vs rule utilirarianism.
[57] Savulescu, J. 'Consequentialism, reasons, value and justice,' 1998 *Bioethics* Vol. 12(3), 12-235.

calculations.[58] As such the theory has been an easy target for criticisms as the ultimate care about consequences and outcomes, it has been argued, implies de facto discrimination.[59] This is considering that utilitarianism has been used as a premise to approve actions that are wrong and demands that people make excessive levels of sacrifices. Hence, to the extent that utilitarianism lacks a credible theory of value, its critics argue that the theory falls short of the ability to protect the essential interests of individuals while preventing them from engaging in personal pursuits that have meaning to their lives. [60]

The criticisms notwithstanding, scholars such as Tuija Takala have offered clarifications in response to the weaknesses that have been raised against utilitarianism. For instance, the author argues that utilitarianism is only demonized when the ethical doctrine of utilitarianism is applied interchangeably with ethics.[61] Hence, she promotes the idea of confining ourselves to the negative utilitarian rule that is aimed at minimizing suffering.[62] As such, utilitarianism should afforded a chance for the sake of the greatest happiness of the greatest number. Regarding the criticisms pointing to the fact that utilitarianism lacks a credible theory of value, it is argued that it is sufficient for an act to be good as long as it produces goods with regard to those that are impacted by it.[63] Hence, the more the good is promoted, the better.

The utilitarian legal theory is essential for this study in for the following reasons. First, it informs the perspectives through which the study shall critically evaluate Kenya's legal framework on borrowing. This is considering that the study shall subject the legal framework to the test of inquiring the consequences of the existing rules. Further, it shall critically analyse them in light of establishing whether the consequences of following the rules as they are will increase the average welfare in the Kenyan society by causing the greatest happiness to the greatest number. Further, this shall inform the perspective to which new rules that may increase the average welfare are suggested. Further, the theory shall be essential in light of evaluating the legal risks incidental to

[58] Westerman, P. 'The moralist. A conversation with John Harris about bioethics,' 2005 *Netherlands Journal of Legal Philosophy* -< https://www.bjutijdschriften.nl/tijdschrift/rechtsfilosofieentheorie/2005/1/RenR_2005_035_001_004.pdf >- on 11 August, 2022.
[59] Singer, P. 'Utility and the survival lottery,' 1977 *Philosophy* Vol. 52.
[60] Scarre, G. Utilitarianism. (Routledge, 1996), 152.
[61] Takala, T. 'Utilitarianism shot down by its own men?' 2003 *Cambridge Quarterly of Healthcare Ethics* Vol 12(4).
[62] Hayry, M. Liberal Utilitarianism and Applied Ethics. (Routledge, 1994).
[63] Bentham, J. An Introduction to Morals and Legislation. (Methuen, 1982).

Chinese contracts as the study's approach investigates Chinese lending practices from a consequentialist perspective. As such, it guides the approach to which the study shall analyse and suggest actions that are essential for state agencies and officers to take during pre-contractual stages of obtaining Chinese debt with a view to mitigating against negative consequences while maximizing the happiness of the greater number of Kenyan tax payers.

1.7.2 Relational Contract Theory

The overriding averment of the relational contract theory is that various transactions are often undertaken based on underlying relationships between parties and not necessarily based on discrete transactional environment.[64] Owing to this nature of the contracts, interventions related to breach of and litigation over such agreements include adjustment by the parties through social and political processes that are distinct from the positive mechanisms and instruments of the state.[65] As such, the norms that govern parties in relational contracts emerge as a form of 'internal law' between the parties which develops from the nature of the arrangements that the parties have had as well as the patterns of interaction that have been manifest in their relationships and not from the rules of conventional law.

Therefore, such technical rules and formal laws are only external to the parties. This implies that relational contracts cannot be described in conventional terms that described an ordinary contract. Relationists therefore, point to the existence of a relational gap in relational contracts that exists as a result of the distance between the doctrinal law and the law in action within the conventional contract.[66] According to them, relational contracts are incomplete in nature as they do not comprehensively specify the obligations of the parties with the effect of leaving more room for vast interpretation. This is attributable to the implicit understandings that exists between the parties owing to the underlying relationship that has existed between the parties over time.[67]

This theory is essential for the study of exchange relationships and is critical for this research to examine how contractual decisions with respect to government borrowing in Kenya are reached

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[64] Palzer KA, 'Relational contract theory and sovereign debt' 8(3) *North-western Journal of International Law & Business* 1988, 728.
[65] Schwartz A, 'Relational contracts in the courts: An analysis of incomplete agreements and judicial strategies' 21(2) *The Journal of Legal Studies,* 1992, 271-318.
[66] Collins H, 'Introduction: The research agenda of implicit dimensions of contracts,' in Campbell D, Collins H and Wightman J, *Implicit dimensions of contract: discrete, relational and network contracts,* Hart Publishing, 2003, 18.
[67] Wessel J, 'Relational contract theory and treaty interpretation: End-game treaties v Dynamic obligations' 60(149) *NYU Annual Survey of American Law,* 2004.

and expressed. This is based on the appreciation that the contractual arrangements between the government of Kenya to procure external debt from non-Paris club states such as China cannot be perceived as mere contractual transactions in the strict sense. While customary practice makes it clear how members of the Paris club deal with default in external public debt, the events that follow default in debt from non-Paris Club lenders such as China are still unclear. In the spirit of the relational contract theory, this research shall undertake a comparative study to establish the pattern of interaction between China and its debtors who have previously defaulted in its debt to pre-empt the consequential legal risks that Kenya should anticipate with respect to its present debt and establish how the country may protect itself or mitigate such legal risks in its future interactions with non-Paris club lenders.

1.8 Literature Review

Different scholars have over the years commented and analysed the development of the law in the aspects of debt finance as well as the concerns about recent relations between China and developing economies. So far, very limited literature exists on the legal risks resulting from default on external debt from non-Paris Club creditors. Even so, the following part reviews some of the literary works applicable in this area with respect to pointing out the gaps that this study is going to fill in its contribution to knowledge in this area of study. This shall be in light of explaining shading light on the legal risks incidental to non-traditional lending practices and the role of the law and regulation in protecting against and mitigating risks.

1.8.1 The Nature of Chinese Debt

Scholars such as **Roland Rajah**, **Alexandre Dayant**, and **Jonathan Pryke** in '***Ocean of debt? Belt and Road and debt diplomacy in the Pacific,'* 2019** invoke address concerns that the non-concessional aspects of foreign loans from China have raised questions as to whether the country is leading a debt traps diplomacy across the economies of developing countries.[68] However, their empirical study finds that there is no evidence to demonstrate that China has been engaged in a deliberate debt trap diplomacy. However, they suggest that these concerns would be addressed when China adopts formal rules that emulate multilateral development banks to create some transparency and legitimate expectation in the king of arrangements that they have. However, they

[68] Rajah R, Dayant A, and Pryke J, 'Ocean of debt? Belt and Road and debt diplomacy in the Pacific.' *Lowy Institute for International Policy* 2019.

fail to appreciate that the victims of debt distress who are the citizens of these debtor countries continue to shoulder the burden of repaying debt and if this approach was accurate, would continue to remain at the mercy of China deciding to come up with rules, when the former could as well legislate on a framework that would protect them from risks of default in Chinese debt. As **Were** agrees, the debt trap narrative is a mechanism that downplays the ability of African governments[69] to come up with substantive legal and regulatory frameworks such as this study is trying to drive to delineate the parameters of protection against legal risks.

According to **Nishan de Mel** in ***'Financing Structure: The (non) Concessionality of concessional loans,'* 2020**, the Concessionality of a loan is measured by measuring its Grant Element (GE) and Tied Element (TE) before using quantitative methods to establish the concessional threshold of such loans. When measuring the grant element of foreign loans between 2005 and 2019, China ranked lowest registering an average grant element of 31% compared to the overall average of 41% while countries like Japan recorded an average grant element of 68%.[70] It was therefore established that the Concessionality of a foreign loan would be eroded when their Tied Elements are taken into consideration. The TE of a loan in this regard refers to aspects of the debt that by law or by fact are tied to the procurement of goods and or services from contractors linked to the debtor country. The TE has the effect of eroding Concessionality because factors in hidden costs that are not considered when measuring the GE. These hidden costs are attributable to aspects of the loan that prevent competitive bidding coupled with increased risks of costs escalation resulting in an adverse arrangement that is no longer concessional as would have been originally anticipated. As such, there is empirical evidence to establish that the unfavourable procurement terms and methods incidental to bilateral loans erode the favourable financial terms that are apparent at the face of it. Hence, in the period between 2005 and 2019, China recorded the highest number of tied loans 18 out of a total of 28 loans 12 of which originated from unsolicited proposals. Hence, the average tied element of foreign loans from China was 99%. Therefore, loans from China might be characterised by grant elements that make them concessional. However, this

[69] Were A, 'Debt trap? Chinese loans and Africa's development options.' 66 *South African Institute of International Affairs* 2018.

[70] Nishan de Mel, 'Financing Infrastructure: The (non) concessionality of concessional loans,' Verite Research Institutional Knowledge Repository, 10 September 2020, - < https://archive.veriteresearch.org/xmlui/bitstream/handle/123456789/3035/20200910EconConcessionalLoansSeminarNishanF.pdf?sequence=1&isAllowed=y > on 1 February 2022.

ceases to be the case when the grant element equals the cost escalation on the tied element. Hence, it was concluded that loans from China are at more risk of being non-concessional.

In order to build up on these empirical findings, the following study establishes the legal risks incidental to such external loans and investigates the metrics of a legal framework that would strike a balance between the tied element and the grant element of the bilateral loans that Kenya procures. Hence, it discusses these parameters in the context of a legal framework considering that the country's popular constitutionalism and the place of the people as the sovereign in the Kenya democracy would require an input of their risk tolerance while legislating a regulatory framework. Hence, the framework would reflect the portion of the tied element and grant elements that the people would tolerate beyond which such would be eligible to be rendered odious.

1.8.2 The Effects of Unregulated External Borrowing from Non-Paris Club Creditors

Marco Armone and **Andrea Presbitero** in '***Debt relief initiatives: policy design and outcomes,'* 2016** make the following observations. That when establishing debt relief initiatives, policy makers often work on account that large external debt operates as an obstacle to the processes of development in relatively poor economies.[71] The authors' account for this position is based on the debt overhang effect; an instance in which a creditor does not expect to be fully repaid owing to the existence of a large stock of debt accrued by their debtor.[72] According to the authors, this effect forces the government to resort to detrimental macroeconomic policies resulting in the inflation of tax and increased uncertainty among other austerity measures. Further, they observe that excessive external debt is likely to yield capital flights from the country, increase in tax rates and pre-empt continuous borrowing with a detrimental effect on growth. It is against this background that they invoke concerns that payment of interests in external debt is likely to crowd out public investment with the effect of cessation of the development of infrastructures and diminished allocation of resources to health and education.

According to the ***UN Expert on the Effects of Foreign Debt*** the Paris Club represents an informal organization voluntarily joined by creditors from industrial countries that has played a key role in the restructuring of debt.[73] In the absence of an official international framework for debt relief, the

[71] Arnone M and Presbitero AF, Debt relief initiatives: policy design and outcomes, Routledge, 2016, 115.
[72] Arnone, M. and Presbitero AF, *Debt relief initiative,* 116.
[73] [73] United Nations, 'Effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights,' 2021 *Report of the Independent*

Paris Club has so far played a critical role in undertaking processes essential in preventing and resolving debt crises through collective relief initiated by various official creditors. Despite its plausible role, the UN Independent Expert reported that the Paris Club's policies are more inclined towards protecting the interests and needs of creditors as well as creditor-dominated institutions. The independent Expert noted that between 1950 and 2010, out of the 600 cases of sovereign debt restructuring, majority of the restructured debts have failed restore the sustainability and confidence of the debtors involved. As such, it might be too soon to perceive the Paris Club as the perfect mechanism for collective debt relief especially for low-income countries. It is for these reasons that the Independent Expert recommends reforms on the global debt architecture with emphasis on human rights taking a central place.[74]

As such, while agreeing to the sentiments of the two authors, the following study places prominence on the essence of regulating the procurement of non-concessional sovereign debt. That a regulatory concessionality framework is one of the mechanisms that would go away to limiting the tied effects that are applicable to bilateral loans that the national government takes out towards infrastructure development. It would be anticipated that a concessionality framework would limit the chances of the state finding itself into a debt overhang as it would avert the possibility of procuring excessive debt with less concessional terms that would result in difficulty in repayment.

1.8.3 The Place of Substantive Law and Regulations in the Global Financial Markets.

Contrary to common belief, **Titto Cordella, Antonio Ricci** and **Marta Ruiz-Arranz** in ***'Debt overhang or debt irrelevance,'* 2010** observe that there is still evidence that countries with good policies and institutions still depict evidence of debt overhang.[75] That debt overhang is apparent in various economies especially where debt comprises at least 25% of the GDP. However, they observe that debt starts to become irrelevant when it hits above 80% of the GDP. In another twist, they find in their empirical study that there is weaker evidence of debt overhang in countries that have bad policies.[76] These findings are made in light of establishing the finding that debt relief

Expert A/76/167 - < https://documents-dds-ny.un.org/doc/UNDOC/GEN/N21/194/50/PDF/N2119450.pdf?OpenElement>- on 13 August, 2022.

[74] United Nations, 'Towards global fiscal architecture using human rights lens,' 2022 *Independent Expert on the effects of foreign debt* -< https://documents-dds-ny.un.org/doc/UNDOC/GEN/N22/427/11/PDF/N2242711.pdf?OpenElement >- on 13 August, 20222.

[75] Cordella T, Ricci LA, and Arranz M, 'Debt overhang or debt irrelevance.' IMF, 57, 2010.

[76] Cordella T, Ricci LA, and Arranz M, 'Debt overhang or debt irrelevance'.

might not be the best approach to mitigate debt at all levels. However, there is no such direct link between the good or bad policies and the nature of debt overhang in the respective countries. That is why **Anna Gelpern**[77] in ***'Odious, Not Debt'*** **2007** notes and appreciates, as this study does, that the prevailing complexity incidental to state obligations and official sovereign debt is one factor that the corporate sector has dealt with while it is yet to be responded to when it comes sovereign debt in terms of having clear substantive law and regulations.

Alastair Hudson in ***The Law of Finance, 2013*** appreciates that substantive law, therefore, works in a positive sense to the extent that it requires obedience to rules. However, he also notes that substantive law may at times be detached from the realities of the financial markets.[78] He, therefore, notes that the common objective between substantive law and financial regulation lies with their common concern with the attribution of risks between parties. An overlap is also manifest between the two. For example, there are instances in which judges have relied on the principles of financial regulation to measure liability in a range of substantive law claims that have been presented before them. This depicts the same way in which high-level principles of financial law regulation should be construed in a manner that mirrors substantive law doctrines. As such according to him, the nature of the law is that it is concerned with the establishment of liability and compensation. Financial regulation on the other hand is concerned with ensuring the smooth functioning of the financial system in a manner that can instil confidence in investors and other key players.

Hence, the objectives of financial regulation. According to Hudson, the scope of financial regulation exists beyond a mere coercive-regulatory dimension to include an economic dimension, and educational dimension and an ethical dimension.[79] The objectives of the law and regulation, however he observes, coincide and overlap when it comes to the allocation of risk between contracting parties. When it comes to the conduct of contracting parties, the role of regulation is to ensure that the common law principle that the buyer is aware. Hence, as the contract itself allocates various risks among the parties as would be enforced through substantive law, regulation serves to ensure that the parties make informed decisions as regards the risks that are left open.

[77] Gelpern A, 'Odious debts and state corruption' 70((3) *Law and Contemporary Problems*, 2007.
[78] Hudson A, 'Substantive law and financial regulation,' in Hudson A, *The Law of Finance*, Sweet & Maxwell, 2013, 54.
[79] Hudson A, 'Substantive law and financial regulation', 54.

It is in the line of this dimensions that the following study seeks to explore the scope of a regulatory framework applicable to state agencies and the government generally. A coercive-regulatory dimension that covers the scope of ensuring that state agents and agencies can be held liable for decisions made in the procurement of external debt. Further, that the regulatory framework is founded on an economic dimension that ensuring that bilateral loans are more market driven than strategic; an educational dimension that ensures that the greater public understands the nature and implication of bilateral loans especially as regards the scope of Concessionality; and the ethical dimension that ensures that certain ethical foundations and concerns are set in place to deal with irregularities that mar bilateral loans. That even though the contractual terms themselves distribute risks to the various parties, while leaving other risks uncovered, the buyer is still protected because regulations enables them to assume these risks from an informed perspective. In this regard, the regulation is meant to shield the buyer from its own lack of expertise that might cause them to make a decision that is detrimental to them.

1.8.4 The Gap in Literature

Existing literature on the nature of debt from China predominantly focuses on the risk that Chinese debt is advanced based on an underlying debt trap diplomacy. Even though various works have been published to refute this claim, there scholars keen on investigating the legal risks incidental to Chinese debt are yet to deeply explore other risks especially those that emanate from debt contracts. This is essential as the identification of these risks leads to identification of the legal parameters that national legislation must address to anticipate and mitigate these risks. More work has also been done in highlighting the effects of unregulated government borrowing which results in austerity measures, capital flights and diminished allocation of resources to health and education and other socio-economic priorities. Even so, these effects are only reflective of outcomes that have been recorded as a result of default of external debt from conventional lenders. However, considering that the effects of default on Chinese debt (a non-conventional lender) are yet to be experienced in Africa, it is essential to examine their lending patterns and establish the kind of effects to anticipate and mitigating measures that can be taken with respect to the same. The following study, therefore, examines these risks and the effects that are likely to emanate from them in order to inform the metrics of a domestic legal framework that anticipates and mitigates the same.

1.9 Methodology

The most appropriate methodology to answer the posited research question that this study shall be undertaken by way of doctrinal study. The following study shall generate data through examining documentary sources which include primary legal sources such as cases, legislation, case reports, articles, and policy documents. From these sources, the study intends to adduce the evidence of policy directions and the legislative intent regarding the regulation of the procurement of external debt in Kenya, as well as providing an understanding of the best practices as well as the shortcomings of the domestic and international legal system in addition to establishing the trends that inform the agenda for change with respect to averting the submergence of economies into debt crises.

1.9.1 Limitation of the Study

While this study is focused on pre-empting the legal risks that are likely to arise from Chinse debt contracts in Kenya, the main data that informs the findings of the study shall be obtained from secondary sources. These include sources that have investigated other Chinese contracts with other developing countries. The risks drawn by the study, therefore, are not directly based on contracts entered between Chinese official creditors and the government of Kenya. This is considering that these debt contracts have not been availed as documents of public record for open scrutiny. Even though this might affect the accuracy of the findings of the study, the collection of data shall be limited to debt contracts that Chinese official creditors have entered with countries that have similar characteristics as Kenya. These include developing countries in sub-Saharan Africa, Asia and generally the global south. This is pursuant to an attempt to limit the inaccuracies that may result from inferring risks from non-Kenyan contracts.

1.10 Chapter Outline

Chapter 1 is an introductory chapter introduced Kenya's debt profile and placed the debt to China in by providing a factual background to that effect that leads to the problem statement. This chapter also states the research objectives and research questions in light of the problem statement before stating the hypothesis that shall be tested. The chapter further proceeds to provide a justification of the study and also provides and comprehensive literature and theoretical framework. Finally, the chapter also provides a brief outline of the preferred research method that shall achieve the objectives of the study and answer the research questions.

Chapter 2 shall present the legal risks incidental to non-concessional financing from Chinese debt based on the following approach. The chapter initially provides a brief of the nature of non-concessional financing from China and its implications. Following this, it proceeds to highlight the legal challenges resulting from Chinese lending patters in form of. This shall be achieved by reviewing specific contractual clauses that are common in loan agreements for financing issued by Chinese official creditors. The course of the discussion shall then demonstrate the nature of the legal challenges emanating from these contractual clauses while assessing the impacts and consequences they are likely to have with respect to the debt crisis in Africa and generally on the global financial architecture.

Chapter 3 shall undertake a critical analysis of the role of the Kenyan legal framework on government borrowing protects the country from the risks emanating from default on external debt. The analysis shall be conducted based on a thematic approach that distinguishes the legal framework into sovereign immunity laws and democratic accountability laws. Under the former, it shall establish the extent to which the Constitution of Kenya, 2010, the Privileges and Immunities Act, as well as case law provides for protection against legal risks that emanate from default on public external debt. This shall be followed by a review of constitutional provisions, the provisions of the Public Finance Management Act, and the Medium Term Debt Strategy 2022 to establish the extent to which these instruments provide for the protection against legal risks that emanate from default on public debt with respect to democratic accountability.

Chapter 4 shall analyse the legal risks of China's bilateral debt to Kenya in light of key principles that are essential in understanding the risks that underlie default in sovereign debt. First, it examines Kenya's situation in light of China's reluctance to participate in collective debt relief and how this affects Kenya's relations with other bilateral creditors when it comes to the effect of the principle of comparability of treatment. Second, it examines the nature of the risk of policy influence by China over Kenya in light of debunking the Chinese school of relational theory of international relations. Third, it demonstrates the extent to which the collateralization of Chinese bilateral debt contracts affects debt-trap policy claim that various scholars have attempted to debunk. Finally, it examines the international law doctrine of odious debt in light of the problem of a moral hazard incidental to Kenya's unstructured legal and institutional framework.

Chapter 5 - Conclusion and Recommendations. This chapter summarizes the findings of the study with respect to each chapter by demonstrating the extent to which the respective chapters have met the objectives of the study and responded to the research questions. It further proceeds to highlight recommendations in light of the conclusions.

Chapter 2:

The Legal Risks of Non-Concessional Financing Through Chinese Debt

2.1 Introduction

The following chapter shall present the legal risks incidental to non-concessional financing from Chinese debt based on the following approach. The chapter initially provides a brief of the nature of non-concessional financing from China and its implications. Following this, it proceeds to highlight the legal challenges resulting from Chinese lending patters in form of. This shall be achieved by reviewing specific contractual clauses that are common in loan agreements for financing issued by Chinese official creditors. The course of the discussion shall then demonstrate the nature of the legal challenges emanating from these contractual clauses while assessing the impacts and consequences they are likely to have.

The situation of debt sustainability in various African countries have in recent history benefited from various debt relief initiatives. Major debt reduction initiatives such the Heavily Indebted Poor Countries (HIPC) initiative has benefited countries such as Ghana, Mozambique, and Congo among others.[80] However, recent debt accumulation patterns, characterized by the accumulation of non-concessional lenders such as China threaten to render such steps towards debt sustainability a zero sum game. In addition to cancelling the effect of debt relief, non-concessional terms under which Chinese official creditors lend also threaten to give Chinese debt more superiority compared to other official debt with the possibility of putting African countries in compromising relations with other official creditors; especially from the West. Not only are the commercial costs incidental to such debts higher, but also the political costs.

Being the world's largest official creditor,[81] it is not possible to ignore the implications of Chinese debt and its contribution to the Debt crisis in Africa. Any attempts to iterate the global financial architecture in response to the global scale debt crisis must therefore be based on careful monitoring of the Chinese lending patterns and the legal risks incidental to them. In a quest to

[80] International Monetary Fund, 'Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative.' March 23, 2021. Retrieved from: https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/11/Debt-Relief-Under-the-Heavily-Indebted-Poor-Countries-Initiative

[81] Morris, S. 'Testimony on China's lending practices and the international debt architecture,' 2021 *Centre for Global Development* Retrieved from: https://www.cgdev.org/publication/testimony-chinas-lending-practices-and-international-debt-architecture

manage repayment risk, Chinese contracts are implemented with clauses that expose official debtors to a wide range of legal risks discussed in this paper. The legal risks of non-concessional financing arising from Chinese debt have a significant bearing to the debt crisis in Africa and other developing countries in the world today.

2.2 The Nature of Official Non-Concessional Financing

The lending practice adopted by China includes blending commercial and official lending terns coupled with novel non-conventional terms. This approach is meant to maximize its commercial leverage over the sovereign debtor while maintaining priority over other creditors. The concessionality of official debt is determined by measuring its Grant Element (GE) and Tied Element (TE) before using quantitative methods to establish the concessional threshold of the debt. The concessionality of official debt that would ordinarily appear to be concessional is eroded when one keenly evaluates their TE. The TE has the effect of eroding Concessionality because it reveals hidden costs that are not considered when measuring the GE.[82] These hidden costs are attributable to aspects of the loan such as provisions against competitive bidding coupled with increased risks of costs escalation.[83]

All these result in an adverse arrangement that is no longer concessional as would have been originally anticipated. For instance, with regard to procurement procedures, there is empirical evidence to establish that the unfavourable procurement terms and methods incidental to official bilateral loans erode the favourable financial terms that are apparent at the face of it.[84] The TE of a loan in this regard refers to aspects of the debt that by law or by fact are tied to the procurement of goods and or services from contractors linked to the creditor country.[85] When measuring the GE of foreign loans between 2005 and 2019, China ranked lowest registering an average GE of 31% compared to the overall average of 41%.[86] On the other hand, countries such as Japan recorded an

[82] Scott, S. 'A clear, quantitative definition of 'concessional in character' in line with prevailing financial market conditions" 2014 OECD. Retrieved from: https://www.oecd.org/dac/financing-sustainable-development/Presentation%20January%20expert%20group%20concessionality%20NO%20NOTES%20REV%20Simon.pptx

[83] Scott, S. 'A clear, quantitative definition of 'concessional in character'

[84] Kitili, A. "Debt Concessionality.' 2006 *Fourth Meeting of the Advisory Expert Group on National Accounts on 30 January – 8 February 2006, Frankfurt.* Retrieved from: https://unstats.un.org/unsd/nationalaccount/aeg/papers/m4DebtConcessionality.PDF

[85] Kitili, A. "Debt Concessionality.' 2006 *Fourth Meeting of the Advisory*

[86] Nishan de Mel, 'Financing Infrastructure: The (non) Concessionality of Concessional Loans' 10 September, 2020. Retrieved from: https://archive.veriteresearch.org/xmlui/bitstream/handle/123456789/3035/20200910EconConcessionalLoansSeminarNishanF.pdf?sequence=1&isAllowed=y

average GE of 68%.[87] In this period between 2005 and 2019, China recorded the highest number of tied loans, that is, 18 out of a total of 28 loans; 12 of which originated from unsolicited proposals.[88] During this period, the average TE of foreign loans from China was 99%. Therefore, loans from China during this period would be characterised by GEs that make them concessional. However, this ceases to be the case when the TE equals the cost escalation on the TE. Hence, there is a risk that loans from China are at more risk of being non-concessional if not apparently so.

2.3 Legal Risks on Accumulation of Non-Concessional Chinese Debt

The legal risks arising from external debt from China arise in form of pre-contractual and contractual risks that become more apparent after default during enforcement. Hence, management of risk can be approached in light of these two perspectives. As such, the management of the legal risks in possible default on Chinese debt has been difficult due to its unique attributes discussed below.

2.3.1 Chinese 'Opaque' Debt Contracts

One thing that characterizes Chinese official loan agreements for non-concessional financing is that they are implemented with unusual confidentiality clauses that restrain borrowers from revealing the terms, conditions, and sometimes even the existence of the debt.[89] A significant portion of Chinese sovereign debt contracts are implemented with confidentiality clauses which are considered unusual compared to other bilateral official loan agreements.[90] Confidentiality clauses commonly involve promises by multilateral and bilateral creditors not to disclose confidential business information or any other sensitive public information obtained in the course of credit assessment before the loans are issued.[91] In other instances, the utility of confidentiality agreements is limited to guaranteeing that the negotiation of the official credit shall not become public.[92] However, there is an inevitable conflict between confidentiality and the principle of

[87] Nishan de Mel, 'Financing Infrastructure: The (non) Concessionality of Concessional Loans'
[88] Morris, S., Parks, B. and Gardner, A. 'Chinese and World Bank Lending Terms: A Systematic Comparison Across 157 Countries and 15 years.' 2020 *Centre for Global Development* Retrieved from: https://cisp.cachefly.net/assets/articles/attachments/82062_chinese-and-world-bank-lending-terms-systematic-comparison.pdf
[89] Horn, S., Reinhart, C. M. & Trebesch, C. 'China Overseas Lending.' 2021 *Journal of International Economics* Vol. 133. Retrieved from: https://www.sciencedirect.com/science/article/pii/S0022199621001197
[90] Horn, S., Reinhart, C. M. & Trebesch, C. 'China Overseas Lending.'
[91] Schier, H. Towards a Reorganization System for Sovereign Debt: An International Law Perspective. (Martinus Nijhoff Publishers, 2007). P. 225, 226.
[92] Schier, H. Towards a Reorganization System for Sovereign Debt, P. 154, 155.

transparency that pose risks and challenges in Chinese contracts advancing non-concessional funding to Kenya.

Chinese contracts are implemented with confidentiality undertakings on the sovereign borrowers not to disclose the terms and conditions of the agreements. A standard confidential clause in a Chinese contract involves an undertaking by the borrower to keep all terms and conditions as well as all standard of fees applicable in the agreement strictly confidential.[93] As such, the sovereign borrower may only disclose any such contract information and any other dealings in connection with the agreement subject to the consent of the lender save for instances when it is required by the 'applicable law'.[94] In a study conducted in 2021 examining the provisions of at least 100 Chinese debt contracts, it was established that all debt contracts from China Development Bank and 43% of contracts from China Exim Bank were implemented with such confidentiality clauses.[95]

It is important to understand that the procurement of sovereign debt is a commercial act of the state.[96] This is with the implication that the state cedes its privileges incidental to sovereign immunity that would otherwise accrue to it at international law.[97] When it comes to its citizenship and the right to self-determination, the state still owes democratic accountability to the people.[98] The citizens play a critical role in the servicing of sovereign debt since they shoulder the ultimate burden for the repayment of sovereign debt. Therefore, the act of the Kenyan government in entering into bilateral contracts to procure sovereign debt under non-concessional terms, including broad provisions for confidentiality undermines the state's domestic democratic accountability to the people in the following ways.[99]

[93] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA. P. 24.
[94] Gelnpern, et al. (2021). P. 24.
[95] Gelnpern, et al. (2021). P. 22.
[96] Wright, M. L. J. 'The Theory of Sovereign Debt and Default.' 2011*Encyclopedia of Financial Globalization* Retrieved from: http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.642.188&rep=rep1&type=pdf
[97] Wright, M. L. J. 'The Theory of Sovereign Debt and Default.'
[98] Trampusch, C. 'Do Parliaments have Control Over Sovereign Debt Management?' 2019 *West European Politics* Vol. 44(2). P. 229.
[99] Usman, Z. 'What do we know about Chinese lending in Africa?' June 02, 2021, *Carnegie Endowment for International Peace*. https://carnegieendowment.org/2021/06/02/what-do-we-know-about-chinese-lending-in-africa-pub-84648

First, the lack of basic legal and technical facts about the terms and conditions of Chinese non-concessional bilateral loan contracts have implications on inhibiting transparency which is essential for public debt management. The lack of transparency in Chinese contracts, therefore, poses a significant challenge to policymaking initiatives and multilateral surveillance.[100] Lack of access to knowledge of the terms of Chinese loan contracts makes it difficult to establish the debt management problems to which macroeconomic policy-measures are to respond. The Chinese confidentiality clauses are so broad with the scope of information they cover to the extent that limits chances of public scrutiny. Transparency is an essential indicator of high-quality debt management within any national government because it plays a critical role in creating sound microeconomic policies.[101] Any chances of increase in government indebtedness at a very unsustainable rate coupled with the absence of appropriate macroeconomic and regulatory policies spells doom on debt sustainability in Kenya.[102]

Second, the confidentiality clauses also inherently prevent the sovereign debtor from benefiting from debt renegotiation and restructuring and other collective debt relief mechanisms. Ordinarily, debt restructuring, renegotiations and collective debt relief processes are undertaken subject to requirements that the debtor discloses all their public sector financial commitments.[103] For instance, efforts by bondholders to renegotiate Zambia's public debt has been fettered by lack of sufficient information regarding the nature of China's debt to Zambia.[104] As a result, the bondholders have turned down invitations to proceed with renegotiations.[105] Similar incidences among other developing countries in Africa set to default on Chinese debt imply that the continent is likely to plunge into a deeper debt crisis owing to the confidentiality terms incidental to Chinese contracts across the continent. The opaque nature of Chinese contracts therefore continues to bear heavily on the possible debt crisis in Kenya as confidentiality clauses make it difficult to accurately

[100] Reinhart, C. B. 'Key to resolving COVID's global debt crunch: Transparency.' March 4, 2021. *International Monetary Fund* Retrieved from: https://www.imf.org/en/News/Articles/2021/03/12/vc-key-to-resolving-covid-s-global-debt-crunch-transparency
[101] Wheeler, G. Sound Practice in Government Debt Management. (2004, The World Bank). P. 29.
[102] Wheeler, G. Sound Practice in Government Debt Management. .
[103] OECD, 'A "debt standstill" for the poorest countries: How much is at stake?' May 27, 202. OECD. Retrieved from: https://www.oecd.org/coronavirus/policy-responses/a-debt-standstill-for-the-poorest-countries-how-much-is-at-stake-462eabd8/
[104] Nyabiage, J. 'China under pressure to restructure loans to Zambia, analysts say.' September 27, 2020. *South China Morning Post* Retrieved from: https://www.scmp.com/news/china/diplomacy/article/3103231/china-under-pressure-restructure-loans-zambia-analysts-say
[105] Nyabiage, J. 'China under pressure to restructure loans to Zambia.

ascertain the country's debt sustainability when bound by such confidentiality clauses. There is a threat that this is likely to derail efforts on crisis response and fetter recovery from the debt crisis.

Finally, the confidentiality clauses also block other potential creditors from knowing the actual financial position of the sovereign debtor. In the event the borrower procures more official debt, the sovereign borrower remains exposed to more debt distress and increased chances of default. Such lack of transparency could also be used by other official creditors turn down requests to extend credit as the subsequent official creditors are not in the best position to ascertain the former's position when it comes to debt sustainability. Alternatively, such creditors may extend official credit at higher interest rates to manage the risks incidental to such uncertainty.[106]

2.3.2 The Absence of Comparability of Treatment through 'No Paris Club' clauses

Most of the debt from China is procured based on promises by debtor countries that they undertake to renounce multilateral debt restructuring processes, for instance, through 'No Paris Club Clauses.'[107] A 2021 study inquiring into how Chinese official creditors lend revealed that at least 81% China Exim Bank and 43% of China Development Bank debt contracts were implemented with these No Paris Club Clauses (NPCs).[108] These refer to contractual clauses with promises by the parties to keep Chinese debt out of collective restructuring arrangements in the Paris Club of official bilateral creditors or any other collective debt restructuring initiatives.[109] The implication of these clauses is that the sovereign borrowers in this regard undertake not to seek from Chinese official creditors any comparable treatment, terms or conditions reflected in agreements by other official creditors.[110] The clauses effectively imply that Chinese official loans rank higher in seniority compared to other official creditors to which the sovereign debtor may be owed. These clauses are complemented by the confidentiality clauses already discussed earlier. The unusual confidential clauses in Chinese debt contracts, thus, limit sovereign borrowers from debt restructuring by forbidding disclosure of the contract terms to Paris Club Creditors.

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[106] Chorzembpa, M. & Mazarei, A. 'Improving China's Participation in Resolving Developing-Country Debt Problems.' May 2021 *Peterson Institute for International Economics* Retrieved from: https://www.piie.com/sites/default/files/documents/pb21-10.pdf

[107] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA. P.28.

[108] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends P. 35.

[109] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends P.8.

[110] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends P. 34.

Comparability of treatment is a core pillar in international financial architecture recognized as part of the six key Paris Club principles. Its utility in the international sovereign debt markets has been associated with coming to the aid of countries in distress. In the event of distress, it enables a debtor state to obtain comparable relief from its various creditors (participating in the Agreed Minutes) to whom it owes significant debt-servicing obligations.[111] It is only multilateral creditors that have conventionally been excluded from the application of comparable treatment principle before Chinese official bilateral creditors joined it. The NPC clauses are dismissive of the principle of comparability of treatment clauses that are prominent in the Paris Club's agreed minutes to an extent that might require debtors to act in a manner that is averse to the interests of the Paris Club Creditors. This is considering that the Agreed Minutes establishing the principle often entail a most-favoured nation (MFN) clause. The MFN clause imposes an obligation on the debtor not to accord creditors not participating in the Agreed Minutes more favourable treatment than is accorded to the Paris Club of creditors.[112] However, the NPC clauses are drafted in such a way that their construction leaves the debtor with no option than to violate their MFN obligations that accrue to the Agreed Minutes of the Paris Club of official creditors contrary to the comparability of treatment principle.

In managing their repayment risks, Chinese creditors force sovereign debtors to jeopardize their relationships with official creditors that participate in the Paris Club in a manner that is detrimental to the debtor's future interests. This could also be with implications that worsen the situation when the debtor is in a debt crisis and intends to restructure and renegotiate its debt with participating creditors of the Paris Club. Whether or not the sovereign debtors effectively comply with the principle as established in the Agreed Minutes actually determines and influences the attitude of the creditors in subsequent consolidation and rescheduling by the Paris Club.[113] Therefore, in the quest to satisfying their contractual obligations regarding the repayment of Chinese debt, Kenya puts itself at risk of losing out on the privileges of collective debt relief, restructuring and

[111]Dillion, K. B. 'Comparability of Treatment,' IMF. Retrieved from: https://www.elibrary.imf.org/downloadpdf/books/084/05573-9780939934522-en/ch04.xml P. 17.
[112] Rieffel, A. 'The Role of the Paris Club in Managing Debt Problems,' 1985 *Essays in International Finance* Retrieved from: https://www.piie.com/sites/default/files/documents/pb21-10.pdf
[113] Dillion, K. B. 'Comparability of Treatment,' IMF. P. 17.

rescheduling enjoyed pursuant to consolidation arrangements under the Paris Club of Official Debtors, IMF and other multilateral creditors.[114]

As a matter of practice, Kenya is yet to lose-out on Paris Club relief for lack of comparability of treatment especially with respect to Chinese debt. However, it continues to remain a real risk that could materialize anytime soon and worsen the debt crisis within the continent. In November, 2020, China among other G20 members (who do not participate as creditors in the Paris Club) agreed under the Common Framework to restructure their debt claims while applying the principles of comparability of treatment[115]. In this regard, China committed – under the G20 Common Framework for Debt Treatments beyond the DSSI – that it will leave G20 governments to coordinate all its debt relief terms.[116] However, this was only limited to the debtors who were eligible to be classified as the 'poorest borrowers'.[117] Following the effects of the Covid-19 pandemic, both the Debt Service Suspension Initiative (DSSI) under the IMF as well as the G20 Common Framework relied on a straight-jacket eligibility criteria to establish countries eligible for such relief.

A criteria that has been used previously to respond to liquidity and sustainability problems which is tied to comparability of treatment conditions that do not guarantee write-downs of debt for most of the low-income countries[118]. The UN independent expert in their 2021 report called out the criteria for its obsolescence considering the realization that very many small island states no longer qualify for this debt relief if this outdated and illogical criteria is to be applied.[119] This has had the effect of ignoring the needs of poor people from both middle and high-income countries that could benefit from such relief. It is such premises that inform the need to reform the global debt architecture with human rights taking a central place. A look at a recent turn of events indicates

[114] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 35.
[115] G20-Italy, 'The Common Framework for Debt Treatments beyond the DSSI,' Retrieved from: https://www.mef.gov.it/en/G20-Italy/common-framework.html
[116] World Bank Group and International Monetary Fund Support for Debt Relief Under the Common Framework and Beyond, March 25, 2021. Retrieved from: https://www.devcommittee.org/sites/dc/files/download/Documents/2021-03/DC2021-0002%20Debt%20final.pdf
[117] Braitigam, D. 'Chinese Debt Relief: Fact and Fiction.' April 15, 2020. *The Diplomat* Retrieved from: https://thediplomat.com/2020/04/chinese-debt-relief-fact-and-fiction/
[118] Kring, W. N. 'The failures of the G20 Debt Service Suspension Initiative,' 2021 *East Asia Forum* - < https://www.eastasiaforum.org/2021/09/07/the-failures-of-the-g20s-debt-service-suspension-initiative/ >- on 14 August, 2022.
[119] United Nations, Effects of foreign debt, 2021.

that these restructuring arrangements were in the short term as a result of the effects of the Covid-19 global pandemic. China has since declined requests to extend further debt relief measures to its sovereign borrowers.[120] As a result of such NPC clauses, Kenya risks not availing itself to any debt reduction, renegotiation, restructuring or any other debt relief schemes without compromising its relations with other official creditors.

2.3.3 Policy Influence through Cross-Default, Acceleration and Stabilization Clauses

So far, a review of a few clauses in Chinese debt contracts imply its official creditors going beyond maximizing their commercial advantage. This part proceeds to demonstrate how China seeks political advantage through acceleration, stabilization and cross-default clauses by limiting and influencing the domestic, economic and foreign policies of the sovereign borrower. All in the quest to protect China and its entities against any adversities in the borrower country and in relation to other official creditors.

Official loans procured through China Exim Bank are implemented with cross-default clauses that are conventionally only found in commercial debt contracts. These clauses empower Chinese official creditors to terminate and demand immediate full repayment (acceleration) in the event the sovereign borrower is found to have defaulted on its other official creditors.[121] Cross-default clauses are conventionally used by official creditors to protect their priority in the event the sovereign debtor defaults on other official debts.[122] Chinese debt contracts are, however, strangely unique. The agreements provide for cross-default clauses that are not only triggered by default in another creditor's debt, as has been the conventional objective of such clauses.[123] Instead, they triggered by all events of default covered in the debt contract.[124]The provisions empower China to invoke cross-default clauses in the event it is established that the sovereign borrower perpetrates to undertake any such actions (not related to the contract or the funded project) that contravene Chinese investment interests in that country.[125] As such, the clauses have the implication of

[120] Wheatly, J. 'Chinese loans deter poor nations from seeking relief, says Paris Club Chair,' December 30, 2021 *Financial Times* Retrieved from: https://www.ft.com/content/db7753b7-a2b5-469c-9441-e85afb44ea12
[121] Wheatly, J. 'Chinese loans deter poor nations from seeking relief.
[122] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 37.
[123] Wheatly, J. 'China's secret loan contracts reveal its hold over low-income nations,' March 31, 2021 *Financial Times* Retrieved from: https://www.ft.com/content/7e98795f-159b-4455-903e-6e21c345d4a9
[124] Wheatly, J. 'China's secret loan contracts
[125] Ams, J., Baquir, R., Gelpern, A. & Trebesch, C. Sovereign Default, *IMF*. Retrieved from: https://www.imf.org/-/media/Files/News/Seminars/2018/091318SovDebt-conference/chapter-7-sovereign-default.ashx

empowering the China politically to influence the domestic and foreign policies in Kenya. According to some of the cross-default clauses in contracts issued by China Development Bank, it is enough for the sovereign debtor to perpetrate any actions averse to the interests of an entity in China (not necessarily related to the funded project) to trigger the said clauses.

In other instances, Chinese debt contracts have been found to combine both cross-default and cross-cancellation clauses in the same contract. Conventionally, cross-cancellation clauses are often used by bilateral and multilateral creditors to suspend the flow of finances into failed projects or in the event of poor policy outcomes.[126] However, Chinese official creditors use this contracting tool as a security device for its loans while protecting China's interests in the debtor country. The clauses effectively empower the China (the lender) to stop making disbursements to the sovereign borrower in the event the latter's domestic policies are inconsistent with or adverse to the interests of the former causing deterioration in their relationship.[127] In this regard, today, it might not be possible for Kenya to legislate on new and progressive domestic laws and policies that make it illegal to seize state assets for non-repayment of debt even if it would be in the greater public interest to do so. Such action would automatically trigger the cross-default clauses forcing the country to accelerate payment. With regard to ongoing project, the outcome would be the termination of financial flows into the funding of the projects until the policies are regularized in the interest of China and its entities in the borrower's country.

In the same vein, Chinese debt contracts are also implemented with stabilization clauses aimed at managing the risk of legal and regulatory changes within the sovereign debtor's jurisdiction. In this regard, they provide for economic equilibrium clauses that impose an obligation on the sovereign debtor to compensate Chinese official creditors for the costs they would incur in complying with changes in law.[128] This implies that they leave themselves open to enjoying the advantages of such legal changes that are beneficial to them but exclude themselves from disadvantages incidental to such legal changes. Similarly, with regard to termination, it has been established that a greater portion of Chinese official bilateral loan contracts make provision for

[126] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 38.
[127] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends.
[128] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 40.

clauses that confer the creditor with the right to terminate and demand immediate payment in the event there is significant law or policy changes in the debtor or even the creditor country.[129]

Even though it is not unusual for lenders to seek to influence debtor-policies, however, Chinese debt contract clauses are much broader and threaten to be costly. Compared to other bilateral, multilateral and commercial creditors, Chinese loans are therefore skewed to limit the options that borrowers have at the face of a debt crisis – to rely on policy and legislative interventions to work their way out of the crisis. Instead, it complicate any debt management efforts that could be optimized through various policy and regulatory changes.[130] It is for these reasons that China has been branded 'a muscular and commercial-savvy lender to the developing world.'[131] The official lender maintains the power to terminate and accelerate repayment in the event of policy changes. It also absolves itself from incurring costs that could be incidental to complying to policy changes and maintains the right to terminate the flow of funds at the face of adversity. This is a significant set-back on the manner in which Kenya could effectively legislate on human rights issues and sustainable development without compromising Chinese interests.[132] For instance, when it comes to the impact of projects on environmental and social standards, China is not a member of the Equator Principles that establish principles on environmental and social standards for banks with respect to lending for projects whose value exceed $10 million. [133] As such, if Chinese creditors are to incur additional costs to comply with environmental and social standards when implementing funded projects, the additional costs will be shouldered by the Kenyan government. That is if the lender does not invoke the cross-default and acceleration clauses.

2.3.4 'Cash Collateral' Arrangements, Potential Lawsuits, and Seizure of Strategic Assets

In order to secure debt repayment, Chinese non-concessional finance is collateralized through provision for the establishment of separate (escrow) accounts with the lending Chinese state-owned institution or any other institution that is acceptable to the lender. Collateralization refers to an arrangement with respect to a debt instrument where the creditor maintains certain rights

[129] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends P. 41.
[130] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends P. 41.
[131] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends P. 2.
[132] Bantekas, I. & Lumina, C. Sovereign Debt and Huma Rights. (Oxford University Press, 2018).
[133] Moss, T. & Rose, S. 'China ExIm Bank and Africa: New lending, new challenges,' 2006 *Centre for Global Development* Retrieved from: https://www.files.ethz.ch/isn/38231/2006_11_06.pdf

over identified assets or revenue streams with a view to securing repayment of the debt. [134] Under this arrangement the borrower grants the creditor lien over identified assets. For instance, when it comes to revenue streams, the creditor maintains lien over future receivables from the funded project to secure repayment of the loan.[135] Collateralization is therefore considered standard practice in financing within the private sector for the sake of mitigating the creditor's perceived risks incidental to the borrower or attributable to the nature of the transaction.

The approach to collateralization adopted by the Chinese official creditors involves the creation of escrow accounts with a view to facilitate the debt repayment process from the funded projects.[136] However, they are also established to function as a security for the debt repayment. Pursuant to the debt agreements, the sovereign debtor promises to maintain a minimum account balance that would often represent the annual principal, interest and fees payable under the debt contract.[137] These accounts are to be established under terms that legally empower the bank to offset the account holders' debts against the account balances in a bid to perfect their security interests.[138] The sovereign borrowers therefore undertake as an obligation, to fund these accounts from all the revenue flows from project financed by the debt contract. Sometimes the agreements require the borrower to fund these accounts with cash flows from export revenues and some of the debtor's financial assets – and other sources not related to the financed project – to supplement the project revenues.[139] This, it is argued, could be based on the need to cover for instances when the project revenues are not sufficient to repay the debt for one reason or the other.[140] As if that was not enough, the Chinese official creditors under these arrangements retain the power to block the sovereign lender from withdrawing funds from the revenue accounts especially over a specific

[134] International Monetary Fund, 'Collateralized transactions: Key considerations for public lenders and borrowers.' January 24, 2020. P. 4.
[135] International Monetary Fund, 'Collateralized transactions.
[136] Acker, K., Brautigam, D. & Huang, F. 'Debt Relief with Chinese Characteristics.' 2020 *China Africa Research Initiative* Working Paper No. 39. Retrieved from: https://static1.squarespace.com/static/5652847de4b033f56d2bdc29/t/62130490b56fca3b5d703df8/1645413600581/WP-39-Acker-Brautigam-Huang-Debt-Relief-V5.pdf
[137] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 27.
[138] Lui, K. & Chen, Y. 'The Evolution of China's Lending Practices on the Belt and Road,' November, 2021 *ODI Emerging Analysis* Retrieved from: https://cdn.odi.org/media/documents/The_evolution_of_Chinas_lending_practices_on_the_Belt_and_Road_ODI_template.pdf , P. 17.
[139] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 27.
[140] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends, P. 27.

period (for instance 35 days) preceding repayment date.[141] In the event project revenues are channelled to a Project Trust Account, withdrawals can only be made towards payment of fees, loan repayment as well as project expenses in a specific order of priority prescribed in the contracts.[142]

According to the World Bank and the International Monetary Fund, collateralized financing can only be beneficial to borrowers from developing countries only under very limited circumstances, depending on the legal processes and the institutions of the borrowing country.[143] In their analysis, collateralized financing is more likely to result in beneficial outcomes if, first, the funds are directed to projects that develop assets from which revenue streams can be used for repayment of the debt. Second, the debt contract has to reflect improved financial terms to mitigate the risks resulting from collateralization. Third, it is important that the sovereign borrower passes a debt sustainability assessment. More importantly, the arrangement must be executed under circumstances that embrace full public transparency on all contractual terms besides the requirement that the collateralization complies with any applicable negative pledge clauses.[144]

The World Bank and the International Monetary Fund when advising public lenders and borrowers also warn of certain instances when collateralized financing is more likely to be harmful. They reduce this to three circumstances. First, is when the transaction does not produce an asset or a revenue stream that can be directed to repayment; second is when the nature of the transaction and its volume raises various financing or debt distress concerns. Finally, they also warn that collateralized financing can also be harmful in the even the transaction is not undertaken under adequate transparency and disclosure to the extent that impedes the ability of future creditors to accurately establish risks and lend sustainably.[145]

Even though most of Chinese non-concessional official loans are directed towards financing infrastructure projects, the debt contracts are implemented without full public transparency owing to the unusual confidentiality clauses coupled with poor financial terms. Further, the loans are

[141] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 27.
[142] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends P. 27.
[143] IMF & The World Bank, 'Collateralized Transactions: Key Considerations for Public Lenders and Borrowers, January 24, 2020. Retrieved from:
[144] IMF & The World Bank, 'Collateralized Transactions.
[145] IMF & The World Bank, 'Collateralized Transactions.

often advanced without due regard to the performance of the borrowers' performance on debt sustainability.[146] There have be claims that most debtors to Chinese non-concessional finances are directed to debtors who would most likely fail debt sustainability assessments. Based on this five-tier test, there is a chance that Chinese collateralized non-concessional finances to Kenya are less likely to register beneficial in the long-term. The underlying implication of collateralized financing from Chinese official creditors is that the revenues emanating from the projects remain outside the control of the sovereign debtor's control.

Further, the sovereign lender is also under obligation to deploy part of its public finance to fund these escrow accounts towards repayment of the debts. The discretion to block the sovereign borrower from withdrawing funds from the project revenues account also bears the implication that the Chinese official creditors may prevent the tax payers from enjoying the benefits of the financed projects until the loans are settled. Hence, in addition to the unusual confidentiality clauses that afflict Chinese debt contracts, such financial terms attributable to their collateralized financing almost accurately guarantee that such collateralized non-concessional financing could be harmful to Kenya.

Potential law Suits and Seizure of Strategic Assets

The enrichment of the African continent with natural resources has made it a strategic target for Chinese official non-concessional debt transactions.[147] This is owing to the proposition and perception that countries that have natural resources bear relatively higher debt-servicing capacities.[148] What is key to remember when it comes to natural resources and strategic national assets is that the procurement of sovereign debt is already considered to be a commercial act of the state. This conventionally implies that the state waives its sovereign immunity privileges that traditionally occur in public international law. As such, it is not strange that Chinese loan contracts

[146] Horn, S., Reinhart, C. M. & Trebesch, C. 'Hiden defaults,' 2022 *World Bank Group* Policy Researc Working Paper 9925, 7.
[147] Usman, Z. 'What do we know about Chinese lending in Africa?' June 02, 2021 *Carnegie Endowment for International Peace* Retrieved from: https://carnegieendowment.org/2021/06/02/what-do-we-know-about-chinese-lending-in-africa-pub-84648
[148] Seleshie, L. "Can China and the Paris Club work together in serving Africa?' August 20, 2021 *The African Report* -https://www.theafricareport.com/115591/can-china-and-the-paris-club-work-together-in-serving-africa/ > on June 13, 2022.

contain sovereign immunity waivers.[149] Part of the implications that follow such waivers is that the sovereign borrowers can be subjected to the jurisdiction of foreign domestic courts and in this instance, those of the Chinese official creditors, to enforce debt repayment.[150] While this is in line with ordinary commercial contracts as well as the LMA template, it establishes the foundation of the legal risks that borrowing developing countries are exposed to in light of the tied elements attributable to Chinese non-concessional financing.

When it comes to enforcement of the loan agreements, Chinese lenders such as the Chinese Exim bank elect Chinese domestic law as the governing law and a dispute resolution forum that is also established within the country.[151] For instance, when it comes to arbitration, most of the contracts have been found to specify resolution of contractual disputes China International Economic and Trade Arbitration Commission (CIETAC) pursuant to the procedures established by the Commission. However, in other instances, the parties agree to submit to the procedural rules established by the International Chamber of Commerce based in London. However, it is only some of the loans issued by China Development Bank that elect English or New York law as the governing law coupled with the ICC rules. So far, china has not commenced or continued any lawsuits against its sovereign borrowers. While this could be commendable for the time being, it is still difficult to establish how the terms in Chinese official bilateral loan contracts would be interpreted. Hence, it remains difficult to predict how various clauses detrimental to the borrower would fair during an actual law suit.

Regarding seizure of strategic assets, China has a reputation of writing contracts – through mortgage over assets clauses – that allow it to seize or take control of strategic assets in the event debtor countries default or run into financial problems.[152] There have been resounding disagreements between academic and policy literature regarding the 'debt-trap' myth purporting China's deliberate advancement of sovereign debt to gain strategic advantages including mineral

[149] Pasquet, L. 'Some Considerations on State Immunity and Sovereign Debt,' October 16, 2020. Retrieved from: https://www.afronomicslaw.org/2020/10/16/some-considerations-on-state-immunity-and-sovereign-debt

[150] Brautigam, D. & Kidane, W. 'China, Africa, and Debt Distress: Fact and Fiction About Asset Seizures,' 2020 *China Africa Research Institute* Policy Brief No. 47. Retrieved from: https://www.econstor.eu/bitstream/10419/248226/1/sais-cari-pb47.pdf

[151] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 8.

[152] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends. P. 4.

concessions, ports and other strategic assets.[153] In an attempt to debunk this 'myth', various propositions have been advanced to interpret whether the waiver of sovereign immunity in Chinese debt contracts creates room for China to seize its sovereign debtors' strategic assets. Brautigam and Kidane, argue that there is a difference between waiver of sovereign immunity and waiver of immunity from enforcement.[154] In their argument, waiver of sovereign immunity initially is with respect to lawsuit and arbitration which is different from waiver of immunity from enforcement.[155] In their construction of this waiver, sovereign assets not used for commercial purposes are invariably protected. However, the protection enjoyed by sovereign assets used for commercial purposes depends on the nature of the domestic laws regarding enforcement over foreign assets. For instance, the US adopted a Foreign Sovereign Immunities Act in 1976 formalizing the immunity from lawsuits unless the same is expressly waived.[156]

A review of a number of Chinese debt contracts by the China Africa Research Institute in 2020, it was established that most of the agreements provide for waiver of sovereign immunity with respect to dispute resolution as well as enforcement.[157] Even though Chinese official creditors are yet to be seen to use arbitration courts to enforce against default in loan repayments, previous attempts by other bilateral official creditors to enforce against commercial assets have failed. For instance, in 2004, a successful dispute by a German export credit agency against Zimbabwe's Steel Corporation allowing the former to attach and seize the latter's commercial properties outside the country ended in futility.[158] This suggests the difficulties that official creditors encounter in enforcing favourable awards. This notwithstanding, the risk of enforcement against strategic assets is still very alive. The proposition that such enforcement is difficult is weakened by the limitation that the ability of the Chinese official creditors to enforce against such commercial assets depends

[153] Carmody, P., Taylor, I. & Zajontz, T. 'China's Spatial Fix and 'Debt Diplomacy' in Africa: Constraining Belt or Road to Economic Transformation?' 2022 *Canadian Journal of African Studies* Vol. 56(1). Retrieved from: https://www.tandfonline.com/doi/full/10.1080/00083968.2020.1868014

[154] Brautigam, D. & Kidane, W. 'China, Africa, and Debt Distress: Fact, Fiction about Asset Seizures.' 2020 *China Africa Research Institute* Policy Brief No. 47. Retrieved from: https://static1.squarespace.com/static/5652847de4b033f56d2bdc29/t/5ef387a1b5869d0dd74eee2d/1593018274134/PB+47+-+Brautigam%2C+Kidane+%E2%80%93+Debt+distress%2C+Asset+seizure.pdf P. 2.

[155] Brautigam, D. & Kidane, W. 'China, Africa, and Debt Distress.

[156] Simmons, K. P. "The Foreign Sovereign Immunities Act of 1976: Giving the Plaintiff his Day in Court.' 1977 *Fordham Law Review* Vol. 46(3). Retrieved from: https://core.ac.uk/download/pdf/144223224.pdf

[157] Brautigam, D. & Kidane, W. 'China, Africa, and Debt Distress: Fact, Fiction about Asset Seizures.' 2020 *China Africa Research Institute* Policy Brief No. 47. P. 2.

[158] Brautigam, D. & Kidane, W. 'China, Africa, and Debt Distress.

on the jurisdictional rules of the country where the execution of the judgment is sought.[159] The risk of such seizure is given life by the previously discussed cross-default, cancellation, acceleration and stabilization clauses that inherently limit Chinese sovereign debtors such as Kenya from developing policy or legislating domestic laws that are averse to China's broad interests. This coupled with China being Kenya's largest official creditor implies that it is possible for Chinese creditors to exploit the weak jurisdictional rules in Kenya (as demonstrated in the subsequent chapter) to enforce against commercial and strategic assets. This is considering that they may still rest in the conform of their policy influence that already bars African countries (including Kenya) from ameliorating their national laws to protect against such enforcement for national benefit and for the benefit of other African sovereign debtors.

2.3.5 Unfair Liability for Odious Debt

Another legal risk of non-concessional financing arising from Chinese debt lies with the proposition that repayment of Chinese debt imposes an unfair liability on citizens shouldering what would otherwise be written off as odious debt. The concept is based on the idea that national debt procured by a despotic regime should not be enforceable. Rather, such debt should be the personal debt of the regime that incurred it as it is not dent of the state.[160] The doctrine of odious debt is no longer part of international law following its conspicuous absence from the Vienna Convention on Succession of States in Respect of State Property, Archives and Debts[161] coupled with the little support it has received in legal literature. The doctrine has so far never been successfully invoked before any tribunal to cancel debt service responsibility. Instead, governments are strictly held liable for illegitimate debts incurred by their predecessors to which they owe no moral obligation.[162] Many countries in the world today continue to shoulder the burden of servicing odious debt such as South Africa with respect to debt procured by the apartheid regime; Nicaragua with respect to debt procured by Anastasio Samoza who was overthrown in 1979; Zaire with respect to debt accumulated by Mobutu and channelled to his personal accounts; and Philippines with respect to debt procured under Ferdinand Marcos regime.

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[159] Brautigam, D. & Kidane, W. 'China, Africa, and Debt Distress.
[160] Kremer, M. & Jayachandran, S. 'Odious Debt: When Dictators Borrow, Who Repays the Loan?' March 2003, *The Brookings Institution* Retrieved from: https://www.brookings.edu/articles/odious-debt-when-dictators-borrow-who-repays-the-loan/
[161] Paulus, C. G. 'The Concept of "Odious Debts": A Historical Survey." 2008 Retrieved from: https://www.iiiglobal.org/sites/default/files/120_Odious_Debts_Christoph_Paulus%5B.pdf
[162] Dimitriu, C. 'Agency law and odious debts,' 2017 *Ethics and Global Politics* Vol 10(1). P. 77.

The main principle that underlies the doctrine of Odious debt is that state debt has to be contracted and deployed towards the needs and interests of the state.[163] In the event the lender has knowledge that the contracted debt is utilized for purposes that are contrary to the needs and interests of the nation, then such debt should fall with the regime that procured it.[164] This should often be the case when the lenders are often regarded to have committed a hostile act against the people. Hence, the critical and most important attributes include the knowledge of the lender, the debt incurred without consent and regard for the benefit it is supposed to have on the people. Based on the foregoing, the concept should incentivize official creditors to lend based on transparency and for public benefit.

The global financial architecture in the world today is not characterized by the procurement of debt from colonial rulers or oppressive dictators. However, it is characterized by bilateral creditors who issue debt – that would otherwise be odious – under predictive non-concessional terms. As such, Alexander Nahum Sack's claim[165] on what comprises of odious debt may today, in the study hereby, be rewritten as follows. That when a despotic official creditor issues debt, not for the needs or interests of the state, but rather to strengthen itself under terms that suppress the conventional principles of democracy and human rights, such debt is odious for the people and does not bind the debtor nation.[166] This implies that the modern perspective through which official debt should be examined for being odious should be based on the legitimacy of the terms under which such debt is offered with respect to the principles of democracy. It is no longer debt that is procured by odious rulers, but rather debt that is issued under odious terms to 'odious rulers' in the guise of democratic leaders. Traditionally, odious debt has been perceived through the lenses of the use of debt by odious governments to finance repression.[167] However, odious debt today is manifest through official loans issued under non-concessional odious terms with odious obligations that

[163] Kremer, M. & Jayachandran, S. 'Odious Debt,' 2002 *Finance and Development* Vol. 39(2). Retrieved from: https://www.imf.org/external/pubs/ft/fandd/2002/06/kremer.htm

[164] UNCTAD, 'The Concept of Odious Debt in Public International Law,' 2007 *United Nations* Discussion Papers No. 185. Retrieved from: https://unctad.org/system/files/official-document/osgdp20074_en.pdf

[165] Ludington, S., Gulati, G. M., & Brophy, A. L. 'Applied Legal History: Demystifying the Doctrin of Odious Debts,' 2009 Retrieved from: http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5511&context=faculty_scholarship

[166] Toussaint, E. 'The Doctrine of Odious Debt: From Alexander Sack to the CADTM,' 2016 *CADTM* Retrieved from: http://www.cadtm.org/The-Doctrine-of-Odious-Debt-from-Alexander-Sack-to-the-CADTM

[167] Nehru, V. & Thomas, M. 'The Concept of Odious Debt: Some Considerations.' 2008 *World Bank* Policy Research Working Paper No. 4676. Retrieved from: https://openknowledge.worldbank.org/bitstream/handle/10986/6825/WPS4676.pdf?sequence=1&isAllowed=y

occasion financial repression that account for the debt crisis in the African continent today. As such, the doctrine should be repurposed with a view to ensuring that creditors are put on notice that any future official loans under odious non-concessional terms cannot be transferable or enforceable against successor governments.

The fact that Chinese debt contracts are implemented with predatory clauses that give China political (besides commercial) advantage, makes the discussion around odious debt inevitable. The implications of the secrecy of Chinese debt prevent the people whose taxes are deployed to repaying the official debt from the nature and the terms of the government's borrowing. These far-reaching confidentiality clauses in Chinese official loan agreements for non-concessional financing deprive citizens of the opportunity to hold their governments accountable for such clandestine debts.[168] This is despite the fact that it is these citizens that shoulder the ultimate burden for the repayment of the debt. These confidentiality clauses coupled with other contractual tools create an unaccountable government regime. By compromising democratic accountability of the state with these confidentiality clauses, Chinese loan agreements set up the state at the risk of power abuse, corruptive practices, and violation of fundamental human rights in exercising control over public resources.[169] Chinese debt therefore impedes the capacity of debtor states to realize adequate growth and achieve their social and economic objectives among other development requirements.

Even though it could be argued that the citizens are the ultimate beneficiaries of infrastructure projects, this cannot be accounted for by the level of control that the Chinese official creditors maintain over the revenue accounts for such infrastructure. As established earlier in this chapter, the Chinese official creditors even retain the discretion to block the sovereign debtors from withdrawing funds from the project revenue accounts with a view to enforcing repayment.[170] Further, in case project revenues are channelled to Project Trust accounts, withdrawals are only limited to payment of fees, loan repayment and project expenses.[171] How can debt arrangement under such terms not be considered odious to the extent that they are oppressive to the people when

[168] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 6.
[169] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends.
[170] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 27.
[171] *Ibid.* P. 27.

a substantial share of a sovereign borrower's national revenue remains under the effective control of a single creditor?

The extent to which citizens and future generations are imposed upon the burden of shouldering the repayment of official bilateral debt from China is one of the prevailing issues that form part of the legal risks arising from Chinese debt. The extent to which developing economies cannot declare and write-off such debt as odious is part of the current unjust global international economic order 'that institutionalizes the marginalization of the most indebted countries in the world.'

Payment of what would otherwise be odious debt to Holdout creditors such as China implies that ordinary people are subjected to 'austerity measures' that are 'inconsistent with their human rights.' Further, the manner in which Chinese loan contracts are implemented with clauses seeking to maximize commercial and political advantage emanates from the lender's desperate need to manage repayment risk. It would suffice to infer that China extends loans to which there are high chances of default and implements them with strict clauses to manage the repayment risks by conferring to themselves commercial and political advantage over other official creditors. One of the characteristics that conventionally have to be satisfied for sovereign debt to be odious is the requirement that there was some anticipation of default.[172]

Chinese debt contracts are implemented with tools discussed herein such as cross-default and cross-cancellation clauses that widen China's exit options while limiting the borrowers'. On the one hand, these clauses effectively exert policy influence to the extent that incoming governments are not at liberty to make relevant policy changes for the benefit of its people especially if they have adverse effects of Chinese interests. For instance, the CDB extended a $ 2 billion loan for the construction of Belgrano Cargas Railway in Argentina. CDB would later invoke cross-cancellation clauses threatening to cancel the railway project when a new government perpetrated to cancel the construction of a dam on environmental grounds.[173] This was attributable to the fact that the dam construction project was financed by a $4.7 billion syndicated loan from Chinese banks.[174] As such, the country would be bound to shoulder negative environmental consequences resulting from the construction of the dam in the name of protecting China's interests. On the other hand,

[172] Choi, A. H. & Posner, E. A. 'A Critique of the Odious Dent Doctrine,' 2007 *Law and Contemporary Problems* Vol. 70(3). Retrieved from: https://www.jstor.org/stable/27592195?seq=1

[173] Paulus, C. G. 'The Concept of "Odious Debts": A Historical Survey." 2008 Retrieved from: https://www.iiiglobal.org/sites/default/files/120_Odious_Debts_Christoph_Paulus%5B.pdf

[174] Paulus, C. G. 'The Concept of "Odious Debts".

stabilization clauses imposed by Chinese Official Creditors pose a significant set-back on the manner in which Kenya could effectively legislate on human rights issues and sustainable development policies.[175] This is oppressive to the extent that it limits the entitlement of the sovereign borrower to self-governance (and self-determination). This is considering that issues relating the environment, public health, sustainable development, and labour form part of areas where Kenya is still making progress and anticipate more legislative changes. However, the benefits of such legislative changes are likely to be off-set by the costs incidental to effecting them when they are in any way adversarial to the interests of the Chinese official creditors.

2.4 Conclusion

The predatory lending practices to developing countries, of which Kenya is just an example, as perpetrated by China have conventionally been justified by the following explanation. That such developing economies as African countries are termed as high-risk countries with high likelihood of sovereign defaults due to their weak institutions.[176] This argument could only remain valid in the period when most of these developing countries were still established within young democracies having just secured political independence from their colonial masters. However, this justification is today debunked by the position that various developing economies are established within strong political and democratic institutions to the extent that it may no longer be necessary to use predatory contract tools to manage repayment risks by labelling these countries as high-risk debtors.

China has developed a lending pattern that undercuts the sovereignty of its sovereign debtors which exposes them to various risks especially when it comes to non-concessional financing. The screaming lack of transparency in Chinese official loan contracts marks the beginning of all legal risks attributable to non-concessional financing that culminates in unfair liability for odious debt by Kenyan tax payers. Default on Chinese debt (implemented with odious terms) gives it more bargaining power (in the course of bilateral engagements involving restructuring and rescheduling) to extract more sovereign (or otherwise) concessions from Kenya in the event of default. An accurate depiction of Hegemony in the relations between Kenya and China.

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[175] Gelnpern, A., Horn, S., Morris, S., Parks, B. & Trebesch. 'C. How China lends: A rare look into 100 debt contracts with foreign governments.' 2021 AIDDATA., P. 40.

[176] Buchheit, L. C., Gelpern, A., Gulati, M., Panizza, U., Mauro, B. W. & Zettelmeyer, J. 'Revisiting Sovereign Bankruptcy.' 2013 *Committee on International Economic Policy Reform* Retrieved from: https://www.brookings.edu/wp-content/uploads/2016/06/CIEPR_2013_RevisitingSovereignBankruptcyReport.pdf

The recent recognition of China as the world's largest bilateral creditor puts China at a strategically stronger position to define and influence the global finance architecture in the world today. Kenya's debt sustainability is increasingly at risk as a result of odious terms and conditions implemented in Chinese non-concessional official credit agreements. The call for restructuring Chinese debt is also met with challenges that threaten to compromise the relations between Kenya and other official creditors such as those participating in the Paris Club of official bilateral creditors. The clash between Chinese and Paris Club official credit terms calls for innovation in debt relief before the continent is engulfed deeper into a debt crisis. For instance, IMF's managing director has been intimating the idea of a China-Paris Club Agreement to save African countries benefiting from collective debt relief initiatives such as the DSSI. This calls for the need to adopt a more conducive international architecture of sovereign debt that does not put official creditors at logger heads to the detriment sovereign debtors whose debt vulnerabilities are only exacerbated by such conflicts. A new sovereign debt restructuring mechanism that could meet these legal risks should uphold Kenya's inalienable right to national development while supporting co-responsibility of lenders for dent issued under odious terms.

Chapter 3:

The Role of the Kenyan Legal Framework in Anticipating and Mitigating Against Legal Risks Incidental to Default on Public External Debt

3.1 Introduction

The following chapter undertakes a critical analysis of the role of the Kenyan legal framework on government borrowing in protecting the country from the risks emanating from default on external debt. The analysis shall be conducted based on a thematic approach that distinguishes the legal framework into sovereign immunity laws and democratic accountability laws. Under the former, it shall establish the extent to which the Constitution of Kenya, 2010, the Privileges and Immunities Act, as well as case law provides for protection against legal risks that emanate from default on public external debt. This shall be followed by a review of constitutional provisions, the provisions of the Public Finance Management Act, and the Medium Term Debt Strategy 2022 to establish the extent to which these instruments provide for the protection against legal risks that emanate from default on public debt with respect to democratic accountability.

3.2 Democratic Accountability Laws

Democratic accountability laws are also essential for the protection of the interests of sovereign debtors and specifically with respect to the actual sovereign (the people). It refers to the mechanisms through which citizens, political agencies, and other democratic actors provide feedback, and reward or sanction state officials in charge of setting public policy.[177] Democratic accountability laws are therefore essential in mitigating legal risks attributable to contracting external debt in the pre-contractual and post-contractual stages. The ideal outcome of well-functioning mechanisms of democratic accountability is a government that works in the best interests of its citizens.[178] In this regard, the role of the law is to ensure spell out and distinguish the specific obligations and limitations that apply to public financial managers with respect to requiring them to be professionally and democratically accountable when it comes to the

[177] Jelmin, K. 'Democratic accountability in service delivery: A synthesis of case studies,' 2012 *International Institute for Democracy and Electoral Assistance* -< https://www.idea.int/sites/default/files/publications/democratic-accountability-in-service-delivery-a-synthesis-of-case-studies.pdf >- on March 23, 2022., 3.
[178] Jelmin, K. Democratic accountability.

procurement and management of public external debt.[179] The following part shall therefore highlight Key provisions of the Kenyan legal framework that form part of democratic accountability laws with respect to external debt. Further, it shall demonstrate the extent to which these laws have accomplished accountability through various results analysed in this part.

3.2.1 The Sovereignty of the People

The powerful role of the citizens of Kenya when it comes to public external debt and its management is prominently entrenched in the Constitution of Kenya, 2010. Pursuant to Article 1 of the Constitution, Kenyans confer to themselves all sovereign power based on the entrenchment that all such power belongs to the people of Kenya and can only be exercised according to the Constitution.[180] The Constitution further places the people right at the centre of the affairs of all state organs in order to emphasize the people's sovereign power.[181] It is for this reason that the High Court of Kenya in 2016 interpreted this position to imply that the people of Kenya rank the highest when it comes to the pecking order of sovereign power.[182] This implies that even though sovereign power is donated to the three main arms of government[183] to be exercised at the national and county levels of government,[184] the power has to be exercised in the interests of the people. Therefore, state officials in charge of the procurement, servicing and management of public debt have to do so at the service of the people of Kenya.

This constitutional pillar is essential when it comes to the risk of unfair liability for odious debt discussed in the previous chapter. Considering that it is the people who eventually shoulder the burden of repaying external debt and suffering austerity measures that come with debt management, it is anticipated that the Executive exercises caution in procuring public debt. This is important considering that ideally, the citizens should not be liable to shoulder the burden of debt that has been procured illegitimately without due regard to the interest of the people. While it is anticipated that the Executive exercises the powers donated to it in the interest of the people, actions such as procuring debt under terms that are inherently illegitimate and likely to undermine

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[179] Justice, J. B. 'Democratic accountability for public debt,' 2017 *Annual Conference of the Association for Budgeting and Financial Management Society for Public Administration, Seattle, Washington,* October 6-8, 2018. - < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2913198 > on April 27, 2022.
[180] Constitution of Kenya, 2010, Article 1(1).
[181] Constitution of Kenya, 2010, Article 1(2).
[182] Sammy Ndung'u & 5 others v Governor, Laikipia County [2016] eKLR.
[183] Constitution of Kenya, 2010, Article 1(3).
[184] Constitution of Kenya, 2010, Article 1(4).

the sovereign will of the people of Kenya forms a proper basis for raising the question of whether such debt is odious or not.

3.2.2 National Values and Principles

The constitutional provisions on sovereignty of the people are supported by other constitutional principles and provisions that cement the accountability of the state to the people. For instance, according to the Constitution, all state organs, state officers and public officers shall be guided by the national values and principles of governance that include rule of law, democracy, social justice, inclusiveness, good governance, sustainable development, transparency and accountability; and more importantly, the participation of the people.[185] These values and principles play a key role in public debt management when it comes to the responsibility the state and its officials owe to the people. Considering that citizens are directly affected by the decisions relating to the procurement and management of public debt, these national values and principles anticipate that they (the people) should be accorded an opportunity to take part in decision-making[186] and budget making processes.[187]

From these constitutionally endorsed national values and principles also the principle of intergenerational equity. The principle has been well acknowledged in various legislations drawing from these constitutional national values and principles albeit with regard to environmental protection and conservation. For instance, the Environmental Management and Coordination Act defines intergenerational equity as the responsibility of the present generation to ensure that the exercise of their right to beneficial use of the environment and natural resources is maintained and enhanced in the interests of the future generations.[188] The same has been invoked in courts to develop jurisprudence around intergenerational trust that places responsibility of the current generation to consider the interests of the future generations while exercising their rights to

[185] Constitution of Kenya, 2010, Article 10(2).
[186] Abe Semi Bvere v County Assembly of Tana River & another; Speaker of the National Assembly & another (Interested Parties) [2021] eKLR.
[187] Local Empowerment for Good Governance & 6 others v Community Executive Committee Member Finance & Economic Planning - County Government of Mombasa & 2 others [2021] eKLR.
[188] Environmental Management and Co-ordination Act, 1999, Section 2.

development.[189] Hence it implies the assertion the economic welfare of the country is held in common between the past present and the future generations of this country.[190]

The national values and principles as expressly and implicitly entrenched in the Constitution of Kenya, 2010 are essential with respect to responding to the risk of opaque debt contracts. Principles such as public participation are put to test herein to establish the extent to which the people of Kenya were involved or participated in the negotiations leading to the execution of various debt contracts with Chinese official creditors. Further, the principles of transparency and accountability are essential in addressing the risk of ending up with opaque contracts. As such, they are essential in examining the extent to which the Executive has been open in letting the people of Kenya into the terms and conditions under which Chinese debt contracts in Kenya have been executed. In addition, transparency and accountability in this regard would be essential for decisions made by policy-makers and legislators when strategically legislating and developing debt management laws and policies within the country.

3.2.3 The Right of Access to Information

It has also been established in the previous chapter that lack of knowledge of the terms and conditions of Chinese debt contracts through broad confidentiality clauses forms a major legal risk with which these contracts are marred. Even so, the constitutionally established national values and principles are supported by the fundamental right of access to information. Through this constitutional right, the people of Kenya confer upon themselves the right to access information held by the state.[191] The same right extends to information held by a person other than the state, that is required for the exercise of protection of any other fundamental right or freedom entrenched in the Constitution.[192] Further the state is also under the constitutional obligation to publicize information that it finds important to the extent that it affects the nation.[193] These aspects of the right to access to information are essential towards realizing transparency and accountability with respect to public external debt. It confers to the citizens the entitlement to require the relevant state

[189] Isack M'Inanga Kiebia v Isaya Theuri M'Lintari & another [2015] eKLR
[190] Kariuki, M. & Kariuki, F. 'Sustainable development and equity in the Kenyan context,' 2012 -< http://kmco.co.ke/wp-content/uploads/2018/08/A-Paper-on-Sustainable-Development-and-Equity-in-the-Kenyan-Context.pdf>- on 12 August, 2022.
[191] Constitution of Kenya, 2010, Article 35(1)(a).
[192] Constitution of Kenya, 2010, Article 35(1)(b).
[193] Constitution of Kenya, 2010, Article 35(3).

agencies procuring debt on behalf of the people to adduce information regarding the terms and conditions of loan contracts in addition to reporting on debt servicing as well as the information regarding the country's financial situation. These constitutional provisions are enabled by the Access to Information Act that makes provision for procedures for access to information[194] and a broader scope of the limitation of the kind of information that the citizens may have access to upon request.[195] For instance, the Act provides that this right shall be limited in the event information whose disclosure is likely to occasion substantial prejudice on the commercial interests of the public entity from which the information is to be obtained.[196] This could be construed to inhibit citizens from access to having information on the terms and conditions of external debt contracts that are implemented with confidentiality clauses. To this end, such a limitation could inhibit the level of accountability in the procurement and management of public debt.

The effectiveness of this constitutional right of access to information and the limitations provided for under the Act might not be of great utility with regard to unveiling the terms and conditions of debt contracts implemented with confidentiality clauses. For instance, in the *Okiya Omtatah* case (petition No. 58 of 2014), the court dismissed the petition on the grounds that contracts – regarded as public documents – were obtained in a manner that was inconsistent with the Constitution of Kenya, 2010 and the Evidence Act.[197] In this case, the Petitioners sought to challenge the process of public procurement that culminated in the awarding of a tender to construct the standard gauge rail way in Kenya to the China Road and Bridge Corporation. A project that was to be funded through public debt.[198] The Petitioners were unable to access information regarding the procurement and financing of the project and therefore sought alternative means to procure them. The further declined to indicate to the court the manner in which the documents were obtained. The Constitutional and Human Rights Division of the High Court upheld the position that self-help was not an acceptable means for procuring documents that were held in confidence, and therefore refused to admit the documents.[199] This replicates the extent to which the prevailing legal tools for promoting access to information may not be sufficient to facilitate democratic

[194] Access to Information Act, 2016, Section 8.
[195] Access to Information Act, 2016, Section 6.
[196] Access to Information Act, 2016, Section 6(1)(e).
[197] Okiya Omtatah Okoiti & 2 others v Attorney General & 3 others [2014] eKLR Para. 126.
[198] Okiya Omtatah Okoiti & 2 others v Attorney General & 3 others [2014] eKLR Para. 30.
[199] Okiya Omtatah Okoiti & 2 others v Attorney General & 3 others [2014] eKLR Para 82.

accountability by enabling access to external debt contracts that are implemented with strictly broad confidential clauses.

3.2.4 Principles of Leadership and Integrity

Another aspect of democratic accountability that is manifest in Kenya's constitutional dispensation relates to the provisions on leadership and integrity entrenched under Chapter 6. From an initial point of view, the Constitution upholds the authority granted to a state officer as a form of public trust that ought to be exercised with great responsibility[200] subject to the best interests of the people of Kenya.[201] For these reasons, it has to be exercised in a manner that is consistent with constitutional objects and purposes and in a manner that promotes the confidence of the public in the integrity of that public office.[202] Some of the applicable constitutional principles that guide leadership and integrity include objectivity in decision-making and accountability to the public for decisions and actions taken.[203] These principles are relevant with respect to the institutions and office holders that are responsible for procurement and management of external official debt.

3.3 Public Finance Management Law

Public finance management law also forms a significant part of the democratic accountability laws. They are essential in mitigating the risk of policy influence emanating from Chinese debt contracts through cross-default and stabilization clauses. When it comes to the management of public finance and management, the constitution entrenches the following democratic accountability mechanisms when it comes to borrowing by the national government. First, the Constitution provides for of the principles that govern all public management that are applicable to external debt. These include openness and accountability with regard to the borrowing and management of external debt; promoting the development an equitable society; intergenerational responsibility that calls for equitable sharing of the burdens and benefits attributable to public borrowing; and responsible borrowing and management of public debt.[204] It is anticipated that these principles applicable to public borrowing and debt management shall be used as the yardstick upon which

[200] Constitution of Kenya, 2010, Article 73(1)(a).
[201] Leadership and Integrity Act, 2012.
[202] Constitution of Kenya, 2010, Articles 73(1)(a)(i) & (iv).
[203] Constitution of Kenya, 2010, Articles 73(2)(b) & (d).
[204] Constitution of Kenya, 2010, Article 201.

the state organs and public entities should analyse the legal risks incidental to default on external debt.

The constitution also empowers the National Parliament of Kenya to legislate of the terms upon which the national government may procure debt.[205] The legislation should also impose upon the relevant state agencies the obligation to tender relevant reports with respect to government borrowing.[206] The prominent role of Parliament extends further having been conferred the power to summon the Cabinet Secretary in charge of finance to present information regarding government loans before the relevant committee.[207] This is a very strong tool for democratic accountability considering that Kenya is a representative democracy. Even the sovereign (the people) might experience challenges in accessing information regarding public debt contracts, their democratically elected representatives are conferred with the requisite powers to inquire into debt contracts and hold the relevant state officers responsible and accountable for decision-making. However, the information that may be sought by Parliament only relates to such information that adduces the extent of the country's indebtedness, the use to which proceeds of loans have been put, the provisioning that has been made for servicing the debt and the progress that has been made with respect to repayment.[208]

3.3.1 Public Finance Management Act

When it comes to the legislation prescribing the terms on which the national government may borrow, Parliament enacted the Public Finance Management Act that came to force on 27th August, 2021. It's coming to force was with effect to repealing previous laws that would make similar provisions especially the External Loans and Credits Act.[209] According to the repealed Act, the government (pursuant to any agreement or instrument) had the power to borrow in foreign currency from other governments upon terms and conditions that the Minister responsible for finance found fit.[210] Under the current dispensation, the Cabinet Secretary in charge of finance may only raise loans according to the country's most recent budget statement as well as the debt

[205] Constitution of Kenya, 2010, Article 211(1)(a).
[206] Constitution of Kenya, 2010, Article 211(1)(b).
[207] Constitution of Kenya, 2010, Article 211(2).
[208] Constitution of Kenya, 2010, Article 211(2)(a),(b),(c) & (d).
[209] Cap. 422, Laws of Kenya.
[210] External Loans and Credits Act, Cap. 422 Laws of Kenya (Repealed).

management strategy of the national government in the medium term.[211] This implies the government takes a flexible approach with regards to the terms and conditions under which it procures external loans. First, the Budget Policy Statements change from time to time. This implies that the minimum terms and conditions upon which public debt is procured is influenced by the reigning political regime. As such, there are no particular legislative provisions that protect various interests such as strategic state assets or socio-economic rights as forming part of the minimum terms upon which external debt may be procured. This leaves it possible for a reigning regime to procure external debt under terms that are likely to be harmful and leave the same to be shouldered by the next regime and the future generation of citizens without appropriate remedy for the latter. It is therefore important to review the relevant medium term debt strategy and budget policy statement, considering that they form a critical part of the legal framework that determine the terms and conditions under which public external debt is procured in Kenya after reviewing other provisions of the Act. The role of the National Parliament is also important because it has the power to set the public debt ceiling, establish the government's borrowing limits and also set the borrowing thresholds that ought to apply to the default on public debt.[212]

3.3.2 Medium Term Debt Management Strategy 2022

The Public Finance Management Act provides for the National Treasury to strategically guide the country's borrowing and management of public debt through a Medium Term Debt Management Strategy that is underpinned by a Budget Policy Statement.[213] The Strategy is developed by the Public Debt Management Office (PDMO) which is an independent office established under the National Treasury tasked with the management of public debt.[214] The debt policy, strategy and risk management department of the PDMO is charged with procuring financial resources to bridge the country's national budget deficit. As such, it is tasked with preparing and implementing the national government's borrowing plan. This department is also tasked with processing government guarantees and overseeing appropriate disbursement of borrowed funds.[215]

Since 2021, the strategic approach of the National Treasury towards public debt has been founded on hoping to lengthen the maturity profile of public debt in Kenya. The strategy is also founded

[211] Public Finance Management Act, 2012, Section 49(1).
[212] The National Treasury and Planning, *Annual Public Debt Report 2020/2021*, 14.
[213] Public Finance Management Act, 2012, Section 33.
[214] Public Finance Management Act, 2012, Section 62.
[215] The National Treasury, 'Annual Public Debt Report 2020/2021.' September, 2021. 15.

on the need to increase the country's uptake of external debt.[216] This could originate from the legal and or fiscal risks that have been apparent from external loans taken under non-concessional terms. On the other hand, the 2022 strategy is anchored on keeping the rate of debt accumulation in Kenya below the rate of economic growth.[217] It is anticipated that this new strategic approach will help in safeguarding the country's debt sustainability. However, the 2022 strategy aims at weeding out expensive debts while emphasizing the need to adjust the country's debt ceiling in the medium term.[218]

In its analysis of the costs and risks incidental to Kenya's current debt portfolio, the 2022 Strategy reports the following. That the re-financing risk of Kenya's overall debt portfolio was found to have registered significant improvement.[219] This implies that the country is less likely at a risk of not being able to procure new debt when it needs to borrow.[220] It also establishes that the interest rate risk of the overall debt portfolio also declined as of June 2021[221] and on the other hand the strategy indicated that the country's exposure to foreign exchange risk was still real.[222] Hence, besides these economic indicators of risks attributable to public debt, it is important to note that the 2022 Medium Term Debt Strategy does not conduct an analysis of any legal risks and their implications on the country's public debt portfolio. The same is not reflected in the 2022 Budget Policy Statement.[223]

It was established earlier in this chapter that Parliament has delegated its function to determine the terms and conditions upon which debt is procured and left it to the Cabinet Secretary in charge of finance to undertake the same through the Medium Term Debt Strategy as underpinned by the Budge Policy statement. However, a review of these instruments indicates that they neither contain superficial nor comprehensive terms and conditions under which external debt is to be procured. As such, the instruments still leave a wide range of discretion to the Cabinet Secretary in charge

[216] The National Treasury and Planning, 'Annual Public Debt Report 2020/2021' September, 2021 -< https://www.treasury.go.ke/wp-content/uploads/2021/12/ANNUAL-PUBLIC-DEBT-REPORT-2021-final-as-at-oct-21-2021.pdf> - on 23 June 2022.
[217] The National Treasury and Planning, 'Annual Public Debt Report 2020/2021', 55.
[218] The National Treasury and Planning, 'Annual Public Debt Report 2020/2021', 55.
[219] The National Treasury and Planning, '2022 Medium Term Debt Management Strategy,' November, 2021. 11.
[220] Soprano, A. Liquidity management: A funding risk handbook, *John Wiley & Sons* 2015.
[221] The National Treasury and Planning, '2022 Medium Term Debt Management Strategy,' November, 2021. 12.
[222] The National Treasury and Planning, '2022 Medium Term Debt Management Strategy,' November, 2021. 14.
[223] Parliamentary Budget Office, 'Unpacking of the 2022 Budget Policy Statement,' December, 2021 *Parliament of the Republic of Kenya,* -< http://www.parliament.go.ke/sites/default/files/2021-12/Unpacking%20of%20BPS%202022.pdf >- on June 11, 2022.

of finance as well as the National Treasury and Planning to enter into debt contracts subject to terms and conditions that expose the country to various legal risks. The extent to which the instruments are ignorant of any legal indicators of risks that accrue to the country's debt portfolio is a clear indicator of the extent to which the country remains open to entering into legally risky debt contracts. Hence, it would suffice to infer that there is no clear dispensation within Kenya's legal and institutional framework that provides for the minimum legal terms for default on external debt against which government may be held democratically accountable.

3.4 Sovereign Immunity Laws

Sovereign immunity laws play a critical role in protecting states against the legal risks that emanate from default in public external debt (post-contractual strangest). Particularly, these laws are essential with respect to protecting against the legal risks that emanate from cash collateral arrangements, potential law suits and the risk of seizure of strategic assets of the debtor country. This is based on the anticipation that the enforcement of sovereign debt contracts may come with certain enforcement actions that infringe on the customary law principle of sovereign immunity. For these reasons, it is essential to establish the legal protections that the Kenyan legal framework on public debt has in place to anticipate and mitigate against these risks.

The entrenchment of the supremacy of the Constitution of Kenya, 2020 comes with an acknowledgment that the general rules of international law shall also form part of the laws of Kenya.[224] Further, it also provides that all treaties and conventions that have been ratified by Kenya shall be part of the laws of Kenya under the Constitution.[225] These provisions are critical in the establishment of the position of the law in Kenya with regard to sovereign immunity laws with respect to protecting against the risks occasioned by default on external debt. That notwithstanding, sovereign immunity refers to a customary international law principle that plays a critical role in the protection of the state from liability that could be accrued by it in the course of its transactions. As such, this international law principle of sovereign immunity has conventionally been critical for the protection of sovereign debtors. According to this principle, a sovereign cannot be sued in foreign court unless they consent to the same.[226] This premised on the underlying position that sovereign nations are equal under international law. Therefore, being of equal standing, disputes

[224] Constitution of Kenya, 2010, Article 2(5).
[225] Constitution of Kenya, 2010, Article 2(6).
[226] Fox, H. The law of state immunity,2nd ed. *Oxford University Press,* 2008.

between them cannot be settled in the courts of one of them.[227] For these reasons, it is also referred to as jurisdictional immunity.

In Kenya, sovereign immunity is provided for under the Privileges and Immunities Act[228] as read with the Vienna Convention on Diplomatic Relations, 1961 with respect to provisions that have been adopted into the Kenyan Act. Different jurisdictions have adopted different approaches with respect to sovereign immunity where others take the absolute approach while others adapt the restrictive approach. Under the absolute approach, a foreign state enjoys total immunity from being sued and from having its assets seized by a foreign court even with respect to commercial matters.[229] However, the restrictive approach acknowledges that a foreign state is only immune from suit in another states courts with respect to activities relating to the exercise of sovereign power.[230] In this regard, pursuant to this approach, the state can be sued and have its assets seized by a foreign court with respect to commercial transactions or matters in which the state was acting in its private capacity.[231] Even so, recent developments in international law favour the doctrine of restrictive immunity which does not confer state immunity with respect to transactions that are commercial in nature. Discussions regarding the position as to whether Kenya adopts the absolute or restrictive approach have been settled through jurisprudence[232] established in Kenyan courts with reference to the Privileges and Immunities Act as well as the Vienna Convention[233] as follows. That the doctrine of absolute immunity is no longer viable especially with respect to action relating to commercial transactions of the state acting in a private or commercial capacity.[234]

Apart from protection against jurisdiction, the role of sovereign immunity laws in any jurisdiction is to protect against attachment of state assets in the event the state is in default of its obligations that may put its assets within and outside its jurisdiction at the risk of seizure during enforcement

[227] Yang, X. State immunity in international law, Cambridge University Press, 2012, -< https://assets.cambridge.org/97805218/44017/excerpt/9780521844017_excerpt.pdf > - on June 2, 2022.
[228] Privileges and Immunities Act, Cap. 179 Laws of Kenya.
[229] Bankas, E. K., The state immunity controversy in international law Private suits against sovereign states in domestic courts, 2005 *Springer Science & Business Media*.
[230] Sompong, S. State immunities and trading activities in international law, *Stevens & Sons,* 1959.
[231] African Centre for Corrective and Preventive Action & 6 others v Lolldaiga Hills Limited & 2 others; Kenya Wildlife Service & another (Interested Parties) [2022] eKLR Para. 52.
[232] Ministry of Defence of the Government of United Kingdom versus Joel Ndegwa (1983) eKLR.
[233] Article 31, Vienna Convention on Diplomatic Relations, 1962.
[234] Trendtex Trading Corporation v Central Bank of Nigeria [1977] 1 QB 529.

of debt obligations.[235] At international law, the United National Convention on Jurisdictional Immunities of States and Their Property, 2004 plays a critical role in protection of the state and its property from the jurisdiction of another state. The objective of the convention is to enhance rule of law and create legal certainty when it comes to dealings involving the states natural and juridical persons.[236] The key principles that govern the operation of this convention include the principle of state immunity which according to the convention is construed as follows. That a state is entitled to enjoy immunity with respect to itself and its property from the jurisdiction of another state unless through the limitations provided for by the convention.[237]

For instance, when it comes to pre-judgment and post-judgment measures of constraint over property such as arrest, attachment and execution, the Convention provides as follows. That a state shall not take any pre-judgment or post-judgment measures of constraint against the property of another state in connection with proceedings before the courts of the former state.[238] Such pre-judgment and post-judgment measures of constraint against state property can only apply in the event the state has consented to such measures being taken by way of an international agreement, and arbitration agreement in a contract or through a declaration made before the court.[239] Alternatively, such measures of constraint shall only be taken in the event it is clear that the state involved has allocated specific property and earmarked the same for such purposes.[240] Specifically when it comes to post-judgment measures of constraint, the Convention provides that such measures shall only be taken if the subject property is not used by the government for commercial purposes and is located within the territory of the forum state.[241]

In light of the foregoing principles, it is apparent that the provisions of the 2004 UN Convention are critical for the protection of a debtor state's strategic assets against the risk of litigation and pre-judgment and post-judgment measures that may occur after default. However, it is important to note that in 2016, the Court of Appeal at Nairobi in *Unicom Limited v Ghana High*

[235] Panizza, U., Sturzenegger, F. and Zettelmeyer, J. 'The Economics and Law of Sovereign Debt and Default.' 2009 *Journal of Economic Literature* Vol. 47(3), 653.
[236] United National Convention on Jurisdictional Immunities of States and Their Property, 2004, Preamble.
[237] United National Convention on Jurisdictional Immunities of States and Their Property, 2004, Article 5.
[238] United National Convention on Jurisdictional Immunities of States and Their Property, 2004, Articles 18 & 19.
[239] United National Convention on Jurisdictional Immunities of States and Their Property, 2004, Articles 18(a) & 19(a).
[240] United National Convention on Jurisdictional Immunities of States and Their Property, 2004, Articles 18(b) & 19(b).
[241] United National Convention on Jurisdictional Immunities of States and Their Property, 2004, Article 19(c).

Commission[242]reiterated the position that the UN Convention does not form part of the laws of Kenya. This was based on the courts finding that there was no evidence that Kenya had ratified the 2004 Convention.[243] The reasoning of the Court of Appeal was that Kenya was yet to deposit its instrument of ratification, acceptance or approval or accession of the Convention with the Secretary General of the United Nations. Therefore, pursuant to Article 2(6) of the Constitution of Kenya, 2010, the Convention was found not to be reflective of Kenyan law. In the absence of such critical protection that is conferred by this convention coupled by the absence of domestic legislation restraining pre-judgment and post-judgment measures of constraint against Kenya's assets in the events it submits to jurisdiction of the court of another state; it would suffice to infer that the state and its property is at a vulnerable position.

3.5 Conclusion

While the act of procuring sovereign debt has the implications of waiver of sovereign immunity, hence jurisdictional immunity, this chapter has established that Kenya's sovereign immunity laws do not sufficiently protect the country's strategic assets against enforcement in the event of default of external debt. This is made worse by the fact that Kenya is yet to ratify the United National Convention on Jurisdiction Immunities of States and Their Property, 2004. An international instrument that would have played a critical role in mitigating against such risks. With regard to democratic accountability, this chapter has also established that what the country's legal framework on access to information does is subjected to various loopholes that may affect transparency and accountability when it comes to clandestine debt contracts. Further, despite being the apex institution of the country's governance structure responsible for the management of public debt, it is apparent that the National Parliament of Kenya is yet to play a critical role in determining the minimum terms and conditions under which public external debt. This implies that there are vital interests that are left unprotected that are made worse by the risky contractual tools that Chinese official creditors implement to advance their commercial and political interests. In light of this background, the subsequent chapter undertakes and evaluation of the legal risks resulting from default on external debt from China while establishing how these risks can be mitigated based

[242] Unicom Limited v Ghana High Commission [2016] eKLR
[243] Unicom Limited v Ghana High Commission [2016] eKLR, Para. 15.

on the principles of traditional lending as well as practices that have been embraced by other sovereign debtors in default of dent from Chinese official creditors.

Chapter 4:

Towards Understanding and Mitigating the Legal Risks of Default on Chinese Bilateral Debt to Kenya

4.1 Introduction

The following chapter analyses the legal risks of China's bilateral debt to Kenya in light of key principles that are essential in understanding the risks that underlie default in sovereign debt. First, it examines Kenya's situation in light of China's reluctance to participate in collective debt relief and how this affects Kenya's relations with other bilateral creditors when it comes to the effect of the principle of comparability of treatment. Second, it examines the nature of the risk of policy influence by China over Kenya in light of the relational theory of international relations. Third, it demonstrates the extent to which the collateralization of Chinese bilateral debt contracts affects debt-trap policy claim that various scholars have attempted to debunk. Finally, it examines the international law doctrine of odious debt specifically in light of the problem of a moral hazard incidental to Kenya's unstructured legal and institutional framework.

4.2 Collective Debt Relief and Comparability of Treatment

Currently there is a consensus that many developing countries are set to default in the official debts initially contracted by them[244] To this end, the prospect of restructuring debt in the future has become and unavoidable problem that official creditors and sovereign debtors have to contend with.[245] In the absence empirical evidence that Chinese debt contracts with Kenya have no-Paris clauses, it would suffice to infer from its historical lending practices that Chinese official bilateral creditors are averse to collective debt relief especially when it comes to non-concessional debt.[246] However, a look at its traditional practices establish that China has been involved in debt relief mechanisms that involve rescheduling that involve maturity extension and reduction of interest rates.[247] Even so, China's reluctance to participate in the G20 collective debt relief processes and

[244] Eaton, J. 'Debt relief and the international enforcement of loan contracts.' 1990 *The Journal of Economic Perspectives* Vol. 4(1), 43.
[245] Sharma, S. D. 'Resolving sovereign debt: Collective action clauses or the sovereign debt restructuring mechanism,' 2004 *Journal of World Trade* Vol. 38(4), 627.
[246] Chia Africa Research Institute, 'Global Debt
[247] Acker, K. Brautingam, D. and Huang, Y. 'Debt relief with Chinese characteristics,' 2020 *China Africa Research Institute* Working Paper No. 39. -< https://static1.squarespace.com/static/5652847de4b033f56d2bdc29/t/60353345259d4448e01a37d8/1614099270470/WP+39+-+Acker%2C+Brautigam%2C+Huang+-+Debt+Relief.pdf> - on June 11, 2022.

its resort to insisting on bilateral negotiations is likely to aggravate the risks emanating from the principle of comparability of treatment.[248] Such focus on bilateral negotiations without regard for the interests of other official creditors has the direct implication that China is likely to impose debt relief terms that still uphold the superiority of its debt over other official creditors. This is more likely to interfere with the sovereign debtor's future efforts to obtain debt relief from other official creditors through collective debt relief mechanisms such as that which is offered by the Chinese Club of official bilateral creditors.

There is hope that China is making slow progress into orienting itself with collective debt relief mechanisms to avoid putting its sovereign debtors in conflict with other official creditors. In April 2022, it was reported that China finally agreed to co-chair a creditor committee to discuss the restructuring of Zambia's debt.[249] In previous occasions, China had was specifically not open to the idea of meeting with other official creditors through a full creditor committee. However, the new move is likely to see the lender join other Paris Club lenders such as the United States, the United Kingdom, France and other multilateral creditors such as the World Bank and the IMF in discussions towards a debt relief arrangement for Zambia.

The first Creditor Committee for Zambia was formally formed and convened in June 16, 2022 under the Common Framework for Debt Treatment beyond the DSSI as established by the G20 and the Paris Club.[250] During the meeting, Zambia is reported to have presented its request for debt treatment. It is also reported that the Creditor Committee reiterated the importance of official bilateral creditors to Zambia providing debt treatments that are at least favourable under the Common Framework. Hence, reiterating the importance of according debt treatment in line with the comparability of treatment principle.[251] Even though it might be too early to predict the success of the creditor committee, China's continued cooperation with other official bilateral creditors in light of the comparability of treatment principle presents a glimmer of hope for future defaulters of Chinese debt.

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[248] Acker, K. Brautingam, D. and Huang, Y. 'Debt relief with Chinese characteristics.'
[249] Ryder, H. 'China will help restructure Zambia's debt. What exactly does that mean?' April 29, 2022 *The Diplomat* -https://thediplomat.com/2022/04/china-will-help-restructure-zambias-debt-what-exactly-does-that-mean/ > - on June 2, 2022.
[250] Salinatri,'First meeting of the creditor committee for Zambia under the Common Framework for Debt Treatments beyond the DSSI,' June 16, 2022 *G20 Indonesia* 2022 - https://g20.org/first-meeting-of-the-creditor-committee-for-zambia-under-the-common-framework-for-debt-treatments-beyond-the-dssi/ > - on June 20, 2022.
[251] Salinatri,'First meeting of the creditor committee for Zambia.'

On the other hand, China remains an ad hoc participant in the meetings of the Paris Club and is yet to assume full membership of the Club. It is also apparent that its approach towards participating in collective debt relief through the G20 common framework has been motivated by the effects of the Covid-19 pandemic and is not in its conventional practice. To this end, despite agreeing to submit to a joint creditor committee to restructure Zambia's official debt, the move cannot be assumed as assumption of membership to the Paris Club and the endorsement of its principles. As such, China still puts itself at a position to deny its sovereign debtors the benefit of the comparability of treatment principle through its No-Paris club contractual clauses.

The opaqueness of Chinese debt contracts in Kenya still make it difficult to establish whether its contracts with Kenya are implemented with no-Paris clauses. Section 6 of the Access to Information Act 2016 limits the right of access to information if information whose disclosure is sough is likely to substantially occasion prejudice on the commercial interests of the public entity from whom such information is sought. Even though this limitation has not been directly invoked by the state to refute access to the terms and conditions upon which Kenya's Chinese debt contracts are executed, it potentially forms a legal basis that endorses the confidentiality clauses in Chinese contracts. Even so, Zambia's situation already depicts the extent to which it collective debt relief mechanisms are important when it comes to protecting the interests of the state in the event of default on sovereign debt. As such, it presents a real risk that can be legislated on or form a part of the country's long-term borrowing policy.

Based on this premise, there is a compelling public interest for the government of Kenya to adopt legislation that ensures the country borrows under terms and conditions that favour orderly restructurings at the face of debt crises. The role of legislation in this regard, is to protect the Kenyan taxpayers from exploitation by third parties to whom debt is owed.[252] This being in a quest to grant governments the same legal protection that often accrues to distressed businesses under the law of bankruptcy. Hence, part of the terms and conditions under which the Cabinet Secretary in charge of finance through the national treasury should procure non-concessional debt must

[252] Gill, I. & Buchheit, L. C. 'Targeted legislative tweaks can help contain the harm of debt crises,' June 27, 2022 *The Brookings Institution* -< https://www.brookings.edu/blog/future-development/2022/06/27/targeted-legislative-tweaks-can-help-contain-the-harm-of-debt-crises/#:~:text=Sovereign%20bond%20contracts%20issued%20over,prevail%20even%20over%20dissenting%20bondholders.> - on June 27, 2022.

include contractual provision for Collective Action Clauses.[253] This may be represented in form of imposing condition that non-concessional debt shall be procured under arrangements where to all creditors accrues the legal duty to cooperate in good faith in the processes of sovereign debt restructuring in the event of debt distress.[254]

Alternatively, such legislative or policy provisions should limit procurement of non-concessional bilateral debt only from bilateral creditors with membership in collective debt relief mechanisms such as the Paris Club of official bilateral creditors. This implies that the government should be limited to borrowing from official bilateral creditors who are willing to assume the duty to cooperate in collective debt restructuring mechanisms when they are invited to participate on comparable terms with other creditors.[255] Alternatively, this legislative condition may be structured in form of imposing measures that limit the amount that official bilateral creditors may obtain in legal proceedings commenced outside a collective debt relief frameworks.

The goal in this regard is to ensure that even in the absence of participation in collective debt relief, a single creditor does not threaten to jeopardize Kenya's relations with its other official bilateral creditors. While these suggestions may not deal with the potential threat of the current risk, the approach should absolutely protect against this risk in Kenya's future borrowing practices. Similarly, the country could pursue this goal collectively through regional economic communities or the continental framework. For instance, through its investment framework under the AfCFTA, the African Union could play an essential role in the establishment of template external debt contracts that entail non-negotiable provisions that protect the continent against debt crises. Such templates would, therefore, be essential for the negotiation of debt with non-Paris Club creditors such as China that do not have regard for collective debt relief.

4.3 China's Policy Influence and Debunking the Chinese School of Relational Theory

A deeper understanding of the relational contract theory plays a critical role in understanding the magnitude of the legal risks incidental to Chinese debt contracts, for this reasons, it is important to contrast the relational theory of world politics and the conventional freedom of contract that applies to commercial transactions. There are different outcomes when we perceive the legal risks

[253] Sharma, S. D. 'Resolving sovereign debt: Collective action clauses or the sovereign debt restructuring mechanism,' 2004 *Journal of World Trade* Vol. 38(4), 627.
[254] Gill, I. & Buchheit, L. C. 'Targeted legislative tweaks.'
[255] Gill, I. & Buchheit, L. C. 'Targeted legislative tweaks.'

emanating from Chinese contracts when we view them from a relational perspective than when we look at them from a strictly 'freedom of contract' traditional perspective. It is the absence of this kind of analysis that accounts for the mistakes that previous scholarly works have made in passing Chinese relations with Africa as a series of debt traps. A proposition that has recently been debunked by very many scholarly works that have come to account for these fears of a Chinese debt-trap diplomacy by establishing a deeper understanding of China's approach to international relations. It is argued that the mainstream western perspective of international relations is marred with limitations that makes scholars to misunderstand and make fatal assumptions regarding China's relations with the rest of the world through the Belt and Road Initiative.[256] This part therefore analyses the legal risk of policy influence, as previously discussed in the second chapter, through the lenses of the relational theory. This is essential in gauging the magnitude of the risk and the role that domestic laws can play in responding to the risk or aligning to this novel approach to international economic relations.

Kenya and China's relations are tied on public external debt that is directed towards financing infrastructure projects. This is done in light of advancing a Chinese-proposed international policy known as the Belt and Road Initiative. Western realists uphold that what ultimately underlies international politics is the struggle for power and assertion of interests.[257] From this perspective, the BRI cannot be perceived as a mechanism of peaceful development and common prosperity as it purports to be.[258] According to realists, the ultimate objective of every great power is to maximize their power with a view to dominating the system.[259] This is complemented by the traditional argument advanced by constructivists of the International Relations (IR) theory that the relationships between states are mainly influenced by the culture of international politics.[260] However, what remains apparent is that the system of international relations in East Asia has conventionally been different from the Westphalian one and are therefore not comparable. Hence, the argument that China's BRI is a development oriented approach to counter global challenges.[261]

[256] Wang, Z. 'Understanding the Belt and Road Initiative from the Relational Perspective,' 2021 *Chinese Journal of International Review* Vol. 3(1), 4.
[257] Wang, Z. 'Understanding the Belt and Road Initiative from the Relational Perspective,'
[258] Wang, Z. 'Understanding the Belt and Road Initiative from the Relational Perspective,' 2021 *Chinese Journal of International Review* Vol. 3(1), 4.
[259] Mearsheimer, 2014.
[260] Walt, S. M. 'International relations: One world, many theories,' 1998 *Foreign Policy* Vol. 110.
[261] Clarke, M. 'The Belt and Road Initiative,' 2017 *Asia Policy* Vol. 24.

As such, it is a form of international cooperation that does not rely on development of template Free Trade Area agreements or similar forms of regional economic integration.[262] This being a rule-based approach that has conventionally governed economic integration through the creation of unified institutional and regulatory frameworks between countries. Rather, China's approach to international relations leans towards ensuring that different countries at different levels of development achieve a win-win situation as a result of their cooperation.[263] It is neither a game of power and interests nor a system of rules and institutions.

The relational theory of international relations and world politics was advanced by Qin Yaqing as an account of Chinese school of international relations theory. The theory is based on the logic of relationality that provides a different and alternative understanding of China's international policy that is represented through the BRI. According to the relational theory, the international system is a universe of interrelatedness.[264] The actors can therefore only be actors-in-relations. Therefore, it is not possible to understand one actor without reference to another actor. For these reasons, the theory claims that relations should be the primary unit of understanding international politics instead of isolating nation-states as separate entities.[265]

Hence, the logic of relationality is anchored on the idea that countries judge and decide based on their relationships with other countries based on the background of their relational context.[266] As such, a country's security is not anchored on its soft or hard power, rather, it is anchored on its relational power. Therefore, the sole pursuit for material power while disregarding relational management cannot make a country more secure. For these reasons, the country that manages its relations with other countries well becomes the most relationally powerful country. This country will therefore implement relational governance to supplement the already-in-place rule-based governance. This gives rise to a relational international system that is characterized by relational management and relational governance.

[262] Clarke, M. 'The Belt and Road Initiative,'
[263] Zhou, W. and Esteban, M. 'Beyond balancing: China's approach towards the Belt and Road Initiative,' 2018 *Journal of Contemporary China* Vol. 27(112).
[264] Qin, Y. 'A relational theory of world politics,' 2016, *International Studies Review* Vol. 18(1), 35.
[265] Qin, Y. 'A relational theory of world politics,' 37.
[266] Qin, Y. A relational theory of world politics, *Cambridge University Press*, 210.

Drawing from this theory, China's BRI is an initiative that is ultimately meant to improve the country's relations with its neighbours instead of what is perpetrated as hegemonic domination.[267] Second, it emphasizes on relational governance as a tool in international relations that can be used to facilitate and achieve regional development as well as cooperation. As such, it is supposed to be anchored on China's principle of neighbouring diplomacy that prioritizes building good relations in its international relations while providing harmony, security and prosperity.[268]Even though the relational theory may successfully account for the ideas behind the BRI, it does not neutralize the effect of contractual tools that Chinese official creditors use to pursue hegemonic power over sovereign debtors such as Kenya.

At the face of it, the cross-default and cross-cancellation clauses in Chinese contracts – as was established in the previous chapter – appear to imply some level of intrusive influence that China intends to have over its sovereign debtors. This is considering that the nature of the clauses is such that they empower China's official creditors to terminate and expedite repayment of debt or cut the flow of funds. As such, the interpretation of this as an ordinary contract magnifies the nature of the risk that such contractual tools have to Kenya's right of self-determination. This is notwithstanding the position that this study is yet to establish whether the debt contracts signed between China and Kenya have these cross-default, cross-cancellation and acceleration clauses. If legislators and policy makers are to perceive these contracts strictly from the realist and constructivist perspectives of international relations theory, where international relations is a game of power, interests, rules and institutions, then the country may be held up on its efforts to legislate or make policies to respond to its socio-economic issues.

An explanation of the Chinese account of the relational theory conflicts with the nature of contractual clauses implemented by Chinese official creditors in China's debt contracts. For instance, cross-default and acceleration clauses threaten that the creditors would terminate their agreements with the sovereign debtor and demand immediate and full service of the contracts if the sovereign debtor acts in a manner that undermines China's interests in the debtor country. However, the relational theory explains that relational management is different from hard power as it does not give China the ability to force others to do what it wants. A construction of cross-

[267] Wang, Z. 'Understanding the Belt and Road Initiative from the Relational Perspective,' 2021 *Chinese Journal of International Review* Vol. 3(1), 14.
[268] "Xi Jinping's speech as the work forum on peripheral diplomacy," Xinhua, October 25, 2015. - <> - on

default and cross-acceleration clauses has a very different implication. They inherently give China the power and ability to force debtor countries to do what China wants or not do what is not in the interests of China. This coupled with other clauses such as confidentiality clauses, no-Paris clauses, and cash collateral arrangements reflect the manner in which China purports to safeguard its interests and wield power through its debt contracts.

For instance, no-Paris clauses, as initially established, potentially threaten Kenya's future relations with other official bilateral creditors that participate in the Paris Club. This is because, yielding to the seniority of Chinese debt in relation to other bilateral debt come with the risk that Kenya might not benefit from the future collective debt relief advanced by the Paris Club. In another instance, the collateralization of Chinese debt through cash collaterals enabled by revenue accounts are implemented in arrangements that the citizens remain at the risk of not enjoying the benefit of infrastructure projects funded by China. Rather, the citizens run a risk of shouldering the budget of paying for funded projects even in the event they are not beneficial or do not bear a direct economic linkage. Hence, the risk that Chinese debt contracts currently influence or are likely to influence Kenya's domestic policy in the future are still real and ought to be guarded against.

The demonstrated part of Kenya's legal framework established in the previous Chapter depicts the country as a constitutional supremacy with strong constitutional values and principles that are meant to safeguard the interests of the people of Kenya. Even though the cross-default and stabilization clauses threatens success in legislative reforms, it is important to evaluate the place of such international agreements and where they rank in the hierarchy of the laws of Kenya. First, it is already inherent that they a rank below the Constitution. Therefore, pursuant to the supremacy clause, they ought to be rendered unconstitutional to the extent that they are found to be in conflict with the provisions of the Constitution. The same would apply to domestic legislations. Hence, it is important to drive constitutional reforms that are more inclined towards cementing transparency and accountability with respect to state officers involved in the procurement of external debt. For instance, constitutional amendments with effect to compelling the CS in charge of the National Treasury to publish the terms and conditions under which debt contracts in the country have procured would improve effectiveness in debt management. Further, legislative interventions listing minimum conditions under which external debt should be procured would be important if entrenched in provisions of the law to assist with accountability. Such general legislative

interventions do not directly undermine the interests of Chinese official creditors in Kenya. As such, they are less likely to imply breach of the cross-default clauses in Chinese contracts. As such, the generalization approach to such legislative provisions is important to guard against legislations that undermine Chinese interests.

4.4 Collateralization of Chinese Debt and the Debt Trap Diplomacy

Various scholarly works have been published with a view to debunking the notion that China has been leading a debt trap diplomacy through its lending practices with developing countries. Special references have been made to the allegation that China forced Sri Lanka to make sovereign concession by yielding the Hambantota port to the China following default on Chinese debt.[269] Even so, studies clarifying the air and debunking the risk of seizure of sovereign assets indicate that the case of the Sri Lankan port was not a debt-for-equity swap arrangement.[270] A different account of the situation avers that Sri Lanka had leased a majority stake in the port (which was financed by the Chinese) to Merchant Port Holdings which is a Chinese state-owned enterprise.[271] It has been established that by the time this arrangement was taking place, Sri Lanka had not yet defaulted on Chinese loans.[272] It is also argued that the terms of their loan agreements have been maintained and none has been changed with a view to cancel Sri Lanka's debt in exchange for Chinese control over the Hambantota. Further, new findings also reveal that the proceeds of China's investment in the port were not directed towards repaying the country's debt owed to China.[273] Therefore, the newly assumed position debunking the debt-trap 'myth' is that there is no evidence that China is using loans to take over strategic assets.

Further arguments to debunk the argument advancing the idea of China's debt-trap diplomacy claim that China is not using loans to take over natural resources of its sovereign debtors. In a study conducted by Brautingam and Hwang in 2017, there is an attempt to justify China's use of commodity-secured financing.[274] However, the postulations made in this study seem too week to

[269] Chaudhury, S. R. 'China, the Belt and Road Initiative, and the Hambantota Port Project,' 2019 *St Antony's International Review* Vol. 15(1), 153.
[270] Singh, A. 'The myth of 'debt-trap diplomacy and realities of Chinese development finance,' 2021 *Third World Quarterly* Vol 42(2), 244.
[271] Chaudhury, S. R. 'China, the Belt and Road Initiative, and the Hambantota Port Project.'
[272] Sautman, B and Hairon, Y. 'Trade, Investment, Power and the China-in-Africa Discourse,' 2019 *Pacific Affairs* Vol. 18(1), 2019.
[273] Sautman, B and Hairon, Y. 'Trade, Investment, Power and the China-in-Africa Discourse,'
[274] Brautigam D. and Hwang, J. 'Chia-Africa loan database research guidebook,' 2017, *China Africa Research Institute* 4.

debunk the debt-trap 'myth'. First, the authors admit that China indeed strategically issues resource-backed loans that make up at least half of China's loans to Latin America and a third of China's loans in Africa.[275] In Latin-America, China's commodity-backed loans are secured in oil.[276] However, in assorted countries in Africa, the loans are secured by a variety of commodities such as oil, tobacco, cocoa and profits from minerals such as copper and diamond.[277] While this strategic approach is not denied, an account is given that Chinese resource-backed loans are often used in high-risk countries.[278] For these reasons, this approach is justified by the need to mitigate the risk of lending to poor and unstable sovereign debtors that also score very low on credit ratings.[279] Sovereign debtors should therefore be comforted with the ideas that China does not have any interest in securing the long-term natural resource supplies in the long-term. Rather, it is meant to make it easier for developing countries to obtain financing under circumstances that would make it difficult for them to obtain similar financing from the conventional western lending institutions.[280]

To further reiterate the lack of mischief in these Chinese resource-backed lending practices, China's response to Venezuela's default in its debt has been brought to fore. In March 2015, it was reported that the US government sanctioned Venezuela including its Central bank and the state's oil firm that generates at least 90% of the country's national revenue.[281] In response to Venezuela's inability to service Chinese debt, China agreed to renegotiate its oil-backed loans with Venezuela to address the challenges they were experiencing as a result of disrupted cash-flow. The restructured repayment terms would allow Venezuela two years' relief from repaying the principal and further proceeded to buy oil from Venezuela for cash instead of substituting the oil shipments for loan repayments.[282]

[275] Brautigam D. and Hwang, J. 'Eastern promises: New data on Chinese loans in Africa, 2000 to 2014,' 2016, *China Africa Research Institute* Working Paper, 4, 4.
[276] Gallagher, K. P. & Irwin, A. 'China's economic statecraft in Latin America: Evidence frm China's policy banks.' 2015 *Pacific Affairs* Vol. 88(1).
[277] Singh, A. 'The myth of 'debt-trap diplomacy,'
[278] Singh, A. 'The myth of 'debt-trap diplomacy and realities of Chinese development finance,' 2021 *Third World Quarterly* Vol 42(2), 246.
[279] Brautigam D. and Hwang, J. 'Eastern promises, 15.
[280] Singh, A. 'The myth of 'debt-trap diplomacy.'
[281] Brautigam, D. 'A critical look at Chinese 'debt-trap diplomacy: The rise of a meme,' 2020, *Area Development and Policy* Vole. 5(1), 8.
[282] Brautigam, D. 'A critical look at Chinese 'debt-trap diplomacy: The rise of a meme,' 2020, *Area Development and Policy* Vole. 5(1), 8.

Based on initial observation of Chinese lending patters in the second chapter, there is a chance that Chinese debt contract financing the Standard Gauge Railway and the Nairobi Expressway (toll road) are implemented with cash collateral clauses. This implies that there is a possibility that there could be revenue or escrow accounts to which revenues from the two funded projects flows to facilitate repayment. These resource-backed forms of collateralization bear a real risk of the seizure of revenues from these projects in the event of default – which is highly imminent. As conventional practice has been, the restructuring of foreign loan has easily ended up in the establishment of workout agreements with debt-equity swaps in the existence of a collateral. Such debt-equity swaps have conventionally resulted in the seizing of customs or tax revenues as well as the takeover of underlying assets such as railroads, land or export goods.[283] Hence, when dealing with sovereign default risks, experts such as Andritzky recommend that defaulting countries should be well advised to secure their assets against attachment.[284]

In respect of the foregoing, it is important to legislate and develop policy interventions that restrain the ability of creditors to seize the assets of debt-distressed debtors who have consistently acted in good faith.[285] This is a practice that is currently being adopted by various countries across the world either by ratifying the United Nations Convention on Jurisdictional Immunities of States and Their Property or enacting domestic laws.[286] For instance, in 1976, the United States enacted the US Sovereign Immunities Act to limit the enforcement of sovereign debt against state assets used for commercial purposes save for when there is a connection between the asset and underlying claim.[287] A similar approach adopted by UK's State Immunity Act, 1978.

Similarly, consent is a critical aspect in sovereign immunity as it is the element that allows another sovereign to subject another sovereign of equal standing to the jurisdiction of its courts in the event

[283] Andritzky, J. Sovereing default risk valuation: Implications of debt crises and bond restructurings, 2006, Springer, 19.
[284] Andritzky, J. Sovereing default risk valuation: Implications of debt crises and bond restructurings, 2006, Springer, 77.
[285] Gill, I. & Buchheit, L. C. 'Targeted legislative tweaks can help contain the harm of debt crises,' June 27, 2022 *The Brookings Institution* -< https://www.brookings.edu/blog/future-development/2022/06/27/targeted-legislative-tweaks-can-help-contain-the-harm-of-debt-crises/#:~:text=Sovereign%20bond%20contracts%20issued%20over,prevail%20even%20over%20dissenting%20bondholders.> - on June 27, 2022.
[286] UNCTAD, 'Responsible sovereign lending and borrowing,' 2010 *Discussion Papers* No. 198, 7. -< https://unctad.org/system/files/official-document/osgdp20102_en.pdf > - on June 27, 2022.
[287] Reece, T. K. 'Enforcing against state assets: the case for restricting private creditor enforcement and how judges in England have used "context" when applying the "commercial purposes" test,' 2015 *Journal of International and Comparative Law* Vol. 2(1), 9.

of disputes. Kenya's laws on sovereign immunity may not rely on absolute sovereign immunity to ascertain protection against being subjected to Chinese courts and subsequent pre-judgment and post-judgment measures against sovereign assets. The confidentiality clauses in the Chinese debt contracts already prevent the people of Kenya (the sovereign), legislators and policy makers from knowing whether or not the state had given consent to have the country submit to the jurisdiction of Chinese courts in the event of a dispute between them regarding default. To this end, the country may not rely on this international law principle unless it is certain that such consent was withheld. Further, as a future legislative development, the law on public finance management should clearly provide conditions that precede the conferment of such consent by a representative of the state. Especially such consent that is likely to have far-reaching implications that traverse across generations. It is therefore important that the conditions under which such consent may be given to waiver absolute sovereign immunity must include aspects of democratic accountability such as public participation and the approval of the country's legislative houses.

4.5 Chinese Predatory Lending and the Resulting Moral Hazard

The following study in the second chapter has established that the nature of the contractual terms under which Chinese debt contracts are issued result in contracting of debt under odious terms. Hence, taxpayers are inclined to shoulder the burden of debt that could otherwise be disowned as odious debt. The third chapter has demonstrated poor democratic accountability in Kenya's legal framework that to some extent imply a regime with unchecked power to borrow. This is coupled with exposure of the country's sovereign assets and a public finance legal and institutional framework that does not anticipate or guard against the legal risks that Chinese lending practices are infamous for. This part therefore analyses the extent to which the possibility of lending under odious terms coupled with a poorly structured legal framework translates into a moral hazard. A greater legal risk that has to be brought to the attention of policy makers and legislators for future action.

Currently the doctrine of odious debt is no longer recognized at international law. The international community is less inclined to reintroduce it with the effect of allowing governments to disown debt that qualifies as odious. However, the fact that the doctrine is not in force does not imply that there are no external debt arrangements that would pass as odious debt. This position coupled with a poorly structured legal and institutional framework to guard against contracting debt that would

otherwise be odious creates a different problem on a higher level. The problem of moral hazard in the sovereign debt market. The moral hazard emerges when official creditors such as China resort to issuing contracts under 'odious terms and conditions' due to the belief that such debt cannot be legally cancelled for being odious. The failure of the state to internalize and act on these risks places a heavier burden on the taxpayers of the current and the future generations who eventually unfairly shoulder the resulting burden.

Empirical studies have established that resource-based lending practices slow down growth and could potentially cause political instability in the debtor country.[288] The clandestine and opaque nature of Chinese already open room for corrupt practices. Such practices easily play out in resource-rich environments where the leadership (whether or not democratically put in place) is open to directing the national economy into bankruptcy at the expense of the public.[289] From this proposition, it is argued that natural resource stocks are directly held by the government in form of sovereign assets. The potential for poor governance coupled with an unchecked ruler who enjoys property rights in the resources of the state also creates a better environment for the procurement of odious debt.

Therefore, such an unstructured legal and institutional framework also create a dictatorship out of a democratically elected government that could potentially procure odious debt with the full aid of bilateral creditors without any consequences emanating from accountability of the leadership or cancellation of the debt as odious. It's win-win situation that magnifies the problem of the moral hazard even further. What is apparent is that the moral hazard problem may not be resolved by resurrecting the international law doctrine of odious debt. This is based on the proposition that the doctrine itself creates moral hazard problems that now originate from the state more than they do from the official creditor. In this regard, a moral hazard problem features when the debtor state enjoys the liberty to cancel debt and therefore abuses this liberty to borrow recklessly.[290] Therefore, the fizzling out of the doctrine of odious debt only shifted the moral hazard from the sovereign

[288] Sarr, M., Bulte, E., Meissner, C. and Swanson, T. 'Sovereign debt and the resource curse,' in Kolb, R. W. Sovereign debt: From safety to default. 2011 *John Wiley & Sons Inc.* 55.
[289] Sarr, M et al. Sovereign debt, 55.
[290]Mendel, S. 'Odious lending: Debt relief as if morals mattered,' 2006 New Economics Foundation -< https://neweconomics.org/uploads/files/fff4a8929678dfec38_e5m6bdjp4.pdf > - on June 28, 2022. 8.

debtor to the bilateral creditor. However, a structured system of domestic laws can reverse the effect of this moral hazard by anticipating it and the legal risks incidental to it and mitigating them.

An analysis of Kenya's legal framework in the previous chapter demonstrates that the prevailing legal framework in Kenya is not intentionally structured to sufficiently protect the country against the legal risks emanating from resource-based lending. This unstructured approach to resource-based lending as established in the second chapter exposes the current and future generations of taxpayers to shouldering the burden of what would otherwise qualified to be discounted as odious debt. It would suffice to imply that the current legal framework coupled with the risks of borrowing from China does not guarantee intergenerational equity as contemplated in the Constitution. However, the enhancement of the country's participation in multilateral organizations such as the IMF could increase the chances of reforming the current global debt architecture to accommodate the new perspective of the doctrine of odious debt as redefined in the second chapter of this research. Therefore, Kenya, in collaboration with other countries could work together towards lobbying increased participation in IMF to an extent that can influence the protection of African countries against liability for odious debt.

Further, intergenerational inequity is imminent when loan contracts signed by the government are implemented with very broad confidentiality clauses and the democratic accountability laws are not sufficient to bring the terms and conditions of these debt contracts to the knowledge of citizens who shoulder the burden of repayment. Not only was their consent not obtained, but they did not participate in the deliberations leading up to the procurement of the debt. Further, the democratic institutions entrusted with oversight in this representative democracy such as the National Parliament of Kenya has so far not lived to its potential to legislate to mitigate against the discussed legal risks. Further, the role of determining the terms under which the country should borrow have been entrusted with the country's public finance management system established under the National Treasury and Planning. The strategy adopted by this institution is more aware and focused on mitigating against economic risks and is less alive to the legal risks that the terms of lending should guard against. It has been argued that odious debt results from lending practices that result in little other than just debt for the subject country. It may be too harsh to infer that Chinese debt contracts has only resulted to little other than debt for Kenya. However, it is possible that this could be the long-term outcome that would slowly unfold from the materialization legal risks that Kenya

is exposed to by signing up to these resource-backed loan contracts. Hence the argument that unstructured lending undermines efficient sovereign loan contracting and this directly or indirectly results in odious debts.

4.6 Conclusion

The following chapter has established the following regarding the legal risks that result from default in bilateral debt from China to Kenya. First, that even though China is slowly starting to lean towards collective debt relief, any No-Paris club clauses that still bind its debtors – with Kenya possibly affected – put them at the risk of compromising their relations with other bilateral creditors. This is pegged on China remaining persistent in its disregard of the comparability of treatment principle. Second, it establishes that and understanding of China's new approach to international development and cooperation through the lenses of the relational theory of international relations does not diminish the risks of China undermining Kenya's right of self-determination through policy influence. Third, the collateralization of Chinese debt contracts through strategically targeting resource-based loans still imply that the risk of attaching and seizing sovereign assets is still real. Finally, it establishes that the weaknesses in Kenya's legal framework on sovereign immunity, democratic accountability and public finance management leave Kenya vulnerable to unfairly shouldering the burden of odious debt without the privilege of cancelling such debt for being odious.

Chapter 5:

Conclusion and Recommendations

5.1 Summary of Conclusions

The study has conducted a comprehensive evaluation of the legal risks that can lead to and possibly result from Kenya's default on external debt from China. Following a desk study conducted in light of addressing the legal problem and answering the research questions posed in the initial chapter, this study made the following findings in the respective chapters.

The second chapter of the study inquired into the nature of the legal risks of non-concessional financing from Chinese debt and established the following. As a result of an observation of Chinese lending patterns across different parts of the world, it was established that even though China also advances bilateral loans under concessional terms, it is its non-concessional loans that bear heavily with respect to legal risks. The first risk that emanates from Chinese debt was the lack of transparency as a result of broad confidentiality clauses implemented in debt contracts. This goes a long way in affecting democratic accountability in addition to compromising debt restructuring processes. The second risk is the absence of comparability of treatment occasioned by no-Paris clauses that exclude Chinese debtors from benefiting from collective debt relief while threatening good relations between debtors and their Western creditors who participate in the Paris Club of official creditors. Third was the risk of policy influence that emanates from cross-default and acceleration clauses which restrain debtors from developing policies and legislations that negatively affect the interests of China. This comes with the implication that the legislative interventions that this study has identified as a way forward might prove difficult to bring to force without the risks of breaching the cross-default clauses in Chinese debt contracts with Kenya. The fourth risk was the risk of potential lawsuits and seizure of strategic assets emanating from cash collateral agreements. The final risk was the risk of unfairly shouldering the liability of debt that would otherwise pass as odious.

The third chapter examined the role of the Kenyan legal framework in anticipating and mitigating against the legal risks arising from default on public external debt. This chapter conducted a thematic examination of Kenyan legal and institutional framework on government borrowing and established the following. That the country's sovereign immunity laws in Kenya do not anticipate

the risks that emanate from the commercial activities of the state such as borrowing. This is considering that based on such activities, the state loses the privilege of invoking sovereign immunity with respect to liabilities incurred. As such, the study took note of the absence of domestic legislation in Kenya to protect the country's sovereign and strategic assets against pre-judgment and post-judgment measures such as attachment and execution. What is worse is that the country is yet to ratify the United Nations Convention on Jurisdictional Immunities of States and Their Property, 2004. This chapter also established that the democratic accountability laws in the country are also not strong enough to hold state officers accountable for decisions on procurement of debt. Further, with regard to the public finance management law, the study established that there is no clear legal framework or policy that sets out the minimum terms within which the country may contract bilateral debt in anticipation of legal risks incidental thereto.

The fourth chapter conducted an examination of the implication of the legal risks on Kenya's indebtedness to China while highlighting the possible legal and policy approaches that could be essential in mitigating the risks. In light of the No-Paris clauses, the study found that China's recent dalliance with collective debt relief is not promising enough to guarantee absence of the risks incidental to no-Paris clauses. For these reasons, it is important for policy makers to make collective action clauses or collective debt relief as a minimum condition for procurement of bilateral debt or preference to creditors who are conventionally open to collective debt relief. With regard to the threat of China's policy influence, the study established that the nature of Chinese hegemonic contractual clauses in their debt contracts are inconsistent with the relational theory that attempts to account for China's new approach to international cooperation and development. As a result, the risk of China's influence on Kenya's domestic legislation and policy is still real. With regard to collateralization and threat of seizure of assets, this part established that there is no empirical evidence that China has seized strategic assets of debtors that have defaulted on their debt with China. However, its cash collateralization approach to securing its loans still rekindle the need for policy makers and legislators to develop policies to protect the country's resources and assets against pre-judgment and post-judgment measures emanating from possible enforcement of debt in the event of default. Finally, it establishes that the invalidity of the principle of odious debt at international law coupled with the poorly structured legal framework on government borrowing in Kenya creates the problem of a moral hazard on the end of Chinese creditors. This culminates in the risk of shouldering liability for debt that would otherwise be

odious. Hence the need for policy makers and legislators to strengthen the structure of the prevailing legal framework with specific regard for this moral hazard problem.

5.2 Recommendations

Based on the foregoing findings, this study has proved the hypothesis advanced in the initial chapter that the potential default in the burgeoning official bilateral debt from China exposes Kenya to legal risks that the current legal framework neither anticipates nor sufficiently mitigates against. It is based on these findings that the study proposes the following recommendations.;

1. First, Kenya should enact and regularly update the legislation of clear decision-making processes and requirements for procurement of official credit especially if the same is being procured under non-concessional terms as follows:
    a) A constitutional amendment of Article 211 of the Constitution of Kenya 2010 to include the terms and conditions of procuring external loans to be part of the scope of information that Parliament may seek from Cabinet Secretary Responsible for finance when during accountability processes attributable to borrowing by the National government. In the absence of such terms and conditions, Parliament is not able to influence and improve the country's negotiating capacity in light of the anticipated risks. While the process of constitutional amendment might be rigid in Kenya, this proposed amendment is feasible considering that it does not feature among the provisions that must be amended through a referendum and rather through the parliamentary process.
    b) That the National Parliament should legislate on the minimum terms and conditions upon which the national government may procure public debt with respect to protecting specific interests such as the country's strategic assets and key interests of the people. Such legislated terms and conditions are essential in setting the standards against which the National Executive accounts to the sovereign their borrowing decisions. Even though this could be limited by the risk of breach of negative pledge clauses, it is important to approach such amendments from a general perspective to an extent that is not directly averse to the interests of China in Kenya.
    c) The National Parliament should also legislate on minimum legal terms for the procurement of non-concessional debt to include agreement to collective debt relief mechanisms of restructuring and renegotiating official debt in the event of default. This, to a greater extent,

limits the post-contractual legal risks that occur during enforcement of non-concessional debt in the event of default. While these amendments might not be essential towards mitigating the risks with respect to debt contracts that have already been executed, they are essential in anticipating and mitigating the risks in debts that will be procured in the future. They include terms such as procuring external debt only from official creditors who are agreeable to collective debt relief; asserting protection over national assets against seizure; and availability of the terms of the contract for public scrutiny among other related conditions.

2. Secondly, Kenya should lobby for the Africa's increased participation in the World Bank to Influence participation of Kenya and other African countries in the development of policy forming the global financial architecture. This would ensure that the interests of developing economies are taken to account in the decisions made such multilateral institutions. This might take longer to achieve compared to other suggested recommendations considering the difficulty that comes with securing a common position within the continent and also taking to account that it is directed towards suggesting an overhaul of the global debt architecture. Even so, such reforms towards transforming the global financial architecture are underway and enjoy the support of the UN independent Expert on the effects of foreign debt and the UNCTAD.
3. Thirdly, Kenya should ratify the United National Convention on Jurisdictional Immunities of States and Their Property, 2004 to minimize the legal risks attributable to pre-judgment and post-judgment measures of constrain against national assets in the event of court action. The current position is untenable because there is no national legal framework that protects national assets against pre-judgment or post-judgment procedures that may involve seizure of national assets within and outside the country. As such, the ratification should put Kenya in a more secure position pending the enactment of a domestic legal mechanism.
4. Kenya should pursue the possibility of coordinated action by African countries against China and non-Paris Club bilateral creditors at the regional and continental level through institutions such as the African Union by developing template loan agreements essential for negotiating debt terms with China and other similar non-conventional creditors. Although this might be it is important to note that this is likely to be set back by the challenges that inherently occur to the implementation of international laws which remains a predominant challenge in the international legal order. This is considering that the international legal order is not well

implemented with an enforcing mechanism that would restrain the manner in which states negotiate bilateral agreements with official creditors.

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16th May 2022

Mr Odhiambo Moses,
odhiambo.moses@strathmore.edu

Dear Mr Odhiambo,

RE: Evaluating the Legal Risks Resulting from Default on External Debt from China: A Study of The Belt and Road Initiative in Kenya

This is to inform you that SU-IERC has reviewed and **approved** your above **SU Masters'** research proposal. Your application reference number is **SU-IERC1295/22.** The approval period is **16th May 2022 to 15th May 2023.**

This approval is subject to compliance with the following requirements:

i. Only approved documents including (informed consents, study instruments, MTA) will be used
ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-IERC.
iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-IERC within 48 hours of notification
iv. Any changes, anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-IERC within 48 hours
v. Clearance for export of biological specimens must be obtained from relevant institutions.
vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal.
vii. Submission of an executive summary report within 90 days upon completion of the study to SU-IERC.

Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology, and Innovation (NACOSTI) https://research-portal.nacosti.go.ke/ and obtain other clearances needed.

Yours sincerely,

for: **Dr Ben Ngoye,**
Secretary; SU-IERC

STRATHMORE UNIVERSITY INSTITUTIONAL ETHICS REVIEW COMMITTEE
(SU-IERC)
16 May 2022
Email:ethicsreview@strathmore.edu
P.O BOX 59857-00200
NAIROBI-KENYA

Cc: Prof Fred Were,
Chairperson; SU-IERC