UNIVERSITY OF NAIROBI

SCHOOL OF LAW

Legal Framework on Sovereign Debt Restructuring in the Face of Debt Crisis in Kenya

A Thesis Submitted to the University of Nairobi School of Law, In Partial Fulfilment of the Requirements for the Degree

Master of Laws (LLM)

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Course Title: Research Paper

Course Code: GPR 699

Declaration

This Thesis is my original work and has not been presented for a degree in any other University.

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The thesis has been submitted for examination with my approval as University Supervisor.

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Acknowledgement

I am mostly grateful to Allah for the opportunity to pursue my dream. This paper was a culmination of efforts of various persons in their different capacities.

Special thanks to my supervisor, Dr. Jackson Bett, tapping from your wisdom was an honour and a privilege that I do not take for granted. I am grateful to my defence panel members, Dr. Gitahi Munyi and Dr. Ken Mutuma, for their useful reflections and guidance, you were truly inspirational.

I would also like to extend my gratitude to my entire family who gave me support during this time. You are all greatly valued. I am very grateful to my life partner for his support and advice throughout this project.

In the end, I hope we can apply the finding of this paper practically in our Country to help guide with the sovereign debt restructuring process.

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ABSTRACT

Unsustainable sovereign debt may result in adverse economic problems within a Country. Recently, the excessive accumulation of sovereign debt in Kenya has raised issues both locally and internationally this will lead to the inevitable sovereign debt rearrangement of these debts. It has been noted that there is a need for a legal framework to help facilitate the process of on rearrangement of the sovereign debts in the Country. The focus on this research identifying the problems in the existing sovereign debt rearrangement processes such as the controversy on the faults of the existing market structure, and the propose effective and reasonable resolutions for debt predicaments that could be practically applied in the Kenyan context.

CHAPTER ONE: INTRODUCTION

1.0 Introduction

Sovereign debt refers to "debt incurred by governments, typically those of developing countries to foreign investors seeking a competitive return".[1] Public debt is also known as sovereign debt. Article 214 of the Kenyan Constitution, illustrates this to mean all monetary compulsions associated with credits acquired or awarded by federal administration, this includes foreign dues. The public debt refers to a levy on the combined finances but may be charged to other public funds. [2] Initially, federal administrations acquired finances overseas mostly via selling bonds in the foreign stock exchange markets, but with sovereign debt, loans from commercial banks seems to be the preferred means currently. The issuing or guaranteeing of debt by a government of a sovereign state is normally associated with terms that require the state to repay the debt.[3]

In Kenya the sovereign debt has been rising.[4]This has caused alarm even in the international community leading to a warning that Kenya's debt is approaching the unsustainable levels.[5] Sovereign debt may result in a crisis in the economic performance of a nation and its citizens if they are unable to meet the repayment terms such as in the cases in Greece[6] and other countries.[7] Often when a sovereign debt crisis arises, the financier faces negative impacts, while also hurting the concerned nations in the international financial system. A state that is facing a sovereign debt

[1] Eaton J And Fernandez R, 'Chapter 39 Sovereign Debt' 2031
[2] Article 214, The Constitution of Kenya
[3]Macneil, Contracts: Adjustment of Relations Under Classical, Neoclassical, And Relational Contract Law, 72 Nw. U.L. Rev 856.
[4] Joseph Onjala, 'China's Development Loans And Threat Of Debt Crisis In Kenya, 'Institute Of Development Studies,University Of Nairobi(2017).
[5] Imf Country Report Number 18/295,Oct 2018.
[6]Mongare Ev, 'Sovereign Debt Rearrangement Cycles And Crises' [2018] Ssrn Electronic Journal
[7] Caldwell D, *Greece: Economic Crises and Management* (2016)

crisis may also have a major disruption to the regional and international economic performance if it is a major producer or consumer of specific commodities.

The intention of having bankruptcy laws in every nation is to avert these challenges and ensure systematic rearrangement and debt relief.[8]However, the lack of inclusive global bankruptcy approach to facilitate appropriate determination of sovereign debt challenges has thwarted the process. As an alternative, the present sovereign debt rearrangement (SDR) system is characterized by a decentralized market-oriented approach through which the borrower conducts complex consultations with several lenders having diverse securities, usually in the context of Contradictory legal structures of the state.[9]

A functioning sovereign debt reorganization structure ought to facilitate a systematic rearrangement capable of restoring debt sustainability, ensuring that the cost of doing is achievable both the government and its lenders. Nonetheless, changes to the structure ought to guarantee that the possible implications of rearranging are efficient in ensuring that nations have enough motivations to administer their debts as required, hence lowering the interest of borrowing for nations. [10]

The significance of this study lies in the fact that Kenyan debt burden has proven to be unsustainable. Therefore, there is need to propose a legal framework on sovereign debt rearrangement that will facilitate the rearrangement the Country's debts.

[8] Guzman, Martin And Joseph E. Stiglitz. "Creating A Framework On Sovereign Debt Rearrangement That Works". Columbia University Working Paper (2014a
[9] Ibid
[10] Tapas Strickland: Sovereign Debt Rearrangement: Recent Issues And Reforms, Bulletin,2014 (Https://Www.Rba.Gov.Au/Publications/Bulletin/2014/Dec/Pdf/Bu-1214-9.Pdf)

1.1 Problem Statement

National debt challenges are on the rise. As such, citizens in such countries grapples with tax burdens. Even so, there is limited techniques to resolve this type of crisis in the nations that are yet to be in such situations and fear that they will soon land in crisis. In fact, exorbitant expenses coupled with doubts linked with debt rearrangement are holding back foreign exchange efficiency, forcing developing and emerging nations to incur enormous interest rates as opposed to if their alternative means to solve such crises.

The Kenyan government's current rate of borrowing has raised concerns from both the citizens and the international community. In 2019, the Kenyan legislature raised the debt ceiling above 50% of gross domestic product (GDP) as previously provided by the Kenyan law on the debt ceiling.[11] The amendment was occasioned by the strategy of the state to cast the total figures' borrowing limit instead of GDP ratio. An appraisal by the National Treasury indicated a debt ceiling of Ksh. 9 trillion ($86 billion) approved by the Kenyan legislature.[12] As of 2019, Kenya's debt was 59% of the GDP, exceeding 50% of the GDP. By June 2013, the country's total debt was 1.9 trillion shillings, but the country had borrowed 5.8 trillion shillings by June 2019.[13] Kenya's borrowing trends suggest an increased appetite for debt accumulation. The rising debt level approaches the ceiling that might influence unsustainable economic growth, because revenue generation will be relatively lower than the debt obligation. In response to the increasing debt, the International Monetary Fund (IMF) in the year 2018 revised Kenya's possibility of international debt anguish

[11]David Herbling, 'Kenya To Double Debt Ceiling To Almost Match Economy's Size' *Bloomberg.Com* (16 October 2019) <Https://Www.Bloomberg.Com/News/Articles/2019-10-16/Kenya-To-Double-Debt-Ceiling-To-Almost-Match-Economy-S-Size> Accessed 6 October 2020.
[12]Eunniah Mbabazi, 'Senate Committee Approves Treasury's Ksh 9 Trillion Debt Ceiling' (*Kenyan Wallstreet*, 2019) <Https://Kenyanwallstreet.Com/Senate-Committee-Approves-Kshs9-Trillion-Debt-Ceiling/> Accessed 6 October 2020.
[13]Herbling (N 15).

from low to reasonable because of increasing refinancing risks. Kenya's National Treasury derives its authority from the newly promulgated Constitution, the Executive order No. 2/2013, and the Public Management Act 2012.

Law amendment to cast the debt ceiling in absolute figures rather than a GDP ratio is a risky move by Kenya's National Treasury. Not pegging borrowing on economic performance might lead to over-borrowing. Moreover, the National Treasury implements its obligations according to any law as may be established or reevaluated by the national assembly regularly poses a risk of a tasking a partisan legislature with the sole responsibility of setting debt policies.

This has even raised concern in the international community, leading to a warning that Kenya's debt is approaching unsustainable levels.and there is need to mitigate. However, it is worth noting that the national laws mainly provide for sovereign debt management and there lacks a regulatory structure on international debt rearrangement, which is common in many other states. Further, the research discusses why Kenya needs a legal framework around sovereign debt issues by drawing lessons applied in other jurisdictions.

1.2 Objectives

1. To Contextualize Sovereign Debt Rearrangement processes for purposes of the debt situation in Kenya.

2. To identify the absence of the Legal framework to underscore the need for a debt rearrangement system in Kenya.

3. To explore and analyze a number of proposals on sovereign debt rearrangement frameworks, which have been adopted in other jurisdictions and how they could be applied to the Kenyan context.

1.3 Research Questions

1. Is there need to contextualize Sovereign Debt rearrangement processes for purposes of the debt situation in Kenya?
2. Is there an absence in the legal frameworks on rearrangement of the unsustainable debt in Kenya?
3. Are there lessons drawn from other Jurisdictions on various frameworks on Sovereign Debt rearrangement?
4. Is there a proposed recommendation on Sovereign Debt Rearrangement in Kenya?

1.4 Hypothesis

This research is guided by the assumption that gaps exist in legal framework on Sovereign Debt Rearrangement in Kenya and the proposed solutions will enable the debt to be manageable to avoid a major crisis.

1.5 Justification of the Study

This paper argues that there is a looming challenge associated with excessive borrowing by the Kenyan government and therefore there is a need to examine the various approaches on sovereign debt rearrangement that have been used by other Jurisdictions with the aim of drawing conclusions and lessons to aid in countering a greater debt crisis in Kenya.

1.6 Methodology

The research used a critical research literature review. Data and information were retrieved from books, reports, journals, and other relevant materials. The paper adopted a doctrinal approach to critically analyzing the existing legal texts. The thesis relied on both qualitative and quantitative data.

1.7 Theoretical Framework

This paper is premised on two main theories: the virtue ethics theory and the relational contract theory.

Virtue ethics as a school in moral philosophy postulates that human beings should lead flourishing lives (eudamonia). The theory holds that it is the function of the law to ensure that citizens lead flourishing lives.[14]Aristotle propagated virtue ethics theory. It emphasizes the need for human beings to live comfortably and with no struggle. The main philosophy of this theory is that citizens should lead flourishing lives.[15] The government must ensure that its citizens enjoy flourishing lives through the establishment of laws that promote virtues such as fairness, equity, and morality. There should be laws that govern the acquisition and management of a state's resources and finances, which should put into consideration the acquisition and management of public debt. Such measures will ensure that public debt is controlled to avoid getting to unsustainable levels. Unsustainable debt causes debt crises and affects the lifestyles of the citizens as it burdens them with the responsibility of paying the debt. Besides, it leads to underdevelopment and an increase in the

[14] Cf Cimino, 'Virtue And Contract Law'(2009) 88 Or. L. Rev. 703, 715. Cimino Notes That Aristotle, The Originator Of Virtue Ethics, Considered The Achievement Of Human Flourishing As The Function Of Law And Government.

[15]P Koller, 'Law, Morality And Virtue' In Rebecca L Walker And Philip J Ivanhoe, *Working Virtue: Virtue Ethics And Contemporary Moral Problems* (Oxford University Press 2006).

poverty level since the revenue collected is directed towards loan repayment instead of development programs.[16] The theory is relevant for this study as shows the need to restructure debts so that the burden on the citizen due to the unsustainable debts reduces and citizen can live as flourishing life as advocated by this theory.

Relational Contract Theory (RCT) holds that all contracts are embedded in relations ranging from discrete to relational, meaning that they produce relational norms over time.[17] The theory emphasizes the taxonomy of relational contract by considering the majority of the private exchanges to be occurring within the current relationships that exist between the parties involved and not just in the discrete transactional environment.[18] The comprehensive proposition of the current valuation holds that finance and economics professionals ought to come up with fresh ideas of resolving challenges linked with sovereign debt,[19] the legal body within the nation must also stamp their authority as counsellors, diplomats as well as drafters in rearrangement taking into account the need to have a functional ratifying management of sovereign debt.[20] Consequently, the provisions of the relational theory are applied to support the legal team in this issue. This proposition is relevant to this study since it grants a normative lesson to lawyers that serve as a guide in proposing regulatory structure on sovereign debt rearrangement.

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[16]Muriuki Muriungi, 'Towards A Legal Framework On Sovereign Debt Rearrangement: A Developing Countries' Perspective' (Thesis, University Of Nairobi 2016) <Http://Erepository.Uonbi.Ac.Ke/Handle/11295/100281> Accessed 28 October 2020.

[17] Paul J. Gudel, Relational Contract Theory And The Concept Of Exchange, 46 Buff. L. Rev. 763 (1998). Available At: Https://Digitalcommons.Law.Buffalo.Edu/Buffalolawreview/Vol46/Iss3/4

[18]Keith Palzer, 'Relational Contract Theory And Sovereign Debt' (1988) 8 Northwestern Journal Of International Law & Business 727 <Https://Scholarlycommons.Law.Northwestern.Edu/Njilb/Vol8/Iss3/36>.

[19] Hope & Klein, *Issues In External Debt Management,* In 2 International Borrowing: Negotiation And Renegotiation 4.A (D. Bradlow & W. Jourdin Rev. Eds. 1984)[Hereinafter International Borrowing].

[20] Hope & Klein, *Issues In External Debt Management,* In 2 International Borrowing: Negotiation And Renegotiation 4.A (D. Bradlow & W. Jourdin Rev. Eds. 1984)[Hereinafter International Borrowing].

1.8 Literature Review

Public debt sustainability is a major challenge across the globe.[21] In Kenya, the public debt management mechanisms are under scrutiny due to swelling public debt in the country.[22] The Kenyan national assembly has claimed frequent borrowing by the central bank is a result of its incapacity to approve them. The existing legal framework in Kenya is mainly focused on the sovereign debt management. This research focuses mainly on proposing a legal framework or approaches on sovereign debt rearrangement to be applied in Kenya due to the current debt crisis. Unmaintainable debt quantities can be detrimental. This is because they lead to major disruptions to regional and international economic performance. For instance, the government of Kenya lose its authority over significant national assets to international lenders as the case with Sri Lanka.[23]This paper was suggesting the sovereign immunity issues in sovereign debt rearrangement, this research is relevant since it will not only focus on the issues in sovereign debt rearrangement but will suggest solution on rearrangement the sovereign debt. By September 2018, Kenya was facing a debt crisis because of a debt of $51.5 billion, with more than half of the debt ($26.1 billion) being sourced externally. The high debt rate has raised concerns about the nation's ability to repay the debt.[24]

Jorda, Schularick and Taylor states that when the level of public debt is unmanaged, the private sector is likely to be negatively impacted thus contribute to more drastic and lengthy economic

[21] Graeme Wheeler, *Sound Practice in Government Debt Management* (World Bank 2004).
[22] Kenya's public debt is rising to dangerous levels, OdongoKodongo<https://theconversation.com/kenyas-public-debt-is-rising-to-dangerous-levels-100790>
[23]Ibid.
[24]Semkow, Syndicating and Rescheduling International Financial Transactions: A Survey of the Legal Issues Encountered by Commercial Banks, 18 INT'L LAW.869 (1984).

sufferings.[25]This finding was mainly focusing on the economic problems that arose from excessive borrowing. This paper focuses on the need for a regulatory structure on sovereign debt, although economic problems arise on delayed rearrangement the focus is on a legal framework hence dictating this research.

Guzman and Stiglitz stated that the current determinations have accentuated the formerly acknowledged interaction among several authorities but not even one is interested in ceding the right to arbitrate rearrangement to the others.[26]The study elaborated the problems that arise from debt rearrangement due to various jurisdictions involved in the process. Although it is important to point out problems within the rearrangement process, this research mainly focuses on proposing of a legal framework debt rearrangement.

Tapas Strickland provided that in the last ten years, fourteen nations have carried out eighteen debt rearrangements. However, worries related to a number of these rearrangements have prompted legislators and capital market stakeholders to assess their public debt rearrangement strategies as well as agendas. Court rulings that followed legal disputes in the case of Argentina raised up concerns, could be thwarted or blocked by a minority of lenders in the rearrangement agreement, even if approved by most lenders. The paper describes the arguments for reinforcing the present strategy to debt rearrangement as well as evaluates the latest suggestions from the IMF, state administrations, and capital market stakeholders.[27]This research proposes that the current

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[25] Jordà, Òscar, Moritz HP Schularick, and Alan M. Taylor. Sovereigns versus Banks: Credit, Crises, and Consequences. WP No. 19506. National Bureau of Economic Research, 2013 (forthcoming in the Journal of the European Economic Association).

[26] Guzman, Martin and Joseph E. Stiglitz. "A Fair Hearing for Sovereign Debt." Project Syndicate, March 5 (2015b).

[27] Tapas Strickland: Sovereign Debt Rearrangement: Recent Issues and Reforms, Bulletin,2014 (https://www.rba.gov.au/publications/bulletin/2014/dec/pdf/bu-1214-9.pdf)

approaches on debt rearrangement have proven insufficient; therefore, there is a need for soft law approach to reform the debt rearrangement frameworks.

Further, in his article Stiglitz observed that on the contrary, vey many nations are encouraging the establishment of an international regulatory structure, as depicted in the Resolution 69/304 of the General Assembly of the United Nations of September 2014, that was overpoweringly approved (by 124 votes to 11, with 41 abstentions).[28] The structure ought to support the treaties and create mechanisms for the fair resolution of disputes. Building consensus will be critical to your achievement. This in turn requires fulfilling a set of principles over which the different parties involved would agree on, an issue that we analyse in this article. However, this paper encompasses the principles that will help in developing a better legal framework on sovereign debt rearrangement.

Stiglitz and Joseph provided that, while, as we have noted, the significance of the non-appearance of an satisfactory mechanism for sovereign debt rearrangement has long been noted[29], Five changes have helped bring the issue to the fore and motivate the global movement to reform existing agreements: (a) Once again, several nations have seem likely to face a challenge of debt burdens, which they are not able to refund; (b) decisions by the court in the US and UK have emphasized the disjointedness of the present system and made debt rearrangements, at least in some jurisdictions, more problematic if not unbearable; (c) the movement of debt from banks to capital markets has greatly increased the difficulties of debt renegotiations, with so many lenders with often contradictory preferences presented; (d) the establishment of credit default swops

[28] Stiglitz, Joseph E. (2010a) "Sovereign Debt: Notes on Theoretical Frameworks and Policy Analyses," in *Overcoming Developing Country Debt Crises,* B. Herman, J.A. Ocampo, and S. Spiegel, eds., Oxford: Oxford University Press, pp. 35-69.

[29] Stiglitz, Joseph, *Making Globalization Work,* New York (2006).

(CDSs) —financial instruments for shifting risk—has meant that the economic interests of those at the bargaining table may actually be advanced if there is no resolution; and (e) the rise of vulture funds, whose operational theories is to counterattack assessment and, through lawsuit, acquire their exaggerated disbursements, and those received by lenders who have agreed to postpone, also has the reprogramming in the context of existing official arrangements. [30]They pointed out limitations on the reforms process. This paper will mainly focus on the proposed legal framework on sovereign debt rearrangement

According to Townsend, in the absence of information irregularities and contractual expenses the joint venture contracts (shares) would be ideal and that insolvency would be eliminated. Nevertheless, under flawed information and expensive state substantiation, comprehensive risk sharing is suboptimal, and optimal contract is a debt contract.[31]The focus was mainly on the absence of information asymmetries in the rearrangement processes. However, this paper will propose a regulatory structure on sovereign debt rearrangement.

A peculiar feature of the current rearrangement process is that rearrangement countries frequently experience enormous resource underutilization. This is because these countries lack access to external resources; In the middle of a crisis, stock markets frequently become severely inefficient, negatively impacting either collective demand and supply.

Lenders with a narrow and myopic emphasis on payback are imposing government spending cuts (austerity measures), and the combination of financial pressures and falling public and private demand results in a severe recession or depression. They make the fallacious claim that if the

[30] Stiglitz, Joseph E. "Information and Economic Analysis: a Perspective." *The Economic*

[31] Townsend, Robert M. "Optimal contracts and competitive markets with costly state verification." *Journal of Economic Theory* 21, no. 2 (1979): 265-293.

government spends less on itself, it will have to expend more on others in order to pay its obligations. However, they overlook the large factors that exist at such times:

cuts in spending have a negative impact on GDP and tax collection. The country's resources are underutilized, making it impossible to service its obligations; austerity policies are generally ineffective, even from the perspective of the lenders.[32]This mentioned the various features of the rearrangement processes but this paper will focus on the proposed sovereign debt rearrangement framework that can be applied in Kenya.

Ex-ante efficiency is another important trait. A system that does not impose any ex-post duty on lenders does not provide the necessary incentives for ex-ante due diligence. A system that doesn't penalize lenders for revealing information isn't conducive to thorough due diligence. The lender must generally take specific activities in order to select "worthy" borrowers, such as selection (pre-ante) and vigilance (ex- ante). If due diligence is not undertaken, the existence of a sovereign debt restructuring mechanism would be a warning that money is being lost.[33] This is also another problem encountered in the rearrangement processes that exist, however this paper will propose a legal framework that is less problematic hence necessitating this research.

Skylar Brooks, Martin Guzman, Domenico Lombardi, and Joseph E. Stiglitz pointed out that the private sector approach, which focuses on collective action clauses (CAC), is not enough to solve the myriad of problems, including those between lenders and debtors – creditor equity, associated

[32] Guzman, Martin and Joseph E. Stiglitz. "Creating a framework on sovereign debt rearrangement that works". Columbia University Working Paper (2014a

with sovereign debt rearrangement.[34]They assert the collective action clauses are insufficient, this research proposes are efficient framework on sovereign debt rearrangement.

Mandeng provided that all advanced economies have bankruptcy laws. Preserving the capital stock among lenders when rearrangement or liquidating a company is one of the main objectives of these laws. However, at the international level, the lack of a framework for sovereign defaults hampers "an orderly process of debt rescheduling between different and non-contractually linked groups of lenders". The absence of a strong bankruptcy framework also leads to costly delays in sovereign debt rearrangement. [35]Focuses on the issue of a lack of bankruptcy framework, which is also covered in the research. However, the focus on this research is on the proposed legal framework based on soft law hence necessitating this research.

According to Xafa, Greece experienced the largest sovereign default and debt restructuring in world history in March 2012, more than two years after the onset of its crippling debt crisis.[36]This research focused mainly on economic impact of the Greece debt crisis. This research borrows on the lessons learnt in Greece with an aim of proposing a better legal framework on sovereign debt rearrangement.

In 2001, then IMF Deputy Managing Director Anne Krueger proposed the creation of a "sovereign debt rearrangement mechanism" (SDRM), which would function as a bankruptcy

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[34] Skylar Brooks, Martin Guzman, Domenico Lombardi and Joseph E. Stiglitz, Identifying and Resolving inter-creditor and Debtor – Creditor equity issues in sovereign debt rearrangement. < https://www.cigionline.org/sites/default/files/pb_no53.pdf >

[35] Mandeng, Ousmene. 2004. "Intercreditor Distribution in Sovereign Debt Rearrangement." IMF Working Paper No. 04/183.

[36] Xafa, Miranda (2014) "Lessons from the Greek Debt Rearrangement for Future European Debt Crises." CIGI Papers No. 33. June. < Xafa, Miranda (2014) "Lessons from the Greek Debt Rearrangement for Future European Debt Crises." CIGI Papers No. 33. June. >

procedure for sovereigns. After two years of lively discussions and debates, the SDRM was abandoned, in part due to opposition from the United States, which argued that CACs were an efficient and sufficient alternative — although they were an alternative that no advanced country had chosen for resolving domestic rearrangements, which are typically less complicated. CACs were also seen as a more politically feasible alternative. [37]This research borrows heavily from this proposal, but specifically focuses on how these proposals can be implemented in Kenya.

Most countries have concluded, based on both experience and the power of the previous sections' arguments, that the private contractual approach, no matter how enhanced, will not solve the fundamental problem of sovereign debt restructures. As evidenced in the United Nations General Assembly Resolution 68/304 enacted on September 9, 2014, these countries are pressing for the establishment of a global legislative solution.[38]This research also supports these proposals with a special focus of how it can be applied with the Kenyan jurisdiction.

The recent trends in public debt in developing nations, according to Uy Marilou and Zhou Shichao, are reassuring: public debt and debt payment burden have decreased on average as a percentage of gross domestic product (GDP). Capital institutions are progressively being used by developing economies to fund their infrastructure needs. As a result, they are up against new public and private lenders that have increased their involvement in emerging countries.

These changes promise improved access to foreign credit, but they may also increase borrowing countries' risks. Understanding these new sources of risk should inform debt management policy in countries and encourage the international community to develop debt rescheduling

[37] Krueger, Anne O. 2012. *Struggling With Success: Challenges Facing the International Economy*. Singapore: World Scientific Publishing Press.

[38] Guzman(n22)

procedures.[39]They focus on the trends in public debt in developing Countries, whereas this research mainly focuses on legal framework sovereign debt rearrangement and various proposed solution to counter the debt crisis in Kenya hence making this research necessary.

Sergio Chodos stated that the Argentine debt debate and drama are well-known at this point. Obscure Latin idioms like "pari passu" have become common words of art, with a wide range of fresh interpretations and meanings. As previously reported, U.S. Federal District Judge Thomas Griesa determined that Argentina had violated a boilerplate pari passu clause included in sovereign bond issuances and created a novel "equitable remedy" that essentially meant a prohibition on Argentina continuing to pay restructured debt until holdout lenders (vulture funds) were paid in full in advance.

This verdict was upheld by the Supreme Court.[40]He discusses the debt rearrangement problems encountered in Argentina. This research mentions the various problems but specifically focuses on the proposed legal framework to mitigate the debt crisis in Kenya.

[39] Uy, M., & Zhou, S. (2016). Sovereign Debt of Developing Countries: OVERVIEW OF TRENDS AND POLICY PERSPECTIVES. In M. Guzman, J. A. Ocampo, & J. E. Stiglitz (Eds.), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (pp. 33–55). Columbia University Press. (http://www.jstor.org/stable/10.7312/guzm17926.6)

[40] Chodos, S. (2016). From the Pari Passu Discussion to the "Illegality" of Making Payments: THE CASE OF ARGENTINA. In M. Guzman, J. A. Ocampo, & J. E. Stiglitz (Eds.), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (pp. 77–83). Columbia University Press. http://www.jstor.org/stable/10.7312/guzm17926.8 /. Vdc;

CHAPTER TWO: CONTEXTUALIZATION OF DEBT REARRANGEMENT

2.0 Introduction

The chapter focuses on contextualization of the sovereign debt rearrangement process. It explains and gives an overview of the sovereign debt rearrangement approaches, the current problems faced during the rearrangement process and the recent issues and reforms. The major goal of this chapter is to evaluate the current methodologies and challenges in each, as well as to assist in the development of a legislative structure for sovereign debt rearrangement in Kenya.

2.1 Contextualization of Debt Rearrangement

The concept of sovereign debt rearrangement involves exchanging of debt obligations that are outstanding for other debt structures or instruments through a legal process that involves the borrowing and the lending state. Debt rearrangement may involve either rescheduling or reduction of the nominal value.[41] Many African states have resulted in borrowing as a way of financing their developmental needs that are quite huge. Often, they end up in debt crises forcing them to call for rescheduling of the debts. The failure of the borrowing state to meet its debt obligations triggered the process or a call by the state for rearrangement. Such an occurrence forces the government to start some form of negotiation to reach a consensus on the terms of exchange to be adopted as a way of offering debt relief and solve the crises.[42]

The process of debt rearrangement is as painful as any other debt workout plan for all the parties involved. It is thus important to ensure that the whole process is carefully handled to avoid any

[41]Claessens and others (n 59).
[42]Muriungi (n 19).

mishap since a mishandled sovereign debt rearrangement process can result in a crisis that may run for years or decades. A bundled debt rearrangement process may lead to delayed returns to the normal economic activities and widespread disruptions in the economy of the state.[43] The process becomes more challenging where international dimensions are involved. A case where the state is dealing with domestic debts is easy and flexible to handle since it is within its authority where it can come up with its laws that can help prevent default. However, in the international setting, the owing state is forced to face some legal systems that are not their own since one of the resolutions made about accessing international debt market is that a sovereign debt crisis is an international affair.[44]

2.3 Sovereign Debt Rearrangement Approaches

Over the years, many sovereign states have sought external financial support to run their activities, especially concerning development projects. There has been a shift in the way sovereigns finance themselves with a shift from bank loans to a scenario where sovereigns are issuing debts to other states using different instruments guided by a variety of legal jurisdictions.[45] These lenders give different timelines for the debt to be cleared and in a scenario that the debtor experiences problems with debt servicing, they respond differently. There has not been a clear-cut collective action imposed in such an occurrence.

The process of sovereign debt was observed to be taking longer, unpredictable and causing more damage to the debtor and in the process creating trouble for the creditor.[46] Following this

[43]Buchheit LC and Mitu Gulati G, 'Sovereign Debt Rearrangement in Europe' [2018]
[44]Paulino T. Sison III M, 'Sustainability in Indebtedness: A Proposal for a Treaty-Based Framework in Sovereign Debt Rearrangement', *Accounting and Finance - New Perspectives on Banking, Financial Statements and Reporting* (2019)
[45] Krueger AO, 'A New Approach to Sovereign Debt Rearrangement', *Struggling with Success* (2002)
[46]Bohoslavsky, J and Golmann, M 'An Incremental Approach to Sovereign Debt Rearrangement: Sovereign Debt Sustainability as a Principle of Public International Law' [2010] The Yale Journal of International Law Online, 43

realization and the challenges experienced in debt rearrangement attempts, several bodies and states felt that it was necessary to have working approaches to debt rearrangement. More specifically, it was discovered that sovereigns with debts that were unsustainable delayed in seeking rearrangement which causes draining of their reserves, leaving them and their lenders worse than they were. It further complicated the mechanisms involved in working out a debt rearrangement process that is equitable. Ultimately, this creates some uncertainty regarding the overall recovery value.

To curb these problems, Krueger proposes the adoption of an asset-value preservation approach that will also ensure the protection of the creditor while at the same time creating an opportunity for the debtor sovereign to go back to being viable and enable growth.[47] Such an approach should make it easy for the debtor to approach the creditor early enough but also ensure that states that can sustain their debt do not suspend payment. This would help by ensuring that there is an orderly way of rearrangement debt that is predictable and one that protects assets value and the rights of the creditor.

Similarly, two solutions are proposed that can help deal with the prolonged and nasty rearrangement process caused by lack of standard approach.[48] One of their proposals is the adoption of contractual proposals. Their view is that the Collective Action Clauses (CAC) such as improved aggregated clause can resolve this problem. Alternatively, they propose the use of statutory proposals such treaties established through international legal systems. Another proposal

[47] Krueger AO, 'A New Approach to Sovereign Debt Rearrangement' (2002)
[48]Bohoslavsky, J and Golmann, M 'An Incremental Approach to Sovereign Debt Rearrangement: Sovereign Debt Sustainability as a Principle of Public International Law' [2010]

is the use of a public-law approach that imposes a legally accepted framework and which is binding for the parties involved.[49] Such an approach would require a treaty or convention to be made.

One school of thought maintains that sovereign debt rearrangement should start with a legal framework, if the lenders, whether multilateral, bilateral, or commercial, have debt instruments that are not only legal, but also legitimate and binding.[50] These instruments thus create obligations that can be enforced on the debtor. For this reason, the process of debt rearrangement faces the challenge in that the creditor must be persuaded to offer debt relief to the debtor. To achieve this, the restructurer can use either carrot or stick approach. The 'carrot approach' provides for use of enticements as a way of making the creditor agree to offer relief while use of stick advocates for use of other mechanisms such as default, exit of consent, collective action clauses or using local laws where applicable.[51]

In recent years, a new system for sovereign debt rearrangement has arisen, which first appeared towards the close of the twentieth century. This regime was established after some policy initiatives that were taken by institutions that are dominated by wealthy nations, and it has enabled the successful completion of debt rearrangement processes. The combination of interventions by IMF and contract law has seen the success of the process. However, the regime has experienced some failures like was the case with Argentina and Greece.[52] The two cases have led to a post-modern sovereign debt rearrangement debate, which has raised issues relating to the traditional issues regarding the decentralization of debt rearrangement. The IMF's demand for debt relief,

[49]Schwarcz SL, '"Idiot's Guide' to Sovereign Debt Rearrangement' [2005] SSRN Electronic Journal
[50]Buchheit, LC 'Sovereign Debt Rearrangements: The Legal Context. In Sovereign Risk: A World without Risk-free Assets? [2013] Bank for International Settlements
[51]Buchheit LC and Mitu Gulati G, 'Sovereign Debt Rearrangement in Europe' [2018]
[52]Paliouras V, 'The Right to Restructure Sovereign Debt' 115

which might have disastrous consequences for the debtor's financial stability, was a major source of anxiety.

The IMF works as a fair arbitrator in the present debt rearrangement system, assisting debtor states and lenders in reaching an agreement that resolves the debt problem. This mandate is given to IMF since it can influence the actions of the debtors and lenders using its policies of lending. The fact that IMF has the mandate over sovereign states is the main cause of the issues raised against this approach since states can contest such actions based on the international law guidelines that give supremacy to the sovereignty of a state.[53] The process of debt rearrangement, which is IMF guided and coordinated fails to advance several values that are normative to sovereignty. The principles of sovereign debt rearrangement should guide this process.

2.4 Current Problems

The process of sovereign debt was observed to be taking longer, unpredictable and causing more damage to the debtor and in the process creating trouble for the creditor.[54] Following this realization and the challenges experienced in debt rearrangement attempts, several bodies and states felt that it was necessary to have working approaches to debt rearrangement. More specifically, it was discovered that sovereigns with debts that were unsustainable delayed in seeking rearrangement which causes draining of their reserves, leaving them and their lenders worse than they were. It further complicated the mechanisms involved in working out a debt rearrangement process that is equitable. Ultimately, this creates some uncertainty regarding the overall recovery value.

[53]Sarooshi D, *International Organizations and Their Exercise of Sovereign Powers* (2007)

[54]Bohoslavsky, J and Golmann, M 'An Incremental Approach to Sovereign Debt Rearrangement: Sovereign Debt Sustainability as a Principle of Public International Law' [2010] The Yale Journal of International Law Online, 43

Collective Action Clauses are frequently criticized for failing to bring together all the sovereign's lenders and commit them to a comprehensive rearrangement deal with the sovereign. Sovereign bonds are typically reorganized on a series-by-series basis, which means that only a portion of a sovereign's creditors are involved in any given reorganization. Furthermore, because CACs only apply to a certain series of bonds, recalcitrant lenders can still buy a "blocking position" in a specific bond series and undercut an otherwise widely accepted restructuring deal. The International Capital Markets Association (ICMA) is promoting a new type of CAC with a more robust "aggregate" capability to address this problem. The adoption of a'single limb' voting method in the new CACs has gotten a lot of positive feedback. The approach will allow bonds to be rationalized using a single vote across all instruments involved, subject to controls to assure inter-creditor impartiality and mitigate the negative effects of governmental exploitation.[55] The new ICMA and CACs will also enable the establishment of a "two-limb" voting mechanism, allowing lenders to be treated differently.[56]

[55] Skylar Brooks And Domenico Lombardi, Sovereign Debt Rearrangement Issues Paper, Cigi Papers No. 64 — April 2015,<https://www.cigionline.org/sites/default/files/cigi_paper_no.64web.pdf>retrieved on 23rd September

[56] *Ibid.*

CHAPTER THREE: LACK OF DEBT REARRANGEMENT LEGAL FRAMEWORK AND SOVEREIGN DEBT CRISIS IN KENYA

3.0. Sovereign Debt Rearrangement in Kenya

The current Kenyan debt situation points to a debt crisis that necessitates debt rearrangement. Existing literature points to the absence of formal debt rearrangement framework used to guide the rearrangement process. The absence has been discussed for a long period, yet working framework has not been designed nor implemented.[57] Such debates heat up at the onset of a debt crisis but cool down once the situation is contained. The international community has continued to depend on mechanisms that are transitory and informal when carrying out debt rearrangement due to lack of an effective legal framework that is globally accepted as a guiding protocol for the debt rearrangement process.[58] Such a framework would come to mitigate cases of debt crisis like the one currently faced by many developing countries such as Kenya.[59] The current debt crisis in Kenya has been occasioned by high borrowing following legislations that have allowed the National Treasury to execute its borrowing mandate.

3.2 Legal framework on Public Debt Management in Kenya

The Constitution of Kenya 2010 defines public debt as "all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the national government".[60] Section 49 of the Public Finance Management Act, (PFMA) 2012 vests the power to borrow on behalf of the

[57]Yuefen Li, 'The Long March towards an International Legal Framework for Sovereign Debt Rearrangement' (2016) 6 Journal of Globalization and Development.
[58]M Papaioannou and Christoph Trebesch, 'Rearrangement Sovereign Debt: Lessons from Recent History' (*undefined*, 2012) </paper/Rearrangement-Sovereign-Debt%3A-Lessons-from-Recent-Papaioannou-Trebesch/77daf2f85e5f9850e54292cf86a50d9aaa938466> accessed 28 October 2020.
[59]Muriungi (n 19).
[60] The Constitution of Kenya 2010 – Article 214

national government in the Cabinet Secretary responsible for finance subject to Parliament approval.[61] Kenya's debt management aims are secured in the PFMA 2012. *Section 62(3)* of the Act specifies that,

> *The debt management objectives are to (a) minimize the cost of borrowing over the long-term taking account of risk; (b) promote the development of the market institutions for Government debt securities, and (c) ensure the sharing of the benefits and costs of public debt between the current and future generations as provided for under the Constitution*.[62]

Public debt sustainability is a major issue facing both developed and developing countries.[63] In Kenya, the public debt management mechanisms are under scrutiny due to swelling public debt in the country.[64] The Kenyan Parliament has claimed that the lack of power to approve new borrowing by the central government is the reason behind frequent borrowing.

Unsustainable debt levels can be harmful. They can cause major disruptions to regional and international economic performance. In the worst-case situation, Kenya could be forced to surrender control of its strategic state resources to foreign financiers, which has happened in Sri Lanka.[65]By September 2018, Kenya was facing a debt crisis because of a debt of $51.5 billion, with more than half of the debt ($26.1 billion) being sourced externally. The high debt rate has raised concerns about the nation's ability to repay the debt.[66]

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[61] The Public Finance Management Act, 2012
[62] Republic of Kenya, *The National Treasury And Planning 2019 Medium Term Debt Management Strategy 2018-2019*
[63] Graeme Wheeler, *Sound Practice in Government Debt Management* (World Bank 2004).
[64] Kenya's public debt is rising to dangerous levels, OdongoKodongo<https://theconversation.com/kenyas-public-debt-is-rising-to-dangerous-levels-100790>
[65]Ibid.
[66]Semkow, Syndicating and Rescheduling International Financial Transactions: A Survey of the Legal Issues Encountered by Commercial Banks, 18 INT'L LAW.869 (1984).

The level of debt owed by Kenya has greatly risen since 2008. As of 2008, Kenya's foreign debt was Kshs 447 billion,[67] but this has risen exponentially over the years leading to Kenya facing a high risk of debt crisis considering the heavy debt weighing on it since it might be impossible to repay the loan. Kenya's public debt is approximately $49 billion, which translates to 56.4% of its GDP.[68] The rise is a 7.6% increase in ten years since it was at 42.8% in 2008. The rising trend is a pointer existence of debt distress since it exceeds the recommended value by IMF, which should not exceed 40%. A 2017 World Bank report indicated the likelihood for a crisis as it stated that according to data from the national treasury, the public debt owed by Kenya had risen to 4.5 trillion Kenyan shillings, which was noted to be the highest level in the region.[69]

Sovereign debt crisis comes about when the levels of indebtedness go beyond manageable levels, and many states have experienced this economic state. In the period between 1970 and 2007, more than forty-eight countries faced one or two debt crises. Others such as Turkey, Ghana, and the Gambia experienced three such crises while Kenya experienced four.[70] Since Kenya is a small developing nation, it heavily relies on sovereign debt to fund most of its development projects and accelerate its economic growth. Most of the post-independent development projects such as the construction of the Kasarani International Stadium were financed through debts extended by the IMF or World Bank. In the year 2000, the IMF and World Bank extended $150 million and $157million loans to Kenya respectively. The loans were meant for poverty reduction and growth

[67]King'wara R, 'The Impact of Public Debt on Private Investment in Kenya' (2014) 4 Developing Country Studies 88

[68]Kodongo, O, "Kenya's Public Debt is Rising to Dangerous Levels." [2018] The Conversation,

[69]The World Bank, 'Kenya's Economic Outlook to Dip in 2017', 2017. https://www.worldbank.org/en/news/press-release/2017/04/12/kenyas-economic-outlook-to-dip-in-2017. Accessed 19 March 2020.

[70]Braga, 'Sovereign Debt and The Financial Crisis: Will This Time Be Different?' [2011]

through reforming of the economic and public sectors.[71] The appetite for borrowing has continued over the recent years leading to a debt crisis in the country.

The maturity of the Ksh1.2 trillion national public obligation offers the National Treasury the best chance to reorganize Kenya's loans and ease the increasing repayment load.[72] The lack of such benchmarks implies that each state uses its approach toward the process, and judging from the issues that have been reported globally on sovereign debt rearrangement cases in various parts of the world, a legal framework for this process is needed. Since the debt crisis in the 1980s among developing nations in Africa, there have been numerous debts rearrangement processes within the states to align the repayment process with their revenue collection trends.[73]

[71]Republic of Kenya, 'Kenya Vision 2030: A globally competitive and prosperous Kenya' (2007)
[72] Business Daily Editorial, *Treasury Has Chance to Scale down Public Debt* (2019),
[73] Ibid.

CHAPTER FOUR: LESSONS FROM OTHER JURISDICTIONS

Overview

In this chapter, a case study approach was adopted in which Greece and Ethiopia debt crises are reviewed to illustrate the challenges indebted countries face managing their sovereign debt.

4.2 Case Studies

4.1.1 Ethiopia

The recent accelerated economic growth in China has made the country a global creditor to many countries in the world. With the newfound wealth and influence, China has forged trading ties with several countries globally and is currently Africa's biggest trading partner. Specifically, at the Horn of Africa, Chinese foreign direct investments (FDI) and other investment forms have radically increased since the 1990s, supporting economic growth and broader economic expansion. With the ongoing Sino-Africa dealings, it is projected that China will be Africa's largest source of FDI stock by 2030. Chinese loans have helped build new dams, roads, railways, and other physical infrastructure in SSA.[74]Countries in the Horn of Africa, including Kenya, Ethiopia, Djibouti, and Uganda, have significantly benefited from the Chinese FDI worth billions of dollars. China has financed Ethiopia's light railway system and ring roads to the tune of $475m and $86m, respectively.[75]

Ethiopia is the first African nation to have its Chinese debts restructured. Several other African countries face challenges servicing their Chinese loans. They are waiting for loan concessions to

[74] RTE news, Ethiopia and the Chinese dream in Africa'23 Apr 2019, <https://www.rte.ie/news/world/2019/0423/1045064-ethiopia-china/>
[75]*Ibid.*

prevent distress.[76] Beijing approved to reorganize some of Ethiopia's sovereign debt, including the $4B loans used to fund the erection of the railway connecting Addis Ababa with Djibouti by spreading the settlement period by 20 years to make the annual repayments sustainable.[77] Ethiopia asked for the loan rearrangement after her sovereign debt reached 59 percent of her annual GDP.[78]

In February 2019, the Ethiopian government successfully renegotiated with China for the reimbursement duration for 60 percent of its $26bn outward debt,[79] mostly used to fund infrastructure projects that have failed to achieve the desired result.

Ethiopia's achievement and failure in its association with and obligation to China serve other African countries' useful lessons. The rearrangement of the Ethiopia sovereign debt is an indication that China is flexible and open to negotiating repayment terms with other debtors given the growing uncertainties in African countries such as Kenya on the consequences of defaulting.[80]

Ethiopia's Addis Ababa-Djibouti Railway is a significant infrastructure. It will link landlocked Ethiopia to the sea through the Port of Doraleh, opening the county for trade and economic growth.[81] Besides the Ababa-Djibouti Railway, Ethiopia has launched an ambitious trade and infrastructure plan, including dam development, mostly funded by Chinese loans. The Ethiopian

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[76] The East African, ALLAN OLINGO, 'Ethiopia bags China debt deal, others wait 'Saturday September 8 2018, <https://www.theeastafrican.co.ke/business/Ethiopia-bags-China-debt-deal/2560-4750468-mrt46v/index.html>retrieved on 23rd September 2019.
[77] *Ibid.*
[78] Reuters, 'UPDATE 1-Ethiopia PM says China will restructure railway loan' Aaron Maasho, (2018) <https://www.reuters.com/article/ethiopia-china-loan/update-1-ethiopia-pm-says-china-will-restructure-railway-loan-idUSL5N1VS4IW>retrieved on 23rd September 2019.
[79] The African Report, Ethiopia's China challenge, Morris Kiruga,27 March 2019, <https://www.theafricareport.com/11080/ethiopias-china-challenge/>retrieved 23rd September 2019.
[80] Supra n 91
[81] South China Morning Post, 'Ethiopia in talks with China to ease 'serious debt pressure' tied to New Silk Road rail link, envoy says 'Laura Zhuo,24th March 2019, <https://www.scmp.com/news/china/diplomacy/article/3002957/ethiopia-talks-china-ease-serious-debt-pressure-tied-new-silk> retrieved 23rd September 2019.

government has defended the increased borrowing against criticism that it is a "debt trap" for the country.[82]

China has loaned Ethiopia over $12.1B since 2000, making it one of the top recipients of Chinese loans.[83] The Export-Import Bank of China raised $2.9B, or about 70%, of its cost, according to China's finance department. The investment left Ethiopia seeking to reduce its debt burden, just 12 months after the railway's inaugural. Chanaka maintains it was an intelligent move to implement the project since it links Ethiopia with Djibouti, the entry to the Suez Canal and the Red Sea.[84]

Criticisers fear that Africa is transacting too much influence to China for investment. China is already the principal trading associate of Ethiopia and most African nations.[85] For Ethiopia, her foreign debt's sustainability is one of the principal threats to the medium-long-term partisan risk position, which is in category 6/7 as of 2019. Ethiopia borrowed heavily in the last decade to fund several infrastructure and development projects, including dams, roads, and railway. These development projects have helped stimulate economic growth and drove the country's GDP growth, but have increased the country's debt levels significantly[86] because its export level is low, and the total current account takes are only 15% of GDP. While Ethiopia's external debt is not very big to the economy's size, it was above 215% versus the 2017 exports, a high ratio.[87]

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[82]*Ibid.*
[83]*Ibid.*
[84]*Ibid.*
[85]*Ibid.*
[86]Credendo, Ethiopia: Debt Sustainability Remains Largest Risk to MLT Political Risk Outlook, 27th February 2018, <https://www.credendo.com/ru/node/8065>retrieved on 23rd September 2019.
[87]*Ibid.*

The Ethiopian governments negotiated for a restructure of its loans amid mounting concerns over debt distress. When the Ethiopian government asked for a rearrangement of its loans, its sovereign debt was 59 percent of the yearly (GDP). At this percentage, repayment was to become a challenge. The Addis Ababa link with Djibouti handles approximately 95 percent of all incoming trade for Ethiopia and is complete; however, lack of funding has affected the line's expansion to the north of the country.[88] Ethiopia is also seeking more access to the sea and is negotiating a partnership with Eritrea, Sudan, and Somalia through equity agreements in their ports.[89]

Sovereign debt reorganization is expensive and volatile because relationships between lenders are dependent on imperfect agreements.[90] Collective Action Clauses, a common feature of sovereign bond agreements, represent the contractual approach to sovereign debt reorganization. The CACs contain the legal requirements written into the agreements that oversee sovereign debt onuses. The collective representation clauses contain provisions that institute a bondholders' meeting in reorganization and stipulate processes for choosing the bondholders' representative. The majority enforcement clauses bar individual bondholders from taking legal action against the sovereign. In contrast, the majority rearrangement clauses stipulate the size of the (super) majority of bondholders needed to revise payment terms.[91]

The use of Collective Action Clauses in sovereign bond issuances signifies a step in the right direction. It has been argued that they alone are inadequate to ensure an appropriate and tidy

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[88] The Reporter, 'Chinese government to restructure Ethiopia's debt' Yonus Abiye, <https://www.thereporterethiopia.com/article/chinese-government-restructure-ethiopias-debt>retrieved on 23rd September 2019

[89] *Ibid.*

[90] Bolton, Patrick, and Olivier Jeanne. 2002. Sovereign Debt Structuring and Rearrangement: An Incomplete Contracts Approach. Princeton, NJ: Princeton University Press.

[91] Gulati, Mitu and Mark Weidemaier. 2014. "A People's History of Collective Action Clauses," Virginia Journal of International Law 54: 1.

rearrangement procedure.[92] Empirical evidence suggests that CACs are inadequate to address debt rearrangement.[93]

Other nations that have adopted the redesigned CACs include Chile, Mexico, Kazakhstan, and Vietnam. The CACs are designed to deal with the issue by grouping and uniting all bondholders in a single restructuring process. Even if the new ICMA CACs are widely accepted and finally prove effective in addressing the "aggregation problem," it is expected that it will take several years before they are incorporated into the present debt stock. In the wake of this problem, Gregory Makoff and Robert Kahn[94] believe that bond amendments, exchange offers, and integrating lenders and debtors in developing and implementing active plans can accelerate the shift.[95]

4.1.2. Greece

Greece's delay in reorganization and special consideration of holdouts has generated calls for a middle ground between the ends of the spectrum: a legislative strategy, such as the IMF's recommended public debt reorganization system following Argentina's 2001 insolvency, which was opposed by lenders[96] to the current market-based contractual strategy that focuses on specific instance collective action clauses (CAC). [97]

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[92]Bi, Chamon and Zettelmeyer (2011); Bradley, Cox and Gulati (2010); and Das, Papaioannou and Trebesch (2012).
[93] Das, Udaibir S., Michael G. Papaioannou and Christopher Trebesch. 2012. "Sovereign Debt Rearrangements 1950- 2010: Literature Survey, Data, and Stylized Facts. IMF Working Paper/12/203.August.
[94] Makoff, Gregory and Robert Kahn. 2015. Sovereign Bond Contract Reform: Implementing the New ICMA PariPassu and Collective Action Clauses. CIGI Papers No. 56. February. www.cigionline.org/publications/ sovereign-bond-contract-reform-implementing-newicma-pari-passu-and-collective-action-c
[95] Tran, the first modern rearrangement is Mongolia in 1997. Jo Marie Griesgraber notes that Tran does not consider the cases of Zambia and Greece.
[96] Krueger, A (2002), "Sovereign Debt Rearrangement and Dispute Resolution", Speech given at the Bretton Woods Committee Annual Meeting, Washington, DC, June 6.

[97] Miranda Xafa 'Lessons from the 2012 Greek debt rearrangement' (25 June 2014)

Current recommendations focus on enhancing applicable collective action clauses to secure creditor participation and speed up talks, with little interest in reviving debt rescheduling or other arbitration methods. To reduce the possibility of IMF resources being used simply to bail out private lenders, the fund has proposed a lender bailout as a condition for borrowing from the fund in circumstances where the debtor has lost market access until you can clearly assess if a haircut is required. [98] The development of a public debt forum is also proposed, which would provide a place for continual improvement in the process of dealing with sovereign debt service concerns as well as proactive conversations between debtors and lenders in order to reach an early resolution to handle a full-fledged sovereign catastrophe.[99] Nonetheless, the IIF recognizes that the contractual approach could be improved further, especially through more rigorous aggregate terms.[100]

Private lenders, represented by the Institute of International Finance (IIF), feel that trustee negotiations, especially in the difficult case of debtors who are members of monetary unions, remain the most successful framework for negotiating voluntary succession arrangements. They feel that the debtor's unilateral imposition of a status quo, if accepted by the IMF, "would seriously undermine lenders' property rights and market confidence, thereby increasing secondary bond market premiums for the debtor in question and other debtors in similar circumstances "[101]. Nevertheless, the IIF understands that future enhancements to the contractual approach, such as stronger aggregation clauses, are desirable.[102]

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[98] IMF (2013), "Sovereign Debt Rearrangement — Recent Developments and Implications for the Fund's Legal and Policy Framework", 26 April.

[99] Gitlin, R and B House (2014), "A Blueprint for a Sovereign Debt Forum", CIGI Paper No. 27. March

[100] Supra n 114

[101] IIF (2014), "IIF Special Committee on Financial Crisis Prevention and Resolution: Views on the Way Forward for Strengthening the Framework for Debt Rearrangement." January.

[102] Supra n 122

Various organizations, including the IMF, the IIF, the US Treasury Department, and the International Capital Markets Association, are working to establish a better market standard for CACs. The IMF has proposed, based on the Greek instance, to "examine the possibility of replacing the standard two-stage voting rights thresholds in the existing aggregation clauses with a voting rights threshold so that minority blocking on individual bond series cannot undo a rearrangement. " This method, however, makes no distinction amongst bondholders depending on the maturity of their claims. Applying a similar haircut on all bonds, regardless of maturity, results in a higher loss of NPV for bonds with short maturities. These issues highlight the need for a new market standard that, on the one hand, introduces merger clauses and lowers voting thresholds while maintaining a serial majority vote guarantee, achieves a balanced treatment of debtor and lender rights, and on the other hand, maintains a serial majority vote guarantee.[103]

4.1 Chapter Conclusion

The chapter provided an overview of border sovereign debt reformation's key issues, mainly in Ethiopia and Greece. From the two case studies, it is evident that the absence of a rearrangement structure has led to endless debt crunches in both the developed and developing economies. As a result, there is a need for more discussion and investigation of the role of internal laws, powers, and legal action in sovereign debt reorganization. Furthermore, this paper organizes the major themes that are currently being debated about how to best monitor national debt reorganization. In this chapter, the debt crisis analysis in Greece and Ethiopia has demonstrated that both developed and developing economies experience challenges managing their external debts. Moreover, the argument made is that even a simple debt overhang or problems in sovereign debt settlement not reaching a debt crisis level require debt rearrangement.

[103] *Ibid*

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

In this chapter, the conclusion and recommendations are presented based on the discussion and analysis of the literature.

5.1 Conclusion

This study made a case for the adoption of an appropriate global sovereign debt-rearrangement framework that considers the interests of developing countries and which can be applied even in Kenya if they need to restructure any sovereign debts if they are unable to pay when expected. It has revealed that absent such a framework, debt crises are bound to persist, thereby harming the most vulnerable in countries. It has also argued that a continued debt crisis absent a rearrangement harm not only the debtor country but also lenders, as the former are usually unable to overcome a crisis while the latter does not get the monies lent. The study further argued that concerns about the unsustainability of debts giving rise to rearrangement are grounded on the theory or relational contractual theory. The paper also claimed that such a framework's urgency is even more pressing when one considers the increasing uptake of debt of varied nature by developing nations. Considering the foregoing, this paper proposes a global sovereign debt rearrangement legal framework that we consider appropriate from a developing countries' perspective. The paper covered a case study on Greece and Ethiopia debt rearrangement. The case study of Ethiopia is a viable example to the Kenya debt crisis, and the country can adopt such measures concerning Chinese loans. The paper concluded with the proposal of a new debt-rearrangement regime, which countries can borrow.

5.2 New Proposal for Sovereign Debt Reform

A model-law strategy of attaining a more systematic legal resolve framework is supposed to be economically, politically, and legally practicable.[104] The model is proposed legislation for national or subnational governments that can be enacted as internal law in various jurisdictions. It is, therefore, imperative for a government enacting a model law to follow the necessary steps of ensuring that the law is effective in its jurisdiction. The model laws are at times referred as uniform laws to enhance cross-border legal comparability. As such, government seeking to enact a model law is required to adapt the same legislative text. A model law constituted in the UNCITRAL Model Law on International Commercial Arbitration has been consistently sanctioned in a global context. In the United States, the Uniform Commercial Code (UCC) typifies a model law, which has been consistently sanctioned in a sub-national setting.[105]

The development and enactment of a model law through a less formal process can be politically appealing. On International Commercial Arbitration, the UNCITRAL Model Law was adopted successful, in part, because of its considerable informal structure as a model law. Furthermore, the implementation of a model law method does not require universal acceptance. The jurisdictions at national and subnational levels have the capacity to endorse independently a model law as their internal law.[106] The model law can govern contracts administered under the existing law. Consequently, the powerful multiplier effect of a model-law approach is attributed to the choice of law.[107]

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[104]Steven Schwarcz, 'Sovereign Debt Rearrangement: A Model-Law Approach' [2016] Journal of Globalization and Development.
[105] Ibid.
[106] This Is Especially Significant Because, As Explained Below, Most Sovereign Debt Contracts Are Governed By Either New York Or English Law. One Or Both of Those Jurisdictions — In The Case Of New York Law, A Subnational Jurisdiction — Could Enact Legislation Based On A Model Law.
[107] Supra N 124

5.2.1 A Proposed Model Law

It is evident that the holdout problem is addressed by the proposed Model Law through the legally mandated supermajority voting, which can bind holdout lenders given that the requisite percentages agree.[108] The model law provides a debtor-state the capacity to combine creditor voting that exceed specific contracts. The significance of aggregate voting is attributed to prevention of the lenders of independent debt agreements from working as holdouts in respect of other sovereign debt pacts. It also permits a debtor nation to designate substantial classes of claims to avert holdouts such as vulture funds from purchasing enough claims, which can control the voting or inhibit a rearrangement plan.[109]

The Model Law is fundamental to solving the *paripassu* clauses problem. In sovereign debt contracts, *Paripassu* clauses effectively necessitate that costs to lenders under a given debt contract be made *paripassu* to all that contract's lenders even lenders who traded their original rights for debt claims under a new debt agreement.[110, 111]

The Model Law highlights the importance of enabling financially troubled debtor states the capability to acquire liquidity during their rearrangement process. Although the IMF has provided this funding in the past, it may be unable, or reluctant to providing the funds in the required amounts. In case the IMF fails to provide loans that are usually de facto priority, the lenders would not provide funds without a priority repayment claim. Getting the current lenders to subordinate

[108] This Assumes, Of Course, That the Claims Of Those Holdout Lenders Are Governed By The Law Of A Jurisdiction That Enacts The Model Law
[109] Supra N 126
[110] Rodrigo Olivares-Caminal, The PariPassu Clause In Sovereign Debt Instruments: Developments In Recent Litigation, In 72 BIS PAPERS 121, 124–26 (Discussing The Meaning Of The PariPassu Clause, In The Sovereign Debt Context, In The Bliott Case In Belgium And The Argentina Case In New York).
[111]Leonie F Guder, *The Administration of Debt Relief by the International Financial Institutions: A Legal Reconstruction of the HIPC Initiative* (Springer Science & Business Media 2008).

contractually the entitlement to the acquired money would be impractical without a relatively small number of governmental organizations holding the indebtedness of a debtor-state. However, the Model Law prioritizes the provision of new-money by lenders over prevailing lenders as long as existing lenders are notified and provided a chance to block the new lending if the terms are inappropriate or the amount is too high. Furthermore, the Model Law allows a debtor-state to obtain finances from governmental or multi-governmental lenders such as the IMF.[112]

The law's supervisory authority is bestowed on a "neutral international organization" under the Model Law. The law, however, does not stipulate the organization that may qualify as truly neutral because current organizations are considerably political or conflicted such as the World Bank, the IMF, or a debtor state's court. However, the temporary ambiguity should be considered differently from other unrelated issues, which do not apply to the Model Law. The formal rearrangement solutions of sovereign debt such as a treaty incorporate widely empowered supervisory bodies, which use debt-rearrangement discretion that is likely to impact on national sovereignty. Conversely, the Model Law constitutes a supervisory authority that cannot exercise discretion. The binding arbitration offers the approach to adjudicating all disputes. Furthermore, the supervisory authority assumes the administrative and nondiscretionary role, which entails maintaining a list of lenders, fact-checking information, and overseeing the creditor voting process.[113]

The Model Law also incorporates the discretionary element of retroactivity. Because most unresolved sovereign debt agreements are governed by the English Common Law, [114]enactment

[112] Supra N 128
[113]*Ibid.*
[114] Philip R. Wood, Governing Law of Financial Contracts Generally, In CONFLICT OF LAWS AND INTERNATIONAL FINANCE 12 (Ed. 2007); Setser, Supra Note 17, At 16 (Observing That "[A]Lmost All International Bonds Are Now Governed By New York Law, English Law, And To A Lesser Extent Japanese Law").

by the jurisdictions of the Model Law, with retroactivity, could significantly facilitate the rearrangement of not only impending but also current sovereign debt contracts.

As a normative aspect, retroactive lawmaking is morally imperative since it offers substantial social benefit with little harm although it is considered somewhat atypical. A retroactive Model Law also offers significant social benefit related to opportunities available to countries with unsustainable outstanding debts, especially in renegotiating the debts to sustainable levels. Additionally, renegotiation can prevent deprivation of important government services and minimize economic challenges to innocent citizens,[115] envision the possibility of popular protests such as riots,[116] and avert financial chaos caused by a country's debt default.[117] However, retroactivity may cause little harm. The expectations of holdout lenders are likely to be impaired by the retroactivity. The impairment can be limited to willingly agreed changes by a supermajority of *paripassu* lenders, which are based on deteriorating economic circumstances of the debtor-state. The retroactivity should reflect the economic reality and reasonable hopes of lenders that can be ascribed to expected payment under the changed conditions.

From a legal perspective, retroactivity is feasible under universal law provided it is not arbitrary and prejudiced. The key operative provisions of the Model Law should integrate the aspects of supermajority aggregate voting without prioritizing debt rearrangement by financiers of a debtor state. The English law also permits retroactivity.[118] However, retroactivity may cause a contentious legal matter for sovereign debt agreements under the New York law.

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[115] Nick Robins-Early, What's Behind The Economic Chaos In Venezuela, June, 2016, Available At Http://Www.Huffingtonpost.Com/Entry/Venezuela-Economic-Crisisexplainer_Us_57507abde4b0eb20fa0d2c54; Lucy Rodgers &NassosStylianou, How Bad Are Things For The People Of Greece? July, 2015, Available At Http://Www.Bbc.Com/News/World-Europe-33507802.

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Under Article I, Section 10 of the U.S Constitution, the "Contracts Clause" bars states such as New York from enacting legislation that may negatively affect the existing contractual obligations. Nevertheless, the New York State can enact the Model Law in a way that does not encroach upon the Contracts Clause.[119] Overall, a government has a flexibility to impair retroactively agreements given that the impairment is rationally essential to further a significant public purpose and suitable as well as reasonable for effecting that purpose. If the contractual impairment does not have considerable effect, the leeway can be greater. Therefore, New York State can adapt the Model Law that integrates retroactivity into its police powers in the efforts to lessen sovereign debt defaults, which can result in a systemic economic collapse. As a result, the New York State can safeguard economic activity in its borders. Supermajority aggregate voting of the Model Law and prioritization of debt rearrangement of a debtor-state are effectively fashioned to diminish that threat. Furthermore, contractual harm should be minimal and limited to changes under the voluntarily agreement of a supermajority of *paripassu* lenders, which take into consideration the deteriorating economic circumstances of the debtor-state.[120]

Recommendations

The current contractual approach in rearrangement sovereign debt is inefficient. A model-law approach can provide additional information on the development of standards regarding an independent legal framework of debt rearrangement, which goes beyond mere contracting. Furthermore, the model can be integrated into a broader approach to the development of a legal framework of resolving sovereign debt rearrangement.

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[119] *Ibid.*

[120]

The absence of a global legal framework hinders the efficient rearrangement of sovereign debt in Kenya. A market-based approach in rearrangement sovereign debts makes it relatively difficult to resolve conflicts associated with nations failing to meet their debt repayment obligations. The increase in holdout lenders' litigation is an indicator of the problem. Adopting a contractual approach supported by an international legal framework and built on the principals of equity and efficiency could put in place to limit the extent to which the Kenya and her creditor may draw crippling private contracts.

A global legal framework is needed to facilitate governance of the sovereign debt rearrangement. A model-law approach may be more effective than a multilateral treaty because it has multiplier effect that gives the lenders and debtor nations the choice of the model law that they can use to administer their debt contracts with a substantial potential impact. The rationale is the underlying elements of the Model Law have been vetted in deliberations with leading experts across the globe, indicating that the underlined legal approach should be widely accepted.

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