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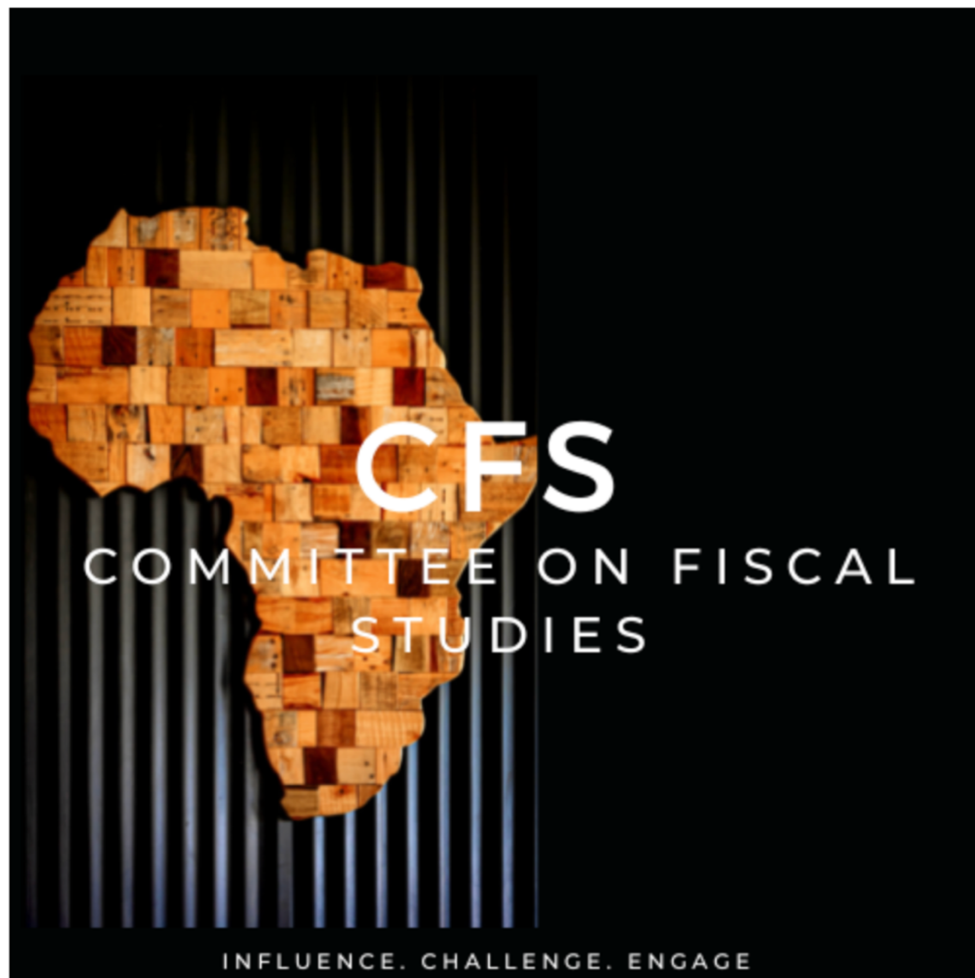
INTERNATIONAL INVESTMENTS TREATIES AND IMPLICATIONS FOR SOVEREIGN DEBT



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International Investments Treaties and Implications for Sovereign Debt

Kimulu Makokha

1. Introduction

An International Investment Agreement (IIA) is a treaty concluded between economies (usually two, sometimes more) with the object of promoting and protecting foreign investment. These usual take the form of Bilateral Investment Treaties (BITs)[1]. A bilateral investment treaty (BIT) is tailored to provide legal tools to regulate and structure investor-state dispute settlements (ISDS) between the contracting parties. The protection provisions inherent in these investment agreements have the ability to impact negatively on a host country sovereign debt, the efficacy of debt restructuring process and increase the risk of sovereign debt default. Currently, Kenya has signed a total of twenty-one BITs where twelve of them are still in force,[2] additionally, Kenya is a party to various multilateral treaties that have provisions which are primarily tailored to guarantee protection of foreign investors; Agreement establishing the African continental free trade Area (AfCTA),[3] Treaty establishing the Common Market for Eastern Africa (COMESA),[4] and treaty for the establishment of the East African Community (EAC)[5]and Energy Charter Treaty. However, despite the overarching objective of BITs to generate Foreign Direct Investment (FDI), it is imperative to examine the nexus between these BITs and acceleration of ballooning sovereign debt with regard to debt restructuring bottle-necks, especially in Global South countries like Kenya.

The impetus of signing BITs was necessitated by the need of a foundational legal framework that will guarantee investors of protection of their investments in a host country from risks like indirect and direct expropriation. For example, a capital importing country could legislate laws that encourage illegal expropriation of foreign investors assets through nationalization. Thus, in such a scenario where a low constraint country is highly likely to expropriate foreign investments by a capital exporting country,[6]then BITs serve the objective of mitigating against such arbitrary actions against foreign investments in a host country. It is imperative to note that, these investment treaties contained provisions that are geared towards pursuing the objective of ensuring protection of foreign investors and their investments in Kenya. According to the United Nations Committee on Trade and Development (UNCTAD), as of March 2023, there are a total of 2831 BITs, of which 2220 are in force. There are a total of 435 treaties with investment provisions (TIPs), of which 364are in force.[7]

Despite assumptions that BITs are critical in precipitating FDI, there is a chorus of critics against BITs; the implicit risk of increasing sovereign debt due to the risk of international arbitration claims. Additionally, BITs inhibit the capacity of capital importing state to implement sovereign debt restructurings when a highly indebted nation has defaulted or is at the risk of external debt distress,[8]with the backdrop of Argentina debt restructuring crisis of 2005-2010 and the attendant arbitral claims, we are now witnessing shift in the investment law landscape where BITs are now being fashioned into a

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[1] Parker, S.L, 'A BIT at a Time: The Proper Extension of the MFN Clause to Dispute Settlement Provisions in Bilateral Investment Treaties.' The Arbitration Brief 2, (20 12), 31.

[2] https://investmentpolicy.unctad.org/international-investment-agreements/countries/108/kenya , Accessed on 22/09/ 2023.

[3]Agreement Establishing the African Continental Free Trade Area.

[4] Treaty Establishing the Common Market for Eastern Africa.

[5] Treaty for the Establishment of the East African Community.

[6] Dremier, above n45(Explaining that proponents of BITs hypothesize that countries with weak domestic property rights can increase their attractiveness as a potential host by explicitly committing themselves to honoring property rights of foreigners).

[7] *See International Investment Agreements Navigator,* INVESTMENT POLICY HUB (Accessed on 01 October 2023) https://investment policy.unctad.org/international-investment-agreements

[8] *IIA Issues Note: Sovereign Debt Restructuring and International Investment Agreements,* https://investmentpolicy.unctad.org/publications/51/iia-issues-note-sovereign-debt-restructuring-and-international-investment-agreements , accessed on 10/1/2023.

conduit to initiate huge compensation claims via Investor State Dispute Settlement mechanisms (ISDS) to detriment of host countries.[9] Technically, the investor-state dispute clause that is a staple in most BITs has facilitated for escalation of litigation to ICSID, thus leading to an alarming increase in the number of disputes between investors and governments. Subsequently, the benefit of attracting FDI is trumped by the effect of huge arbitral awards against capital importing countries.

Critics have also cast aspersions on the poor drafting of first-generation BITs, this poor drafting of BITs, by default afforded unfettered range of substantive rights and procedural guarantees to sovereign creditors at the expense of host countries; majority of BITs have an open-ended definition of investment that includes sovereign debt instruments. The implication of interpretation of sovereign debt instruments as investments under IIAs and BITs has attendant negative impact on sovereign debt restructuring operations undertaken by host countries. The complexity of broad non-exhaustive definition of investment and its implication on sovereign debt restructuring was demonstrated in the case of *CMS Gas Transmission Co Limited v Argentina* under Argentina-US BIT where the definition of investment extended the scope of BITs protection to debt instruments. The same was also demonstrated in the case of *Ambiente v Argentina* and in the case of *Abaclat v Argentina*.[10] It is imperative to underscore the fact, that the wording of investment in the Argentina-USA BIT is similar to the wording in majority of BITs signed by Kenya. This highlights the risk of these BITs in torpedoing debt restructuring process in Kenya in future.

It is without a doubt that bilateral investment treaties have an implication on sovereign debt. With the benefit of hindsight of investment arbitrations claims in Greece (2012) and Argentina 2005-2010), these investment claims that were instigated by debt-restructuring processes lends credence to the interplay between the international investment treaty regime and sovereign debt management processes.[11] Expanded scope of BITs to cover sovereign debt instruments has crucial ramifications for sovereign debt restructuring especially in Global South countries hanging on debt cliffs. Due to the open-ended definition of investments, the impact has been that most BITs now have extended their scope to sovereign debt instruments, these therefore implies that sovereign debt will be subject to BITs and escalation of sovereign debt issues to investment arbitration with the resultant effect of raising the overall cost of sovereign debt, precipitating the existence of vulture funds,[12] frustrating efforts on debt restructuring by host countries, encouraging predatory behavior by holdout creditors and accelerating the risk of *parii pasuu* default by global south countries and the risk of them incurring even more sovereign debt so as to settle their obligations under ICSID as some sovereign debt measures like sovereign debt default or sovereign debt restructuring will ultimately attract arbitration challenges.

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[9] See, e.g., GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (2007). These critiques have led to important reform projects, including through the United Nations Committee on Trade Law (UNCITRAL). See UNCITRAL, Report of Working Group III (Reform of Investor-State Dispute Settlement), Thirty-Fifth Sess., UN Doc A/CN.9/935 (April 23–27, 2018).

[10] See Alexander Stevenson, How Argentina settled a Billion-Dollar Debt Dispute with Hedge Funds, NEW YORK TIMES https:www.nytimes.com/2016/04/25/business/dealbook/how-argentina-settled-a-billion-dollar-debt-dispute-with-hedge-funds.html.

[11] Abaclat and Others v Argentine Republic (formerly Giovanna a Beccara and Others v Argentine Republic), ICSID Case No ARB/ 07/5; Ambiente Ufficio SPA and others v Argentine Republic (formerly Giordano Alpi and others v Argentine Republic), ICSID Case No ARB/08/9 ; (Giovanni Alemanni and Others v Argentine Republic), ICSID Case No ARB/07/8; Postova´ banka, as, ISTROKAPITAL SE v Hellenic Republic, ICSID Case No ARB/13/8 .

[12] Jonathan I Blackman and Raul Mukhi, *The Evolution of Modern Sovereign Debt Litigation: Vultures, Alter Egos, and Other Legal Fauna* 73(4) L. & CONTEMP.PROBS 47, 49 (2010).technically, vulture funds are hedge funds that buy sovereign debt of poor countries from sovereign creditors at a discount. This is done when the indebted country has demonstrated inability to pay its sovereign debt. The vulture fund then using the ISDS mechanism sues the debtor country for the full amount of the debt, plus penalties and interests' .The attendant effect of this is that, the debtor country is forced to pay much more than the original debtor with the original creditor.

It is important to note that, one of the staple aspects in BITs is the increasing gap between the investor states and the poor developing host countries in Africa.[13] This gap is due to the fact that the terms of most, if not all BITS are usually heavily skewed against the host countries, such that the developed nation benefits while the developing nations get the raw deal, which can be termed as modern-day imperialism.[14]Thus affording the scope of applicability of BITs to sovereign debt and sovereign debt instruments will exacerbate the situation even further. Therefore, this begs the question, that, bearing in mind that extension of investment protection to sovereign debt instruments has attendant negative implications on sovereign debt as it was demonstrated in the Argentina debt crisis (2005-201), how should Kenya conceptualize sovereign debt in its IIAs and BITs? With the benefit of hindsight that the expanded scope of BITs to cover sovereign debt will escalate subjection of sovereign debt issues to ISDS mechanisms with negative implications on host country debt restructuring efforts. This policy brief assesses the extent to which Kenya's international investment agreements and by inference BITs may affect its efforts to implement sovereign debt restructurings if Kenya was to default or come close to defaulting on its sovereign debts. Another key issue to consider that will shed light in regard to BITs and sovereign debt is the issue of negotiated debt restructuring in investor-state dispute settlement and its inherent limitations,[15] these limitations in most cases are disadvantageous to the host state at the expense of the investor state, resulting in huge financial burdens and resultant uptick of sovereign debt stock in developing countries.

With recent history demonstrating that Global North countries have demonstrated propensity and reticence in selective application of safeguards against ISDS in relation to sovereign debt issues, this policy paper advocates for the same path to be adopted by Global South countries like Kenya. Governments in global south countries should pursue policies that are specifically tailored in eradication of ISDS from IIAs and Bits. This will mitigate against unfettered powers afforded to foreign private corporations, including private sovereign creditors with predatory tendencies like holdout creditors and vulture funds, from overriding municipal laws and policies of capital importing countries during debt restructuring.

2. Sovereign Debt and the Law in Kenya

2.1. Constitutional Provisions on Sovereign Debt

It is important to note that, Constitution of Kenya, 2010, the Public Finance Management Act, the Privileges and Immunities Act, in complimentary fashion with various case law provides for protection against legal risks that emanate from default on public external debt. The constitution sheds perspective on the role of citizens of Kenya in regards to public external debt. Introspectively Article 1 of the constitution entrenches sovereign power on the people,[16] thus placing the people of Kenya at the top of the food chain of sovereign power. Thus, anything done in procuring public external debt should be done in the interest of the people. This is important as the people are the one who ultimately bear the responsibility of servicing sovereign debt through taxation. Furthermore, the constitution lists national values and principles[17] which must be considered in sovereign debt management when it comes to the responsibility the state and its officials owe to the people. These national values and principles are also

[13] See: International Institute for Sustainable Development (IISD), "Investment Treaties and Why They Matter to Sustainable Development", p. 21, available at https://www.iisd.org/sites/default/files/publications/investment_treaties_why_they_matter_sd.pdf. Accessed on 31/08/2023.
[14] Nguku Grace Wanjiru, "External environmental factors influencing China- Kenya trade: A case study of the ministry of foreign affairs and international trade and Chinese embassy in Kenya." Semantic Scholars, University of Nairobi, Nov. 2013, pdfs.semanticscholar.org/dc28/ec1588929da597c6497d86218a8d7c08a2d6.pdf.
[15] Livia Hinz, International investment agreements and sovereign debt: an empirical analysis, *Capital Markets Law Journal*, Volume 18, Issue 3, July 2023, Pages 365–390,
[16] Constitution of Kenya, 2010, Article 1(1).
[17] Constitution of Kenya, 2010, Article 10(2).

very critical in addressing the issues of opacity that shrouds most debt contracts in Kenya. For instance, the principles of transparency and accountability are essential in addressing the risk of ending up with opaque debt contracts, these contracts have the resultant effect of ballooning sovereign debt due to lack of due diligence inherent in these opaque contracts. Additionally,3 the constitution provides for the right to access information,[18] this further helps in realization of transparency and accountability in relation to issues of sovereign debt. I stress the fact that, this right is essential in the sense that, it affords the people of Kenya to pursue information regarding the terms and conditions of sovereign debt contracts and Bits, stress on the need of adequate accurate reporting on debt servicing as well as the information regarding the country's sovereign debt situation.

2.2. Statutory Provisions on Sovereign Debt in Kenya

Public Finance Management Act 2012 outlays legal framework of borrowing by state and entities of the state and offers guidance the person responsible for guaranteeing public loans. This statutory instrument provides for mandatory reporting on public debt management in Kenya. Section 25 and 33 of the Act mandated the national treasury to prepare and submit to the cabinet the budget statement policy (BPS) and debt management strategy by mid of February every year.[19] Additionally, Sections 47-65 of the Act prescribe for the receipt and the use of grants and loans, guaranteeing loans, lending money, entering into derivative transactions and the establishing of a fully-fledged Public Debt Management Office (PDMO)[20] in the National Treasury.[21]It is important to note that, this office is established with the primary objective of mitigating the cost of external borrowing and minimizing the associated risks of sovereign debt. The Act further provides that, Public Debt Management Office shall prepare and submit to the Cabinet Secretary and the Commission on Revenue Allocation (CRA) the following reports; *Medium Term Debt Management Strategy consistent with the Budget Policy Statement*, *the government borrowing plan for the approved Annual Budget, the statistical and analytical reports on debt and borrowing.*[22] These reports are supposed to be publicised so as to guarantee transparency around the issue of sovereign debt in Kenya. Additionally, Section 49 of the Public Finance Management Act vests the power to borrow on behalf of the national government in the cabinet secretary of finance, but there is caveat, this power is subject to parliamentary approval.[23]

3. Legal Protection of Foreign Investors in Kenya

3.1. Constitution of Kenya 2010

The constitution is the supreme law in Kenya, it outlays a foundational legislative framework upon which protection of foreign investors is guaranteed and enshrined into Kenya's legal framework. The constitution of Kenya 2010, The Constitution of Kenya 2010 has entrenched democratization of treaty making which heretofore did not exist, this lacuna afforded signing of BITs minus parliamentary legislative scrutiny. The 2010 constitutional dispensation pioneered changes in Kenya's treaty making

[18] Constitution of Kenya, 2010, Article 35(1)(a)
[19] Section 25 and 33, Public Finance Management Act No 18 of 2012.
[20] It is imperative to note that the roles of PDMO are tailored towards mitigation of a ballooning sovereign debt. The Public Finance Management Act No 18 of 2012 provides that the roles of PDMO are; maintaining a reliable database for all government loans, performing debt sustainability analysis, preparing a borrowing and servicing plans for the government, monitoring and evaluating all borrowing and debt related transactions to ensure that they are within the guidelines and risk parameters of the debt management strategy. Process the issuance of government debt guarantees including assessment and management of risks in government loans guarantees.
[21] Section 47-65, Public Finance Management Act No 18 of 2012.
[22] Section 64(2) c of Public Finance Management Act No.18 of 2012.
[23] Section 49 of the Public Finance Management Act No 18 of 2012.

and policy making. By dint of these constitutional changes, the constitution has afforded varied legal protection to foreign investors in Kenya. Article 2(6) of the constitution provides that: "Any Treaty or convention ratified by Kenya shall form part of the law of Kenya under this Constitution. The impact of this article is that it affords recognition to international laws and treaties ratified by Kenya *the Treaty making and Ratification Act*[24] implements Article 2(6) of the constitution, setting out procedures for making and ratification of treaties.

Article 40(3) of the constitution of Kenya 2010, underpins the sanctity of private property and mitigates against illegal expropriation.[25] This article automatically buttresses legal protection to foreign investors by providing protection against private property. Thus, foreign investors are assured of the sanctity of their investments and assets in Kenya. The constitution further assures foreign investors of equal treatment under the law. Article 27 (1) provides that; *every person is equal before the law and has the right to equal protection and equal benefit of the law*. The dint of this particular article is that foreign investors are assured of non-discrimination by the law on the basis of nationality. It further constricts restriction of enjoyment of interest and right over property. This high constraints on property will have the resultant effect of spurring attraction of FDI in Kenya. However, there is a limitation on the basis of nationality under Article 66(1) of the constitution on land tenureship by non-citizens, non-nationals are limited to a maximum of 99 years in leasehold tenure.

The Constitution of Kenya 2010 expands the ease of access to justice to foreign investors. Article 47(1) provides that; *every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair*. This article mandates the government of Kenya to ensure that every person inclusive of foreign investors will be afforded an enabling environment to expeditiously access justice. Additionally, Article 159 further mandates the judiciary to accelerate and promote the use of alternative dispute resolution mechanisms in administration of justice. It is also important to note that, the constitution of Kenya 2010 guarantees protection from expropriation, except in cases of eminent domain or security concerns, and all cases are subject to the payment of prompt and fair compensation. This technically guarantees that in case of expropriation on the basis of compulsory acquisitions, foreign investors are guaranteed prompt, prior and fair compensation of their investments.

3.2. Statutes

Kenya's legislative and regulatory framework demonstrates pro-investment policies and legislations replete with provisions that undergirds foreign investors protection in Kenya, the overarching objective of legal framework that is tailored towards protection of investors is meant to accelerate attraction of FDI .Primarily, Kenya has the *Foreign Investments Protection Act (Cap 518*) that was enacted in 1964 with the primary objective to afford protection to certain approved foreign investments. However, this statutory instrument has since undergone several amendments in view of the ever-changing economic environment. With regards to arbitration over investments, the act refers to the provisions concerning compulsory acquisition under the Constitution of Kenya, 2010.[26]This further gives assurance to investors about legal protection assigned to their investments. The Act further guarantees foreign investors that there is existence of high constraints placed in regards to capital repatriation and remittance of attendant interests.[27]

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[24] Act No. 45 of 2012 (Treaty Making and Ratification Act, 2012).

[25] Article 40(3) provides that ;the State shall not deprive a person of property of any description, or of any interest in, or right over, property of any description, unless the deprivation results from an acquisition of land or an interest in land or a conversion of an interest in land, or title to land, in accordance with Chapter Five; or) is for a public purpose or in the public interest and is carried out in accordance with this Constitution and any Act of Parliament that—) requires prompt payment in full, of just compensation to the person; and allows any person who has an interest in, or right over, that property a right of access to a court of law.

[26] Foreign investment Protection Act, Cap 518, Section 8.

[27] Foreign Investment Protection Act, Cap 518, Section 7.

Another statutory instrument that underpins protection of foreign investors in Kenya is the *Investment Promotion Act 2004,* it was enacted to promote and facilitate investment by assisting investors in obtaining the licenses necessary to invest and by providing other forms of assistance and incentives. The *Investment Promotion Act* 2004 furthermore, establishes a statutory body known as the Kenya Investment Authority (Ken Invest) whose primary mandate is to promote investments in Kenya by facilitating the implementation of new investment projects, providing after-care services for new and existing investments, as well as organizing investment-promotion activities both locally and internationally.[28]

3.3. International Investment Treaties

Kenya is signatory to a number of multilateral and bilateral investment treaties, these treaties contained provisions that are geared towards pursuing the objective of ensuring protection of foreign investors and their investments in Kenya. Multilateral treaties are international agreements with more than two countries as parties to the treaty, while bilateral investment treaties are essentially investments agreement between two contracting states, where the underlying premise is the promotion and protection of investments; that a state gives assurance to the other contracting party to act in a way that will not be detrimental to investments by investors from the other contracting party. Kenya has signed a total of twenty-one BITs where twelve of them are still in force.[29]The common denominator in these BITs is the similarity of substantive and procedural provisions that are tailored to afford protection to investors, these are found in the following clauses.

Kenya is a party to various multilateral treaties that have provisions which are primarily tailored to guarantee protection of foreign investors; Agreement establishing the African continental free trade Area (AfCTA),[30] Treaty establishing the Common Market for Eastern Africa (COMESA),[31] and treaty for the establishment of the East African Community (EAC)[32]and Energy Charter Treaty.
At Article 4(f), the agreement establishing the African continental free trade Area (AfCTA) provides for establishing a mechanism for the settlement of disputes concerning their rights and obligations. Technically, this provision guarantees that investors will be afforded avenues to agitate for their rights and obligations. Article 5 of AfCFTA further provides that one of the guiding principles of the agreement will be the Most-Favoured-Nation (MFN) Treatment; this MFN clause in AfCFTA lends credence to the fact that investors will be accorded equal treatment this enhances protection of investors and their investments.

Additionally, AfCFTA has three separate protocols*,* one of these protocols is *the African Continental Free Trade Area (AfCFTA) Protocol on Investment (PoI)*, this protocol reinforces protection of investors in the following ways; it has provisions on Investment promotion and facilitation that protect investors by mitigation of conflicts between conflicts between host states and investors. Furthermore Article 20 of this agreement establishes a mechanism for settlement of disputes, this is one way in which investors are clothed with legislative protection against unlawful expropriation of their investments. Also, Article 4 and 5 on the Protocol on trade in goods provide for MFN and national treatment clauses respectively, these clauses are geared towards buttressing investor protection of member states.

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[28] Foreign Direct Investment Regimes An Overview of Policy and Regulatory Developments in East and Southern Africa (2023), https://iclg.com/practice-areas/foreign-direct-investment-regimes-laws-and-regulations/2-an-overview-of-policy-and-regulatory-developments-in-east-and-southern-africa accessed on 9/16/2023.
[29] https://investmentpolicy.unctad.org/international-investment-agreements/countries/108/kenya , Accessed on 22/09/ 2023.
[30]Agreement Establishing the African Continental Free Trade Area.
[31] Treaty Establishing the Common Market for Eastern Africa.
[32] Treaty for the Establishment of the East African Community.

In regard to COMESA and affording protection to foreign investors, Article 159(1) (a) mandates member states to ensure that FET treatment is accorded to investments by investors of member states. Article 159(5) further grants investors' wide latitude to repatriate capital and profits. Protection of investors is also highlighted in the EAC, treaty for the establishment of the east African Community 1999, Article 127 of this agreement provides in peremptory terms about protection of private property as a way of creating a favourable ecosystem for private investment. Also, Kenya is a member of the International Centre for Settlement of Investment Disputes (ICSID) Convention, and the 1958 New York Convention on the Enforcement of Foreign Arbitral Awards. This therefore, affords investors, sovereign creditors and holdout creditors to pursue international arbitration (the negative implications of investment arbitration in relation to sovereign debt will be canvassed later in this policy brief) in the event of breach of investments agreements, technically this safeguards investor protection in Kenya.

4. Concerns Related to Investment Arbitration in General

BITs ability to attract FDI cannot be scorned, however, BITs have now been fashioned as a platform to initiate huge compensation claims via ISDS against host states, this triggers surging public external debt.[33] It is imperative to note that, majority of these BITs are drafted in such a way that the investor state is guaranteed unfettered legal rights without corresponding responsibilities.[34] The bulk of the literature on the relationship between public external debt, FDI and BITs is heavy on the direct effect external debt and FDI has on economic growth, but very light on addressing the role of BITS in precipitating public external debt. I seek to establish how BITs have resulted in increase in public external debt in developing countries and complicated the issue of debt restructurings. It is imperative to consider that all Kenya's investment treaties that have arbitration provisions allow for ICSID arbitration in case of breach of any provision.[35].This begs the question, what is the attendant consequences of affording sovereign creditors recourse to international arbitration in enforcing sovereign debt obligations? ISDS is a key plank of BITs, Majority of BITs include investor–state dispute settlement mechanisms that affords investor-states respite in international arbitration in the event of breaches by the host state.[36]

According to data from investment dispute settlement navigator, there is a total of 1257 known treat-based ISDS cases as at 31 December 2022.[37]BITS disputes mechanisms are heavily premised on economic considerations at the expense of sustainable development issues like management of external public debt.[38] Dispute resolutions mechanisms of BITs are often likely to lead to a host country incurring public external debt in pursuit of settling huge compensation claims. These dispute mechanisms are heavily-weighted against host countries at the expense of foreign investors. They are shrouded in opacity and majority of their decisions are ignorant of developmental impact on the host country, a case

[33] The World Bank estimation concludes that, more than one third of the countries that qualified for its debt relief initiative have been targeted by lawsuits, including under IIAs, by at least thirty-eight litigating creditors, with judgments totalling north of one billion dollars in twenty six of these cases. See Report of the Human Rights Council Advisory Committee on the activities of vulture funds and the impact on human rights, UN Doc A/HRC/33/54, 20 July 2016. See also: Yuefen Li, "Impact of Hedge Funds' Activities on Human Rights" in South Bulletin 86, 9 October 2015.

[34] *Strategic Consultative Meeting on Reforming Bilateral Investment Treaties (BITs) in Kenya,* CONCEPT NOTE-Kenya BIT Consultative Meeting.pdf (wtochairs.org), Accessed on 29/08/2023.

[35] See Germany, Italy, Slovakia, U.K., Switzerland and France BITs, and COMESA Investment Agreement.

[36] Axel Berger, 'Developing Countries and the Future of the International Investment Regime' [2015] Deutsche Gesellschaft fürInternationale` Zusammenarbeit (GIZ) GmbH, p.8.

[37] https://investmentpolicy.unctad.org/investment-dispute-settlement/country/108/kenya/respondent

[38] Luke Eric Peterson, *The Global Governance of Foreign Direct Investment: Madly off in all directions*, FES Occasional Papers Geneva, No. 19, May 2005.

in point to illustrate this is the ***Nigeria and P&ID*** case in 2012[39]. P&ID instituted arbitration against Nigeria, the arbitral tribunal awarded P&ID 6.6 billion US dollars, and to put this into perspective the award is equivalent to 2.5% of Nigeria's GDP. It is important to note that highly indebted sovereign debtors will ultimately be negatively impacted by huge claims awarded to investor countries. These huge claims will have the effect of depletion of foreign exchange reserves, worsening debt servicing burden and ultimately increase the risk of a host country becoming debt distressed.[40]I reiterate that BITs pose challenges to issues of debt handling, debt management and debt repayment crises in developing countries who are already encumbered with huge sovereign debts. Additionally, heretofore, most developing countries have demonstrated ignorance on the legal implications of BITs in regards to public external debt.[41]

Notably debt service obligations absorb available capital and foreign exchange to pay for imports.Debt service payment in relation to BITs is done in a foreign denominated currency, therefore, debt service obligations can be met only through increased export earnings, reduced import volume or additional external borrowing.[42] With the background of hindsight that, BITs debt service payment are made in hard currency, widespread currency depreciation ,as it is now in Kenya, will have the impact of increasing debt servicing , which will have the ripple effect of exacerbating the public external debt. I argue that, excessive borrowing by the public sector to meet their obligations under BITs is most likely to lead to debt crisis in Kenya and other developing countries in Sub-Saharan Africa who have signed BITs. This lends credence to the imperative need to assess the legal implications of BITs on public external debts, sovereign debtors (as most compensation claims are against foreign debtors) and their impact on expanding the ease of sovereign default risk. Also, debt compensation is likely to create bottle-necks if developing countries embark on a borrowing spree via BITs till their economies experience external shocks. Additionally, astronomic levels of public external debt will ultimately create an economic condition risk that will raise the risk premium on public external debt[43] and thus complicates debt governance in Kenya and other developing countries.

Rising levels of default risks among developing countries calls for urgency in establishing a debt restructuring legal framework to address and mitigate gaps in sovereign debt restructuring architecture in relation to BITs. It is without a doubt that Kenya is currently being affected with debt maturity payment pressures coupled with a ballooned debt-servicing costs and high debt distress.[44] In December 2022. Kenya's public debt was estimated at Kshs 9.145 trillion, with KSh4.673 trillion ($37 billion) in external debt and debt repayments consuming almost 58 percent of the total revenues.[45] This is an alarming rate of debt and it can be exacerbated by the potential risk of Kenya being subjected to international dispute resolution in the event of defaulting.

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[39] *Federal Republic of Nigeria v. Process & Industrial Developments Limited [2020*] EWHC 2379 (Comm), available at https://www.bailii.org/ew/cases/EWHC/Comm /2020/2379.html.

[40] To shed perspective and offer insight on the attendant consequences of huge claims at ISDS on ballooning public external debt, it is imperative to consider this succinct example. In this particular case, litigation ended by awarding almost 15% of the total government social benefits' expenditure to creditors, money that could have been channelled to education, health care and poverty alleviation. In the same fashion, in other varied investor-state disputes litigations, countries facing litigation have been mandated to service their public external debt obligations, thereby reducing their capacity to address poverty reduction and pursue their economic development efforts. The net effect is these countries sinking into more external debt in pursuit of settling these huge claims. See: Report of the Human Rights Council Advisory Committee on the activities of vulture funds and the impact on human rights, UN Doc A/HRC/33/54, 20 July 2016 and Yuefen Li, "Impact of Hedge Funds' Activities on Human Rights" in South Bulletin 86, 9 October 2015.

[41] See: International Institute for Sustainable Development, Investment Treaty News of 16 March 2009.

[42] Chowdbury, A. (2001), External Debt and growth in developing countries; a sensitivity and Casual Analysis. Helsinki: WIDER

[43] Babu, J. O., Kiprop, S., Kalio, A. M., & Gisore, M. (2015), *Result of domestic debt on economic process within the East African community*. Yankee Journal of analysis Communication, 3(9), 73-95.

[44] Kenya was first assessed as being at high risk of debt distress in May 2020. IMF Country Report No. 20/156 (May 2020) contains the previous DSA conducted jointly with the World Bank.

[45]Kenya's public debt stock crosses the $72 billion mark, https://www.theeastafrican.co.ke/tea/business/kenya-s-public-debt-crosses-usd72bn-mark-4114332 accessed on 04/09/2023.

The essential premise of BITs is to offer almost unfettered protection to foreign investors for their investments in the host country. The most used treaty provisions in compensation claims used in arbitration are; Fair and Equitable treatment (FET), Expropriation, Prohibition of Arbitrary, Unreasonable or discriminatory Measures (UAD), Full protection and Security (FPS), Umbrella Clauses, Most Favoured nation Treatment (MFN) among other provisions. These provisions in most BITS, especially the traditional models of BITs were heavily skewed in favour of the investor state especially if it is a huge capital exporting state. With the backdrop of expanded scope of BITs to cover sovereign debt, under FET provision a debt restructuring could be viewed as undermining state contractual obligations, consequently destroying a foreign investor legitimate expectation and affording the investor to escalate the dispute to ISDS. Also, under NET provision, if a BIT covers sovereign debt obligations, then a national treatment claim can occur when domestic bondholders receive better terms during debt restructuring in comparison to foreign bondholders. This lends credence to the risk of the above provisions frustrating debt restructuring processes. As holdout creditors have been afforded the avenue to bringing additional investor-State dispute settlement (ISDS) claims that are highly likely to frustrate debt restructuring efforts or lead to double default or balloon sovereign debt due to costly arbitral awards on the basis of claims instituted by holdout creditors.

Additionally, the upshot of these skewed treaty provisions in BITs is investor friendly BITs. Investor friendly BITs sheds light on the nexus between BITs and sovereign default risk, in the sense that, host state with low constraints is afforded wide latitude to expropriate, with the attendant effect of huge compensation claims awarded to investors and negative impact on the host state sovereign creditworthiness consequently a high risk of sovereign default. While a high political constraint host state will less likely violate BITs provisions, thus a positive effect on sovereign creditworthiness and minimal risk of sovereign default.

Investor friendly BITs coupled with dearth of bankruptcy protection of sovereign debtors and unchecked sovereign debt enforcement latitude afforded to investors (for instance attachment of sovereign assets to meet sovereign debt obligations[46]) by *the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention)*[47] and *International Centre for Settlement of Investment Disputes (ICSID)* has muddied the waters of sovereign debt restructurings.[48] BITs have demonstrated propensity in frustrating efforts of developing countries embarking on debt restructurings; international arbitration of BITs is likely to shroud details about sovereign debt and attendant debt settlement in opacity. This lack of transparency affords debtor states to offer preferential debt settlement terms to different classes of creditors or even concealing existence of their debts to certain creditors which is capable of undermining creditors' participation in efforts of debt restructurings. My argument is that developing states should assign requisite seriousness on the implicit legal implications of BITs provisions and subsequent drafting of the same to mitigate on issues of sovereign default risk borne out of BITs expanded scope of application and by inference substantive protection provisions. This lends credence to the urgency of rethink and review on drafting of BITs and dumping of traditional models of BITs so as to mitigate on exposure of African countries to international arbitration that could result in surging public external debt in settlement of awards.

Additionally, arbitral awards[49] due from international arbitration of BITs constitutes a large chunk of developing countries public external debt, this coupled with the fact that arbitral awards are

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[46] Libby George, Explainer: Nigeria Fights Back, but Threat of $9 Billion Penalty Looms, Reuters (Sept. 27, 2019), https://www.reuters.com/article/us-nigeria-arbitration-explainer/explainer-nigeria -fights-back-but-threat-of-9-billion-penalty-looms-idUSKBN1WC1IR.;

[47] The New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Jun. 10, 1958, 21 U.S.T. 251, 330 U.N.T.S 38, at Art. 3. [hereinafter New York Convention].

[48] See Dilini Pathirana, Sri Lanka Gone Broke: Sovereign Debt Restructuring and Challenges Ahead, Afronomics L., (Sept. 5, 2022), https://www.afronomicslaw.org/category/analysis/sri-lanka-gone -broke-sovereign-debt-restructuring-and-challenges-ahead (arguing that arbitrations by holdouts is one of the potential challenges Sri Lanka may face in its debt restructuring efforts, accessed on 06/09/2023

[49] Article 54 of the ICSID Convention on enforcement of arbitral awards states that "Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary Obligations imposed by that award within its territories as if it were a final judgment of a court in that State".

unpredictable, lends credence to the fact that arbitral awards can make Debt Sustainability Assessments (DSA) ambiguous. It is imperative to note that, DSA are used by International Monetary Fund (IMF) when considering financial assistance to highly indebted countries and in debt restructurings initiatives.[50] Uncertainty of DSA may result in understatement of sovereign debt issues that will ultimately lead to the citizenry of the debtor country bearing the responsibility of debt restructuring via austerity measures and higher taxation.[51]With this as my point of introspection, I stress that the need and urgency of recalibration of provisions of investment law, BITs and ISDS mechanism that affords unfettered latitude to investor-states and termination of BITs that are tailored to accelerate accumulation of external debt stock of developing countries in Africa cannot be consigned to the dustbin of neglect.

5. Sovereign Debt within Investment Arbitration.

5.1. The case of Argentina

The debt restructuring crisis in Argentina of 2001 sheds perspective on the interplay between international investment law, ISDS mechanism and impact on sovereign debt. Due to financial crisis Argentina defaulted on its debt in December 2001, investors proceeded to file a series of lawsuits against Argentina. In addition to this, some holdout bondholders commenced investment arbitration proceedings against Argentina on the basis that the debt restructuring embarked on by Argentina violated obligations under investment agreements, this was argued by Italian holdout bondholders in the case of *Abaclat v Argentina* under the Argentina-Italy BIT. The Tribunal his case determined the definition of investment as is in the Argentina-Italy BIT was to be assigned broad open-ended meaning encompassing sovereign bond instruments and attendant securities. The same holding was reiterated in the case of *Ambiente v Argentina*. I point out that these two cases, buttressed the argument that sovereign debt should be considered as investment afforded protection under BITs and other IIAs.

5.2. IIAs and Kenya's Sovereign Debt

It is imperative to note that the wording of the Argentina-Italy BIT mirror the wording in most of Kenyan BITs. Kenyan BITs mirror the broad open-ended definition of the term investment as it was in the Argentina-Italy BIT. Kenyan Bits define investment as every kind of asset, in addition they provide a non-exhaustive list of assets covered. I point out that this open-ended definition of investment by default expands the scope of Kenyan BITs to cover sovereign debt and sovereign bonds. Thus, Kenya is susceptible to the same experience as Argentina during its debt restructuring process. Kenyan Bits have the impact of affording sovereign creditors, holdout bondholders and vulture funds to use the ISDS mechanism to negatively affect Kenya's debt restructuring efforts by instituting arbitration claims against Kenya and claiming that debt restructuring violates obligations as contemplated in the Kenyan Bits. Therefore, we cannot scorn the potential risk of these BITs on sovereign debt.

With the backdrop of the expanded scope of Bits, it therefore, demonstrates that Kenyan BITs can impact on Kenya's sovereign debt. Majority of BITs signed by Kenya contain broad definition of investor and investment, investment in most of these BITs refers to any type of assets that are considered as investments, this assigning of broad definition to investment affords the broadest range of assets to be covered. Article 1(a) of *Kenya - United Arab Emirates BIT (2014)* provides that; *the term 'investment' means every kind of asset invested by the investors of one Contracting Party in the territory of the other*

This is incentives investor states to aggressively pursue international arbitration to the detriment of host state that is already highly distressed with public external debt.

[50] International Monetary Fund, *supra* note 76, at 33.

[51] *See* IFRS, *IAS 37 Provisions, Contingent Liabilities and Contingent Assets,* (2022), https://www.ifrs .org/issued-standards/list-of-standards/ias-37-provisions-contingent-liabilities-and-contingent-assets/

*Contracting Party in accordance with the laws, and regulations of the Contracting Party in whose territory the investment is made and in particular, though not exclusively, includes…"*This provision denotes the non-exclusive aspect of the list of investment. Article 8 (3) of the *Kenya - United Kingdom BIT (1999)* provides that the decision to choose between arbitration or conciliation lies with the foreign investor. This provision is also found in Article 9 (3) of *Italy - Kenya BIT (1996)* which was terminated

Additionally, the list of investments covered under these BITs are non-exhaustive, the upshot of this is that; such a non-exclusive and non-exhaustive list of investment ensures that a wide variety of their investor's assets were protected in the territories of their capital importing treaty partners plus anything could be interpreted as an investment including sovereign debt.[52] This increases the likelihood of the sovereign creditors (holdout creditors, vulture funds) pursuing investment arbitration at any slight breach like Kenya embarking on debt restructuring process. Another implication of these non-exclusive list of assets considered as investment in BITs signed by Kenya is that, investment arbitral tribunal at ICSID may have jurisdiction regarding issues that may not even be considered as an investment in Kenya leading to Kenya incurring additional sovereign debt or at worse double default.

This is further complicated with the fact that in international investment law, there is no binding precedent. The complexity of the broad non-exclusive definition of investment was demonstrated in the case of *CMS Gas Transmission Co. v Argentina* it his particular case, ICSID Annulment Committee stressed the fact the definition in the *Argentina-US BIT* which provided for *"every kind of investment…owned or controlled directly or indirectly…such as equity, debt…"* was extremely broad, and confirmed that investments made by minority shareholders are covered by that definition as is also recognized by ICSID arbitral tribunals in comparable cases.[53] I point out that the wording in this Argentina-US BIT is almost similar to the wording in in Kenya's BITs. Another critical issue with regards to Kenya BITs relates to the investor-state dispute clause and how this clause impacts on Kenya's sovereign debt. The investor-state dispute clause affords investors unfettered latitude to bypass municipal courts and sue government of Kenya in international arbitration tribunals in the event of an alleged breach of treaty protections and/or provisions. Ideally, this provision relocates decision-making power outside the country and into international investment arbitration whose determinations can have major implications on domestic economic policies and issues on management of sovereign debt like debt restructuring.

This risk is further compounded by the fact that in most BITs signed by Kenya risk of the investor-state dispute provision in Kenya's BITs that it is the decision of the foreign investor that the parties go to investment arbitration. This particular clause has the propensity to scorn the sovereignty of a state and ultimately undermines the judicial system of the host state. Erosion of Kenya's sovereign immunity will result in a series of litigation and arbitration instigate by vulture funds, sovereign creditors and holdout bondholders in the event of Kenya's sovereign debt default. Article 14(2) of *Japan - Kenya BIT (2016)* provides for investment arbitration in the event the contracting parties fail to settle the dispute via diplomatic channels. Also, Article 11(5) on settlement of disputes between contracting parties of the *Kenya - United Arab Emirates BIT (2014)* provides for escalation of dispute settlement to investment arbitration. The investor-state dispute clause is staple in all Kenyan BITs and multilateral treaties, this further buttresses the potential risk Kenya will be exposed to in the event of sovereign debt default or arrangement in regards to sovereign debt restructuring.

Article 8(1) of Kenya - United Kingdom BIT (1999*)* on Reference to International Centre for Settlement of Investment Disputes provides for escalation of investments disputes to international tribunals[54]. Additionally, Article 11 (3) of the Germany - Kenya BIT (1996*)* stresses that the award

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[52] Malik M, *Recent developments in the definitions of Investments in International Investments Agreements*, 2008 *IISD*7.

[53] Malik M, *Recent developments in the definitions of Investments in International Investments Agreements*,2008 *IISD*18.

[54] Article 8(1) of Kenya-United Kingdom BIT (1999)provides that; Each Contracting Party hereby consents to submit to the International Centre for the Settlement of Investment Disputes (hereinafter referred to as "the Centre") for settlement by conciliation or arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States opened for signature at Washington on 18 March 1965 any

given under such arbitrations shall be binding and shall not be subject to any appeal or remedy other than those provided for in the said international investment law. I point out that the fact that this aspect of no room appeal in investment arbitration places a great risk for the Kenyan government in the event that an investor sues the government at an investment arbitration where there will be no room for appeal against decisions that the government may feel have been unjust and detrimental to its economies.

6. Conclusion and Reform Proposals

As it has been demonstrated above, the legal framework for IIAs and BITs has expanded the scope of applicability to cover sovereign debt instruments, this places Kenya at various potential risk by sovereign creditors and the propensity of these sovereign creditors frustrating debt restructuring policies and even leading to double default and debt distress. Also, the ISDS mechanisms is heavily skewed against capital importing countries in the global south. This has afforded sovereign creditors like vulture funds and holdout creditors to even challenge economic policies of developing states resulting in issues of debt crises and debt restructurings challenges in developing countries. In order to mitigate the impact of BITs on public external debt developing countries should adopt the following measures.

First, there is need for a reformed investor-state dispute settlement mechanism, these reforms should be inclined towards uptake of state-state arbitration, reliance on domestic courts and the need of an African investment court system. Second, urgency of customisation and adoption of legislative instruments such as the *Pan-African Investment Code* that is strictly tailored to guide African countries when drafting BITs with foreign investors. This will be key in clarification of various aspects of BITs like expropriation and obligations of contracting parties' provisions which are likely to result in increased public external debt in developing countries. Third, in drafting of future BITs, developing countries need to reduce their exposure to international arbitration so as to manage the adverse implications of arbitration in relation to BITs.

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legal dispute arising between~ that Contracting Party and a national or company of the other Contracting Party concerning an investment of the latter in the territory of the former.