

# DEBT DISTRESS AND THE FACT AND FICTION ABOUT CHINESE "ASSET SEIZURES"

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June 25, 2020

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# “Debt-Trap diplomacy”?



# THE CASE OF SRI LANKA'S HAMBANTOTA PORT

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# China, Sri Lanka, and Debt Distress

**Meg Rithmire**

Harvard Business School

SAIS- CARI Debt Distress Event

June 25, 2020

The New York Times

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# How China Got Sri Lanka to Cough Up a Port

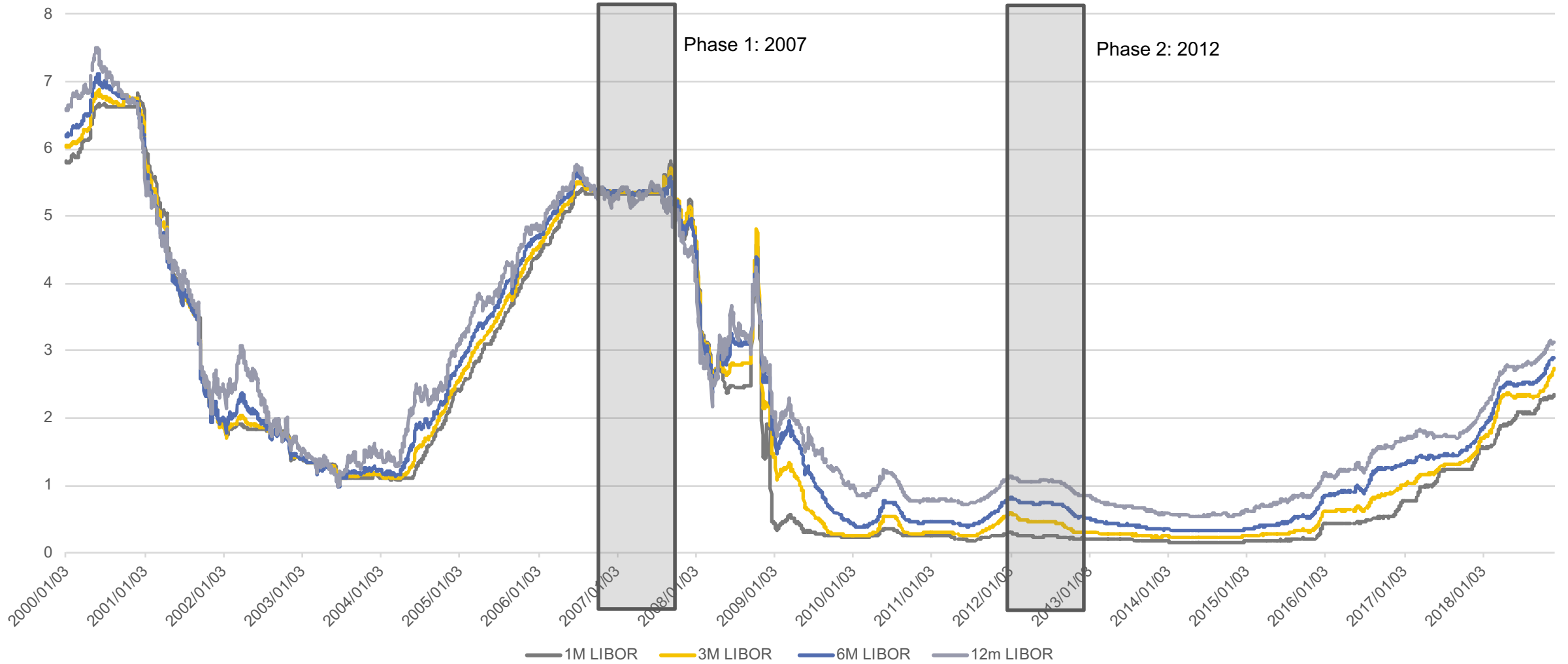


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# Basic Facts

- Hambantota Port:
  - Phase I (niche non-container cargo) 2007: \$307 million at 6.3% + 0.75%
  - Phase II (container port) 2012: \$757 million at 2%
  - Both ExIm Bank, China Harbor Group
- Port City: FDI from China Harbor Group, \$1.4 billion since 2014

# LIBOR Rates, 2000-2018





**Top: "Port City" Development**

**Left: Hambantota Port**



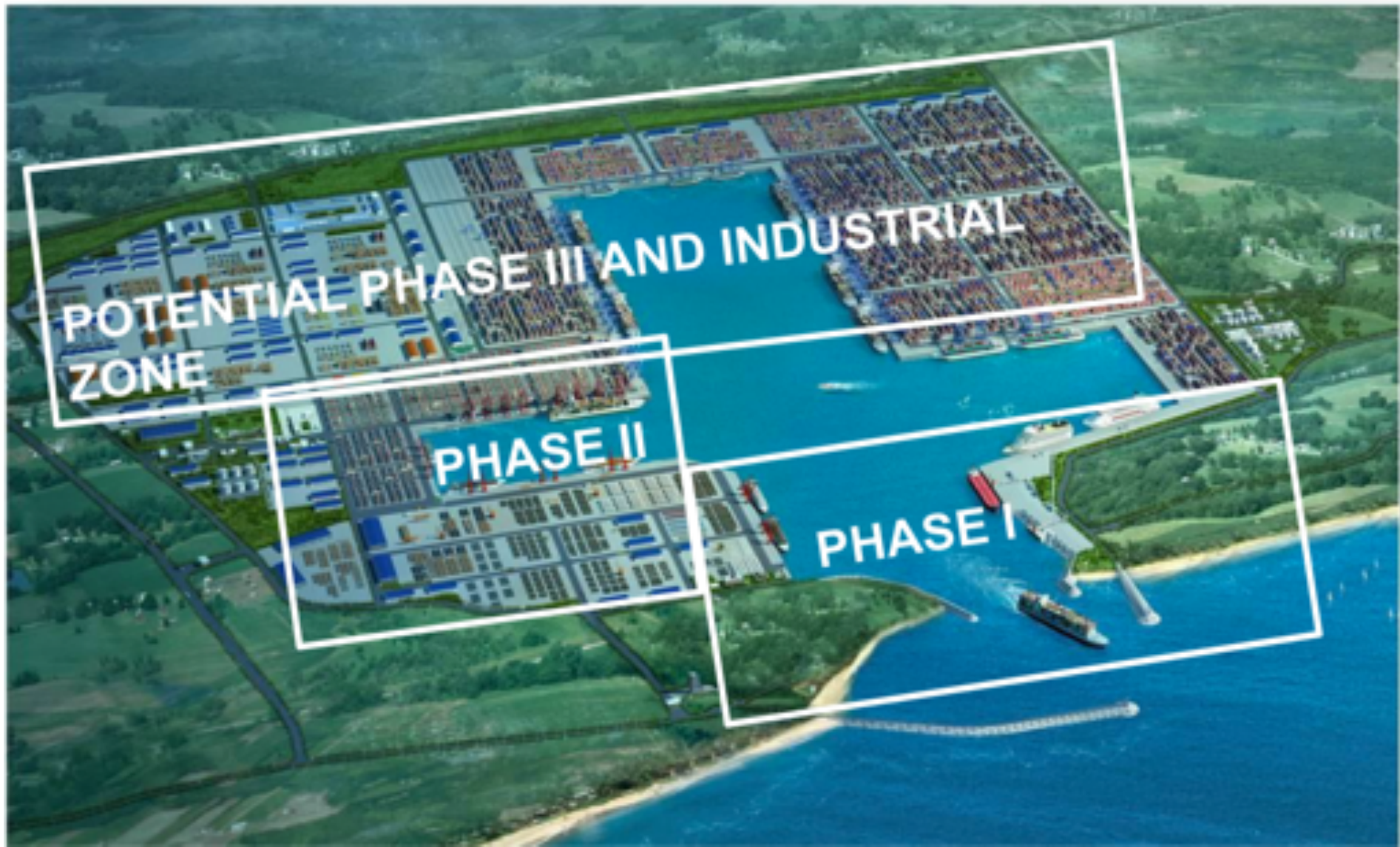


Source: CHEC Port City Colombo Ltd

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# Renegotiation

- Sirasena challenges Rajapaksa in late 2015, wins narrowly early 2016
  - Ran on renegotiating debt
  - Suspended Port City project
- Two offers:
  - China Harbor offered \$750 million for 65% (excluding container terminal) (\$1.136 billion valuation)
  - China Merchants: \$1.12 billion for 85% (port + zone + city concept) (\$1.4 billion valuation)
- Final agreement:
  - 85% at same valuation, three tranches within 2017, CMG to supply equipment for container terminal



HIPG Company Documents, 2018

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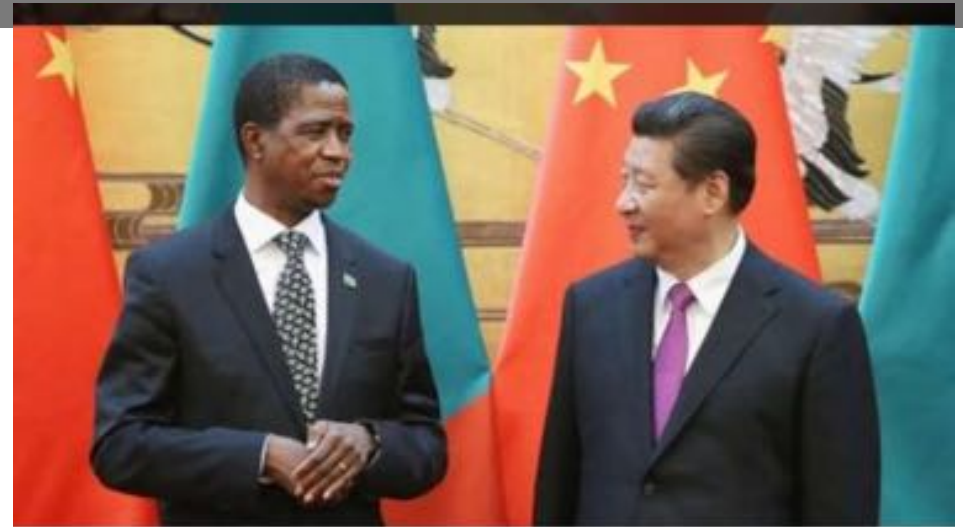
# A narrative of Hambantota

- “Debt-trap diplomacy” + “forward naval base”
- Democratic advantages (see also: Malaysia)
- Contingency and competing interests
- What cost to save reputations?

# A narrative of Hambantota

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# Africa: Wave of concern about possible “asset seizures”



Zambia President Edgar Lungu with his Chinese

**Zambia is reportedly in talks with China over a possible takeover of the country's electricity company, ZESCO, after defaulting on loan repayment.**

This is according to a report by Africa Confidential titled *Bills, Bonds and even Bigger Debts* claiming that Zambia risks losing its sovereignty to China which is bound to seize its national assets once the government defaults on loans.

# Chinese loan contracts: sovereign immunity, Arbitration Venue, Law to be applied

CHINA EXIMBANK GCL NO.(2015) 7 TOTAL NO.(546)

## GOVERNMENT CONCESSIONAL LOAN AGREEMENT

On Polytechnics, Technical and Vocational Training Centers  
Upgrading Project of Ghana

CHINA EXIMBANK GCL NO. (2011) 7 TOTAL NO. ( 357 )

NO. (1420303052011110318)

## GOVERNMENT CONCESSIONAL LOAN AGREEMENT

On Zimbabwe National Defence College Project

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CHINA EXIMBANK GCL NO. (2011) 18 TOTAL NO. (368)  
Series No. 1420303052011110701

## GOVERNMENT CONCESSIONAL LOAN AGREEMENT

SIERRA LEONE DEDICATED SECURITY INFORMATION  
SYSTEM PROJECT

GCL (2016) No. 17 Total No. (587)

## GOVERNMENT CONCESSIONAL LOAN AGREEMENT

On Benin Water Supply Project of Three Cities

BETWEEN

The Government of the Republic of Benin  
Represented by the Ministry of Economy and Finance  
of Benin

AND

THE EXPORT-IMPORT BANK OF CHINA

as Lender

# Sovereign Immunity

- Absolute Immunity
- Restrictive Theory of Immunity for commercial activity
  - Immunity from jurisdiction
  - Immunity from execution
- Example:
  - United States: FSIA 28 U.S.C. 1604
  - Subject to existing international agreements to which the United States is a party at the time of enactment of this Act a foreign state shall be immune from the jurisdiction of the courts of the United States and of the States except as provided in sections 1605 to 1607 of this chapter.



# Exceptions (Waiver)

- **Sec. 1605**
- **(a)** A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case—
- **(1)** in which the foreign state has **waived its immunity** either explicitly or by implication, notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver;
- **(2)** in which the action is based upon a commercial activity carried on in the United States by the foreign state;

# Loan Contracts and Choice of Law

- IBRD Policy General Conditions for IBRD Financing: Development Policy Financing (2017)
  - ARTICLE VIII Enforceability; Arbitration Section 8.01.  
Enforceability  
**[...] nor any Loan Party shall be entitled in any proceeding under this Article to assert any claim that any provision of the Legal Agreements are invalid or unenforceable because of any provision of the Articles of Agreement of the Bank.**

## WB Legal Resource Center (PPP) Sample Wording for Waiver Of Sovereign Immunity

- [...] **hereby expressly**, unconditionally and irrevocably waives such immunity to the fullest extent permitted by the laws of such jurisdiction.

# Chinese Loan Contract Sample

- “The Borrower hereby irrevocably waives any immunity on the grounds of sovereign or otherwise for itself or its property in connection with any arbitration proceeding . . . or with the enforcement of any arbitral award.”

# The Extent of Waiver

- Both for purposes of
  - Jurisdiction (frontend)
    - For arbitration to determine liability
  - Execution (enforcement) backend
    - For court litigation to execute the arbitral award by attaching property belonging to the state

# Recent Example of seizure Tanzanian Plane in Canada (2019)



# Kenya Standard Gauge Railway Case

## Kenya assets risk seizure by Chinese — Moody's

TUESDAY NOVEMBER 27 2018



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# SGR, Kenya Port Authority and Loan Guarantees

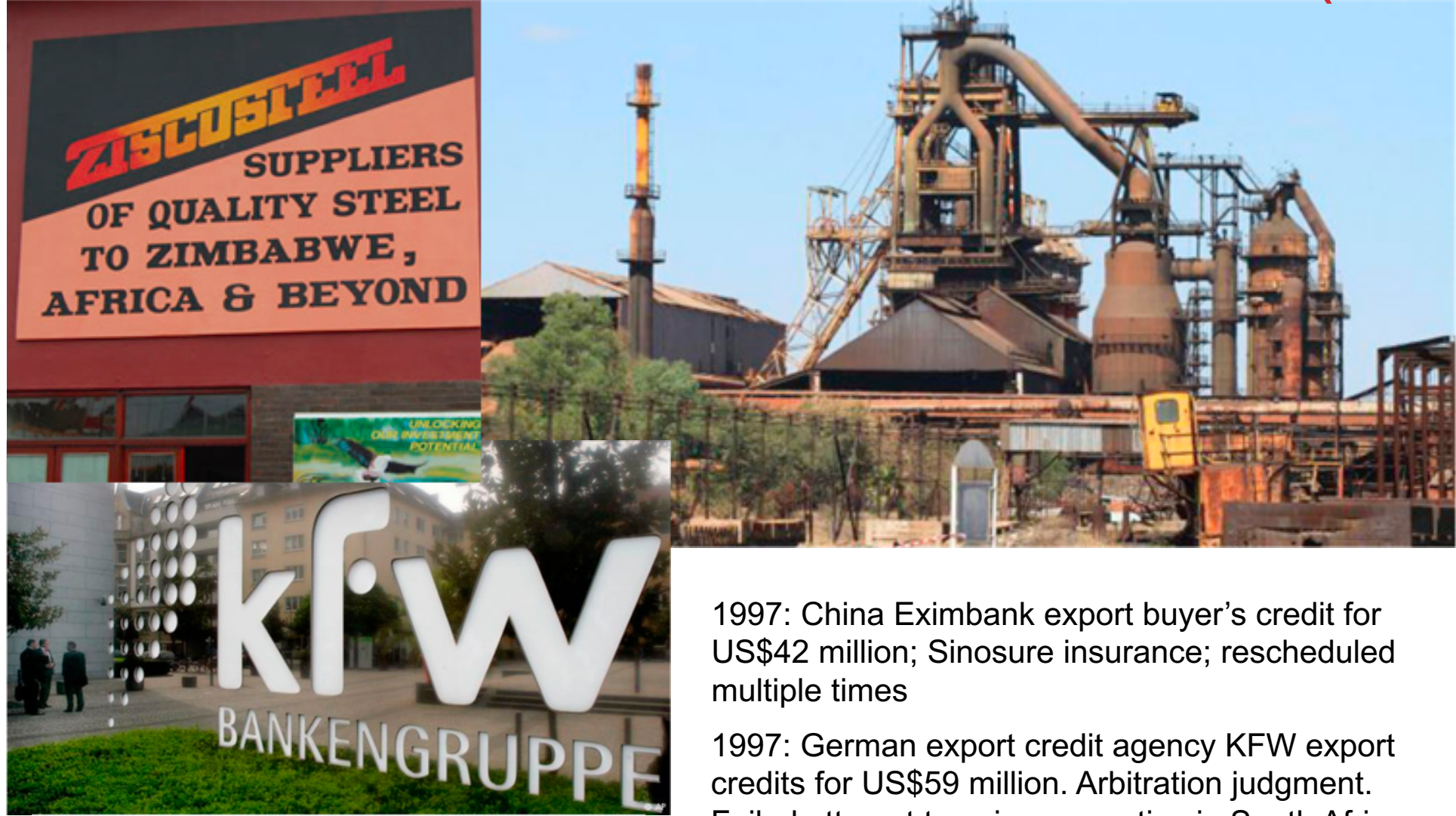
- \$3.6 billion SGR Loans Repayment Guarantee Structure
- Revenues from the SGR => escrow account
  - “Take or Pay” agreement between KPA and Kenya Railway Corp. KPA undertakes to consign a defined minimum volume of freight to be transported on the Standard Gauge Railway. This Agreement forms part of the security package for the loan
  - Railway Development Levy: 1.5% on all imports, Kenya Port Authority responsibility (US\$ 261 million in 2018)
  - Insurance policy with Sinasure: 6.93% of commercial loan



# Kenya Auditor General

- Auditor General Report (December 2018): Because of the Kenya Port Authority's role in the “take or pay” financial guarantee, it is a party to the loan
- KPA financial report should note that this was a potential risk to its assets

# German Bank KFW and Zimbabwe Steel Co. (ZISCO)



1997: China Eximbank export buyer's credit for US\$42 million; Sinosure insurance; rescheduled multiple times

1997: German export credit agency KfW export credits for US\$59 million. Arbitration judgment. Failed attempt to seize properties in South Africa. Penalties => **US\$225 million** (2018)



No Chinese “asset seizures” for sovereign lending in Africa or globally

# Recommendations

1. Diplomatic solutions first
2. Consider modifying waivers of sovereign immunity to protect interests on both sides
3. Best to select arbitration forums outside of home country of lender and borrower
4. Consider rejecting non-disclosure agreements for sovereign lending