Fifty Seventh Sovereign Debt News Update: Kenya partially releases the Standard Gauge Railway Contracts raising continued questions about secrecy

By:

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November 18, 2022

On 5 November, 2022 Kenya's new Transport and Infrastructure Cabinet Secretary, Kipchumba Murkomen, made public three loan contracts (Mombasa-Nairobi standard gauge railway (SGR) contract, Nairobi-Naivasha SGR contract, and the preferential buyer credit loan agreement) signed between the Kenyan government and China Export Import Bank (Eximbank). The three contracts for the Mombasa-Nairobi route and the Nairobi-Naivasha route finance two phases of Kenya's standard gauge railway (SGR). The partial release, which resulted in a media frenzy, failed to end years of speculation on what the country signed. Instead, more questions greeted the government's move to make public the SGR financing agreement, with details of the collateral Kenya put up, which a parliamentary committee had highlighted, being a key issue. In 2021, a parliamentary committee reported that Kenya had used Kenya Railways Corporation (KRC) and Kenya Ports Authority (KPA) as collateral in the Sh477 billion SGR loan procured from the Export and Import (Exim) Bank of China.

If anything, the Cabinet Secretary failed to release the feasibility study conducted by the Chinese contractor, as well as the documents explaining why Kenya Railways was not allowed to participate in developing the terms of reference of the feasibility study. Likewise, according to a tweet by Senior Counsel Ahmednasir Abdullahi, the released documents are not the SGR contract, but one of the finance agreements, and given the dynamite nature of the SGR contract, the public will not see it easily. Another tweet from Donald Kipkorir, a seasoned Kenyan lawyer noted that "true disclosure of SGR contracts are [sic] those of management and commission involving Kenya Railways, China Road and Bridge Corporation and Africa Star Railway Operations Company. These are the contracts where billions went to … other contracts are red-herrings and hot air."

Relatedly, according to the 24th report of the Public Investments Committee (PIC) of the National Assembly on the audited accounts of the country's state corporations, among them KRC and KPA, which was adopted by the 12th Parliament, the two state corporations had their assets used as collateral in the Payment Arrangement Agreement (PAA) between them and Exim Bank of China for the loan. The signing of the PAA was done without the requisite approvals of the KPA board, the Ministry of Transport and the Cabinet. This saw the PIC recommend in the report that the Ethics and Anti-Corruption Commission should investigate the signing of the agreement and for the National Treasury to renegotiate the entire PAA and discharge KPA from the contract and replace it with KRC.

Nonetheless, the release came in compliance with the Court's order in May 2022, where Justice John Mativo ordered the Kenyan government to make public all contracts, agreements and studies related to the construction and operations of the SGR. The release of the three contracts came nearly four years after rumours began circulating that Kenya had staked its valuable Mombasa Port as collateral for the initial US$3.6 billion railway project loans. The minister's disclosure of the contracts was intended to clear the air. Instead, the release has been marred with scepticism and claims of selective disclosure.

The 700-km railway runs between the port of Mombasa through Nairobi to Naivasha. It has been dogged by controversy from the start. Concerns range from public procurement, its massive cost and the government's reluctance to allow detailed scrutiny of the contracts underpinning Kenya's largest infrastructure project since independence. Other critics also contend that the rail line is not commercially viable. It was intended mainly as a freight route, but freight owners have so far stayed away, citing high costs of using rail compared to road transport. Kenyan firms also complain that the government is trying to force them to use the rail line even if it is not economical for them to do so.

Nonetheless, the preferential buyer credit loan agreement, the Mombasa-Nairobi contract, and the Nairobi-Naivasha contract acknowledge the Republic of Kenya, represented by the National Treasury of Kenya as the Borrower, fully liable for the payment and repayment obligations of the loan contracts. This obligation remains, whether or not Kenya Railways Corporation and Kenya Ports Authority perform their own obligations. Through the preferential buyer credit loan agreement, the lender agreed to avail USD 1,600,000,000, at an interest rate of 2% per annum, and a management fee at a rate of 0.25%. This management fee amounted to USD 4 million and was paid 30 days after the signing of the contract. For the Nairobi -Naivasha route, Kenya inked a $1.2 billion in a 20-year loan facility, and was required to pay USD 137.59 million as insurance fees.

After the lapse of a seven-year grace period given by the Export-Import Bank of China to Kenya since the signing of the contract in 2014, the government started servicing the facility in 2020. As far as repayment of the principal and the payment of interest are concerned, the Kenyan government is to repay all the principal amount by 26 equal instalments on each repayment date of interest and principal. The facility matures after 240 months, comprising a grace period of 84 months and a repayment period of 156 months. This maturity period can only be extended subject to a written consent of the lender. The terms and conditions also required that the state create an escrow account with Sh25 billion at all times to restore confidence in the lender that the borrower would still be able to dispense loan repayments on time.

The agreement also requires the parties to provide preferential treatment to China by purchasing the goods, technologies, and services purchased by using the proceeds of the facility to be from China. Through the Agreement, the government undertook to China that its obligations and liabilities would be direct, unconditional, and would rank at par in right of payment and security with all other Kenya's present or future unsecured and unsubordinated debts. Additionally, contrary to reports that the port of Mombasa had been offered as collateral, the Kenyan government undertook to provide as security, inter alia the Railway Development Fund to be applied in priority to repay all loans; a payment account established and opened in China's Account Bank which can be used to maintain the agreed minimum amount of balance as a debt service arrangement in favour of China; a revenue account established and opened in Kenya approved by China; and the Long Term Service Agreement which guarantees a minimum amount of freight throughout the pendency of the Agreement. However, without full disclosure of all the contractual documents, and in light of the above-mentioned 24th report of the PIC, it is impossible to conclude that these are only collateral measures the government has secured for the loan.

For the Nairobi-Naivasha project which was done under Phase 2A of the SGR project, the Chinese Bank loaned Kenya USD 1.482 billion. The money is to be repaid 20 years from the date the agreement was inked with the interest repayment period set as January 21 and July 21 of each financial calendar and final repayment date. A grace period of 60 months was given. The Kenyan government was to raise 15 per cent of the contract amount to China as a self-raised fund before the loan was disbursed. The government is also under obligation to pay USD 137million as insurance premium, a management fee of USD 6 million, an equivalent of 0.5 per cent of the loan facility and a commitment of 0.5 per cent yearly. The Nairobi-Naivasha contract also stipulates that in the event of a default, Kenya is required to pay the principal and interest overdue at the rate of one per cent per year, and the interest shall accrue daily and calculated on the basis of the actual number of days elapsed and a 360-day year and payable on time to time as demanded. The parties also agreed that the amount is to be repaid in full without any set-off, counterclaim, retention and without withholding taxes.

Consistent with most Chinese contracts, these SGR contracts have a non-disclosure clause, requiring the Kenyan government to strictly keep confidential all the terms and conditions of the agreements, unless prior written consent of China is sought. In addition, in the event of a dispute, the Agreement mandates the parties to resort to friendly consultation, and in the event the consultation bares no fruit, the aggrieved party can file an arbitration claim to China International Economic and Trade Arbitration Commission in Beijing, and the arbitration is to be carried out in accordance with the Commission's arbitration rules.

In conclusion, despite being a welcome move, it is important that the government, in compliance with the court order, also publish not only the feasibility study, but also details such as the survey report that guided route selection and options, market share forecasts, the financial modelling study report to determine profitability and bankability, an analysis of transport demand and forecast, and all other SGR-related documents. Merely publishing the three contracts is not enough.

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