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Selected Essays on Development Finance and the Role of the Lawyer in International Debt Operations

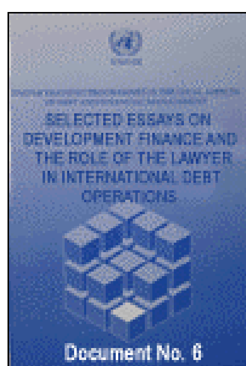

Table of Contents

page

Introduction **2**

Chapter 1: Sub-Saharan Africa and Development Finance **3**

Chapter 2: Role of the Lawyer in the International Debt Operations of Developing Countries **18**

Communique: Workshop on the Mechanics of Loan Agreements **32**

Profile of the Authors **34**

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INTRODUCTION

As part of its training programme in the *Legal Aspects of Debt and Financial Management for Sub-Saharan Africa*, UNITAR brings together African public officials from a range of agencies including the Ministry of Finance, Ministry of Justice, Ministry of Foreign Affairs, the Attorney-General's Chambers, the Central Bank as well as Members of Parliament, parastatals and other agencies involved in borrowing or negotiating international agreements. The primary aim of such workshops-conducted on a regional basis- is to bring together officials with different backgrounds to appreciate the multidisciplinary nature of financial management issues and the centrality and importance of the legal aspects in the borrowing process. Participants at these workshops are not only lawyers but also negotiators, decision makers, financial experts, economists and accountants.

As part of a similar initiative, UNITAR conducted a sub-regional workshop on the *Mechanics of Loan Agreements (Banjul, 3 to 7 May 1999)* jointly with WAIFEM (West African Institute for Financial and Economic Management). Some 40 participants were drawn from the Gambia, Ghana, Liberia, Nigeria and Sierra Leone. The purpose of this workshop was to expose African government officials to current developments in international finance as well as sharpen their understanding of the primary sources of finance and the legal documentation utilized therein. The primary mandate of UNITAR in such exercises is to deal with the *legal aspects* of financial management. Thus, the workshop also dealt, to a great extent, with the legal mechanisms in relation to debt operations as well as the role of the lawyer in the borrowing process.

This document is a logical outcome of the issues discussed at the Banjul workshop. It comprises two chapters dealing with some of the practical issues facing African nations in as far as financial management is concerned. Let me however hurry to say that the Issues raised in these chapters may also apply to other nations just as much as they apply to African economies. The last section of this document contains a communiqué drafted and presented by the Banjul workshop participants at the completion of the workshop in the Gambia.

We hope that this publication is useful to the readers.

Marcel A. Boisard

Executive Director of UNITAR

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SUB-SAHARAN AFRICA AND DEVELOPMENT FINANCE

*by Mr. Bolaji Owasanoye**

Introduction

Africa with the rest of the world is on the threshold of the third millennium. The vision of developed economies is for a new century having a healthy economy, steady growth and sustainable development. In Sub-Saharan Africa(SSA) the expectation is no less high but is dampened by bouts of depression arising from the prevalence of political instability and the parlous state of the economies. In developing countries, more than 1 billion people representing about one fifth of the world population live on less than US$1 a day, a standard of living that the United States and Europe attained two centuries ago. Africa is engulfed in a development crises due to collapsing economies, deepening poverty, growing hunger and pervasive mismanagement. There is also human, political and economic crises. Only few African economies like those of Botswana, Lesotho and Gabon may be said to be growing.

Disparity in growth rates continues to fuel debates as to the factors responsible for the differential development in developing countries generally. The main issues are whether the differences are due to institutional, policy, external or other factors. In recent times, globalisation has crept in and Africa in particular is faced with the cost of globalisation but not its benefit. Inability to benefit from globalisation is also being debated as traceable to various factors including those listed above.

One traumatic experience of development since post colonial days is the external debt burden of developing countries. After independence, many developing countries were worried about the capacity of the private sector to lead the development process therefore they "looked inward" and relied heavily on the public sector for planning and economic growth. The assumption being that the state had better capacity to direct growth. This development strategy emphasized the promotion of heavy industry which was considered basic to growth of the industrial sector generally. But because there was no capital to promote these industries they relied on foreign capital. This reliance led to dependence on western economies and exposed many developing countries to the adverse impact of fluctuation in the world economy[1].

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* *This article has been written by Bolaji Owasanoye (Associate Professor, Nigerian Institute of Advanced Legal Studies, Lagos) for UNITAR following his participation as a resource person in a joint UNITAR/WAIFEM Sub-Regional Workshop on the Mechanics of Loan Agreements for West African Nations (Banjul - The Gambia, 3 to 7 May 1999).*

[1] Mike Kwanashie "Development: African and Non African Perspective" unpublished paper presented at International Seminar on Africa: National Unity, Stability and Development organised by the Yakubu Gowon Centre, Nigeria, October 1996.

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The excess capital needed by developing countries was found especially from mid 70's upward due to the surplus funds available in the commercial banks of developed countries from Organisation Petroleum Exporting Countries (OPEC) between 1973 and 1974. Whereas in some cases external borrowing was based on the development need of the borrower, in other cases it was due to pressure from lenders. In the case of Nigeria for example, the current civilian President, General Olusegun Obasanjo, was the military head of state during the petro-dollar season. He had this is to say of his experience with lenders during his first stint as head of state.

"In 1977 and 1978, at the time of slight dip in the oil market, international bankers were descending upon us in droves. They pressed the case that our economic strength was such that we were grossly under-borrowed, especially for a nation with our type of visionary development programme[2].

In consequence of such pressure, many developing countries borrowed at rates which were then favourable but have today become a vicious debt trap.

While developing countries were being encouraged to borrow, industrialised countries adopted economic policies which though favourable to them at the time, had serious implications for the path embarked on by developing countries. Due to slow economic growth and problems of unemployment in many developed economies, they began to place limitation on free movement of goods and services. They limited the rate at which they imported labour intensive manufactured goods from developing countries, in particular clothing, textile and footwear. At the same time they increased protection for agricultural products. In the European Union for example, maximum barriers were imposed through the Common Agriculture Policy while in the United States similar protectionist policy was pursued[3]. This simultaneous turn of events had far reaching consequences on the debt situation of the borrower/primary agricultural products producing countries in the long run.

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[2] Olusegun Obasanjo "The Politics of International Debt" unpub. lecture delivered to members of the International Debt Management Lawyers Association, July 1992 at p.4.
[3] Mike Kwanashie op cit.

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Sub-Saharan Africa in Perspective

Compared to other regions of the world it appears SSA's external debt in absolute terms is small representing about a fifth of the total[4]. For example, recent figures published on developing countries short term debt stocks from 1994-1997 showed that as at 1997 Sub-Saharan Africa had only $20.8. billion of the world's total of $360.9 billion representing about 5.5% of the total as at 1997[5]. Although the total debt stock looks small the burden of servicing this debt burden is not small because of sub-Saharan Africa's peculiar economy which has been compounded in recent times by wars and refugee crisis in the region.

Other important factors come to mind. First, the average level of income in Sub-Saharan Africa is relatively lower than that of other developing regions. Secondly, most of the countries in the region are classified as among the poorest in the world. Of the 41 countries published as qualified for the Highly Indebted Poor Country Initiative (HIPC), 33 come from Africa[6]. Again, the growth rate in sub-Saharan Africa is the lowest in the world. Agriculture which has been the main stay in this region has been deteriorating in the past decades and stagnating in some cases resulting in falling production of food and export crops. Whereas, falling food production led to rising food import, falling export crop led to decline in foreign earnings. These conditions accentuated the balance of payment crises in the region. Regional conflicts have further eaten into the meager resources of the region such that scarce foreign exchange has been deployed to the prosecution of unproductive but destructive wars in Liberia, Sierra Leone, Rwanda, Burundi, Congo and Angola.

All the factors listed above have contributed to the deterioration of SSA external debt situation. The more pathetic internal factors are the absence of truly transparent government in many countries and the escalation of official corruption.

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[4] Abbey, J.L.S. "The African Problem" in Growing Out of Debt All Party Parliamentary Group on Overseas Development, (Overseas Development Institute) 1989 at p.34; see also Olaloku F. A. "Debt, Development and the Third World: The Issues and the Choices" (University of Lagos Press), 1991.
[5] Global Development Finance, World Bank 1998 at p.9.
[6] Global Development Finance, World Bank, (1998) at p.54.

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Debt Situation as a Hindrance to Development

Development performance in Africa has been particularly disappointing because peace which is a prerequisite to successful development has not been constant. Since nations shape their own destinies, socio-political instability and poor domestic policies have in combination with an unfavourable external environment contributed to the region's economic predicament. The heavy external debt of sub-Saharan Africa has been a significant hindrance to development and recovery processes. This is especially because these factors occur at a time when foreign exchange earnings continue to decline due to lower commodity prices and falling price of oil. The commitment to meet debt service continues to weigh heavily on sub-Saharan African countries. About ten years ago Latin American Presidents declared the effect of external debt on their development aspiration thus -

> *"External debt is now the major obstacle for the region's development, because of the massive net transfer of resources to the industrialised nations. In transferring a sizeable proportion of their domestic savings, Latin American countries have compressed their investment capacity and, as a consequence, their growth potentialities, leading to a significant deterioration in the living conditions of their peoples."[7]*

On the same tone, the Mexican President on assuming office in December 1988 said -

> *"In the present situation, the external debt impedes economic recovery. The country cannot grow, in a sustained way, if the present net transfer of resources abroad, equivalent to five per cent of the domestic product, continues. This situation cannot be accepted and cannot be sustained. I will avoid confrontation. But I categorically state that before the creditors interests come the interests of the Mexican people. The priority will no longer be to pay the debt, but to restore growth."[8]*

The above statements were made over ten years ago but the situation has only slightly improved in Latin America and hardly in Africa.

Also significant is the fact that the flow of capital from industrialised countries has slowed down significantly. Official finance which used to be reliably counted on by developing countries has declined due to changes in the economy of the donor countries. Resources from private sources has also declined.

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7 quoted by Navarrete Jorge Eduardo, "Practicable Solutions" in Growing Out of Debt op cit at pp. 27-28.
8 ibid.

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In its 1998 Global Development Finance Report, the World Bank shows that net concessional finance to developing countries continued to decline in 1997. It attributed this condition to declining strategic and military importance of development aid since the end of the cold war and weak public support for aid in some major donor countries due in part to skepticism about its effectiveness[9]. Unfortunately, the decline in development finance is not accompanied by decline in need for the assistance. For one thing, increasing population in developing countries implies increased need for development finance. According to the report, the number of people in low income countries increased from 2.4 billion in 1980 to 3.2 billion in 1999 while the number of people living on less than $1.00 a day rose from 1.2 billion in 1987 to 1.3 billion in 1993[10].

Due to lack of transparency in government, many donors began to channel increasing portions of their overseas development assistance (ODA) flows through non-governmental organisations (NGOs). This is confirmed by the increased share of ODA to NGOs from less than 10% in 1980 to about 35% in the 1990s. Although, this in itself is not a bad development, but the point must be made that a responsible democratic government is better able to use ODA than the best NGO. The situation is compounded by the loose accounting mechanism allowed to NGOs. In effect, it is arguable that ODA has fared better through NGOs than through the government. As the World Bank itself admits, development assistance is more effective when channeled in support of sound economic policies.[11]

The following observation of the World Bank is relevant.

> *"A nation's commitment to the development agenda is absolutely central in the success of international assistance. Such commitment cannot be "bought" by aid, as the experience of assistance for macroeconomic reform has shown. Macroeconomic reform has gone farthest and been most enduring when the government itself has seen the virtue of reform. In other words, aid conditionality worked best when it was a codification of the governments, own position. When substantial real differences existed between governments and donors, irrespective of any signed agreement between them, the reforms were either not implemented or were reversed after the release of aid." [12]*

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9 Global Development Finance, op cit at p. 49.
10 ibid.
11 op cit at p. 52.
12 A Continent in Transition: Sub-Saharan Africa in the mid-1990s World Bank Africa Region, p.70.

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The expectation of some African states from aid as a plank for development is misplaced because hardly do the conditions which are attached to aid coincide with national development objectives. Similarly, any expectations by a donor that aid is and can serve as an essential protagonist of development is misplaced because, as the observation of the World Bank above shows, intrinsic belief in the development objective is the key issue. African nations must also appreciate that aid is a diversion which reduces the opportunity to compete on an even keel with the developed countries. As far back as 1962, this point was made by Milton Friedman to the American government that-

> *"Instead of making grants to foreign governments in the name of economic aid and thereby promoting socialism while at the same time imposing restriction on the products they succeeded in producing and thereby hindering free enterprise, we should assume a consistent and principled stance. We could say to the rest of the world, we believe in freedom and intend to practice it. No one can force you to be free. That is your business. But we can offer you full co-operation on equal terms to all. Our market is open to you - sell here what you wish to. Use the proceeds to buy what you wish. In this way, co-operation among individuals can be worldwide yet free.[13]*

Although the cold war is over and socialism virtually extinct, nevertheless, the observation of Friedman remains true today in spite of the World Trade Organisation which purports to liberalise trade in a prospective single global market.

Role of Official Finance

Official finance which is so much relied upon by developing countries especially in SSA is made up of loans and grants from agencies and government of developed economies to those of developing economies. Over the years, but particularly since the end of the cold war, there has been a decline in development finance flows from developed to developing economies. Several reasons have been adduced for this development. These include the increasing reluctance of governments of developed economies to provide resources for official finance especially because they see increased movement of private flows to developing economies because some developing countries have found it more comfortable to obtain development finance from international capital market rather than from official sources.

In view of the reluctance to allocate heavy resources to official development finance, donors have also become critical with the little resource allocated. In this regard, donors have tended to support countries with better economic policies. This is especially true of multilateral finance although not so true for bilateral official finance which has tended to be influenced more by political rather than economic factors. But this is not to say that multilateral lenders like the World Bank have not been influenced by political factors at all.

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[13] Friedman Capitalism and Freedom Chicago University Press 1962 at p.74.

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Whereas the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD) has set up an agenda for development of the economies of developing countries by 2015, it remains to be seen if their initiative will succeed in the light of several existing structure in international economic law which suggest that developed economies are only paying lip service to the sustainable development agenda. In particular, DAC intends to reduce by half, population of people living in extreme poverty, ensure universal primary education in all countries, eliminate gender disparity in primary and secondary education, reduce by two-thirds the mortality rates for infants and children under age five, reduce by three fourths maternal mortality, provide access to reproductive health services for all individuals of appropriate age and reverse the current trend in loss of environmental resources.[14]

These are targets that a heavy debt burden makes impossible to achieve. Consequently, how far DAC is able to achieve this target in developing countries remains a challenge. On an optimistic note, it is gratifying that donor effort towards increasing the concessionality of aid and to minimise use of loan as opposed to grants is on the rise. As reported by the World Bank, several donors now provide all their ODA in the form of grants while most provide all ODA to heavily indebted poor countries as grants. At the same time, many have cancelled the ODA obligation of such countries.[15]

Private Capital Flows

Private capital flows to developing countries represent an important supplement to official finance available for investment. In 1997, emerging markets of developing countries enjoyed a boom one half of the year but suffered decline in the second half of the year due to the financial crisis in Asia. Whereas the industrialised countries were able to recover from the decline quickly, due to several economic shock absorbers in-built in their systems, the recovery of affected developing economies was not so rapid.

Of all the available private capital flows instrument available i.e. loans, bonds, portfolio equity and foreign direct investment (FDI), the latter represented the largest source of finance to developing countries. It has been said that FDI flows to developing countries increased due to three factors. Firstly due to liberalisation of the economies of some of these countries particularly through privatisation, secondly, strong growth in the GDP and trade of the major developing country recipient of FDI flows and thirdly, falling cost and rising quality of communication and transportation services which encouraged private corporations to shift towards an integrated global investment and production. In the growth of FDI, the role of multinational corporations stands out.

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14 Global Development Finance, op cit at p. 53.
15 Ibid.

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Unfortunately, however, sub-Saharan Africa hardly featured in the boom which private capital flows portended in the recent past. As revealed by the World Bank -

> *"many small, poor countries (especially in Africa) receive little foreign investment, often because of an unfavourable business environment, poor policies, unstable government, civil strife, weak infrastructure, poorly trained work force or small domestic market"[16].*

In effect, SSA does not have much to look forward to in this area if the above mentioned problems persist. The following table on FDI flows is instructive.

FDI Flows to the top ten recipient developing countries, 1991,1994, and 1997 (billions of U.S. dollars)

Country	1991	Country	1994	Country	1997
Mexico	4.7	China	33.8	China	37.0
China	4.3	Mexico	11.0	Brazil	15.8
Malaysia	4.0	Malaysia	4.3	Mexico	8.1
Argentina	2.4	Peru	3.1	Indonesia	5.8
Thailand	2.0	Brazil	3.1	Poland	4.5
Venezuela	1.9	Argentina	3.1	Malaysia	4.1
Indonesia	1.5	Indonesia	2.1	Argentina	3.8
Hungary	1.5	Nigeria	1.9	Chile	3.5
Brazil	1.1	Poland	1.9	India	3.1
Turkey	0.8	Chile	1.8	Venezuela	2.9
Top ten share in FDI to all developing countries (percent)					
	74.2		76.1		72.3
Source: World Bank - Global Development Finance p.20					

In the table above showing ten top FDI recipients developing countries, for 1991,1994 and 1997, it is revealed that only Nigeria featured from SSA for 1994 and this was attributed to her endowment in the natural resources sectors[17]. It is apparent, that large scale privatisation programmes account for a significant portion of FDI flows

[16] see generally Chapter One of Global Development Finance, op cit.
[17] ibid at p.20.

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but many SSA countries are wary of the privatisation route due to a number of factors including fear of the control of strategic sectors like power or petroleum in the hands of foreigners, creation of private as opposed to public monopolies, the implication of foreign dependence in privatisation, internal disagreement on spread and ownership of shares of what are regarded as national assets, etc. Because the existing models of privatisation have not returned uniform statistics of its benefit it is not clear to many SSA countries which route to follow.

The services sector which has witnessed strong FDI growth has also not benefited SSA in the sense that the factors listed above as inhibiting FDI generally affect the growth of the services sector. As a result, whereas about 40% of the revenue generated by developing countries in the privatisation programme went to the services sector, the investment flowed to the more stable developing country economies like Brazil.

The other disadvantage suffered by SSA in this regard is that FDI is tied to trade expansion and export orientation. Existing studies already show strong links between foreign investment and trade flows. Again in this area SSA is disadvantaged because she has been recording negative trade and export flows compared to developed countries. The instability of commodity prices in international markets combine to affect SSA growth prospect negatively. From this point of view therefore, it not likely that FDI flow into SSA will improve dramatically in the future.

Again, the World Bank suggests that regional economic integration may induce higher foreign investment flow[18]. Whereas, this would have been a strong option for SSA, it is not foreseeable in the nearest future because regional economic co-operation remains weak and divided along colonial barriers. In West Africa for example, the Economic Commission of West Africa (ECOWAS) has not achieved as much as it ought to in regional integration due to Anglophone and Francophone colonial influence amongst other factors. Although efforts are on at ensuring regional monetary unity as a basis for regional economic stability along Anglophone and Francophone lines with establishment of regional bodies for the central banks of the Anglophone and Francophone countries[19], nevertheless, the political instability in the region is slowing down progress.

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[18] ibid at p.23.
[19] For example, in Anglophone West Africa the West African Institute for Finance and Economic Management (WAIFEM, based in Lagos) was established in 1996 to provide capacity building in the formulation and implementation of macro-economic policies in the sub-region. The Institute is owned by the Central Banks of the Anglophone countries in the region. See the 1997 Annual Report of the West African Institute for Finance and Economic Management.

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At the continental level, the African Economic Community Treaty which was signed at Abuja in 1991 has not moved beyond rhetoric. The Treaty of Abuja was expected to boost Africa's share of world trade with the establishment under the agreement of - An Assembly of Heads of State and Government, a Council of Ministers, a Pan African Parliament, an Economic and Social Commission, a Court of Justice, a General Secretariat and seven Specialised Technical Committees to deal with integrative economic activities such as rural economy and agricultural matters; monetary and financial affairs; trade, custom and immigration matters; industry, science and technology, energy, natural resources and environment; transport, communication and tourism; health labour and social affairs; and education, culture and human resources[20].

Unfortunately, these laudable ideas are yet to effectively take off. On the whole therefore, it appears that SSA's strongest option for private capital flow for development may continue to be loans rather than bonds, portfolio investment or FDI. FDI inflow is slow in spite of the introduction of open laws on foreign investment in several SSA countries. In Nigeria for example, the Exchange Control Act No. 16 of 1962 which restricted the free inflow and outflow of foreign exchange was repealed and two major legislations were introduced in 1995 to boost FDI. These were the Nigeria Investment Promotion Commission Decree No. 16 of 1995 and the Foreign Exchange (Miscellaneous) Provisions Decree No.17 of 1995. Both statutes were designed to internationalise the capital market and remove restrictions to investment and the free inflow and outflow of capital. Decree No.16 removed the barriers to foreign investment in certain sectors of the economy which had been exclusively reserved for Nigerians. In fact, investment in petroleum which was hitherto jealously guarded was also liberalised[21]. The two legislation promoted some activity in the portfolio equity investment sector while some FDI also came into the country. Between July 1995 and December 1997 US $43.5 million portfolio equity investment came into the country through the Nigerian Stock Exchange while about US $4.1 million came in by the first quarter of 1998[22]. The result remains insignificant compared to global averages and considering the existing potentials in the country. The reasons for this is not unconnected with the general factors recounted above but also because adequate transparency mechanism did not accompany the legislations.

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[20] see African Economic Community Treaty: Issues, Problems and Prospects Ajomo M.A. and Adewale O. ed., Nigerian Institute of Advanced Legal Studies, 1993.
[21] see Nigerian Investment Promotion (Amendment) Decree No.32 of 1998.
[22] Ibru, G.M., President Nigeria Stock Exchange in an address to a National Workshop on New Trends in Nigeria Capital Market, Nigerian Institute of Advanced Legal Studies, May 1998.

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Impact of Debt Restructuring/Renegotiation

In the face of a dismal economic future as recounted above developing countries continue to call for official debt restructuring i.e. a renegotiation of borrowing terms by both creditor and debtor countries. Such renegotiation which is usually undertaken under the auspices of the Paris and London Clubs including private rescheduling as may be undertaken directly by a country with its commercial bank creditors, always come with serious economic, social and sometimes political consequences for developing countries because the process is usually accompanied by conditions that require the imposition of severe and austere domestic economic policy measures directed at structural adjustment. This is usually rigidly enforced where the IMF stand by arrangement is involved.

Usually, all the options are intertwined in that a private rescheduling which is a direct renegotiation of terms of borrowing by a developing borrower country with a commercial bank will often follow a debtor country's execution of an agreement with the Paris Club. The agreement is itself usually based on adoption of an IMF sponsored economic adjustment program. In essence, the whole process is a grid lock from which a developing country may not escape. It is also unlikely that any of the steps may be avoided.[23]

With years of experience of debt renegotiation and special plans behind[24] one can conclude that debt renegotiation has not moved debt ridden developing countries any closer to development or economic stability than they were before the process. Consequently, the latest initiative is that of significant forgiveness of all debt as part of the jubilee marking the third millennium. The new initiative christened the Highly Indebted Poor Countries Initiative (HIPC) is hinged on the biblical injunction by God to his people Israel that in every fifty years a jubilee should be celebrated and debt forgiveness was to be without conditions[25] but HIPC is not exactly the same. It is established on strict conditionalities which narrows the opportunities to poor countries who may actually benefit from the initiative. Secondly, it does not forgive all the debt of any beneficiary country. Of the 41 countries under the HIPC Initiative 28 are from SSA. These are Angola, Benin, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Democratic Republic of Congo, The Republic of Congo, Cote d'lvoire, Equatorial Guinea, Ghana, Guinea, Guinea Bissau, Kenya, Liberia, Madagascar, Mozambique, Niger, Nigeria, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Tanzania, Togo, Uganda, and Zambia.

[23] Olaloku F.A. op cit at p.5.
[24] i.e Brady Plan, Baker Plan, Toronto Terms etc.
[25] Leviticus 25:10-17.

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The Initiative which was launched in 1996 is geared towards encouraging improved economic and social policies, facilitating the provision of interim finance to strong performers, contributing to a more productive relationship between creditors and debtors and ultimately enabling countries to exit from repeated debt rescheduling exercises.[26]

Laudable as these objectives are, the conditions for eligibility are too strict. They are that - a country must be eligible to borrow from the IDA but not from IBRD, must be eligible to borrow from the IMF's Enhanced Structural Adjustment Facility (ESAF), it must have established a track record of adjustment and reform supported by the IMF and the World Bank and must face an unsustainable debt situation even after full application of existing debt reduction mechanisms[27]. The problems with these conditions is that only very few countries in SSA have a good track record of adjustment and reform supported by the IMF and the World Bank because many developing countries view the conditions with suspicion and regard them as anti-development. Furthermore, the assessment period is too long so very few countries can qualify. In spite of this, some countries are already benefiting from the HIPC initiative, notably Bolivia, Burkina Faso, Guyana and Uganda while more are expected to benefit soon. But it remains to be seen what impact HIPC will make on the debt situation of the beneficiaries especially if trade terms remain unfavourable.

Conclusion

In spite of all said above, it has been argued that Sub-Saharan Africa may still be assessed from a multi-dimensional angle in terms of prospects for economic development especially at the macro economic level[28]. We may consider first, the countries in Eastern and Southern Africa who have moved significantly towards reversing macro-economic crises of the past. Although these advances are yet unstable and fragile especially in the light of the war in Rwanda, Congo and Angola, nevertheless there is the general indication of better macro economic stability which if sustained will help these countries towards sustainable development.

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[26] Global Development Finance, op cit at p.54.
[27] Ibid.
[28] A Continent in Transition: Sub-Saharan Africa in the mid 1990s (World Bank and Africa Region) November 1995, p.67.

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Secondly, there are the CFA countries in which, as reported by the World Bank a few years back, macro economic reform began some years into the last decade of this century[29]. The reforms must be sustained for any meaningful impact. Thirdly, there are countries where macro economic reforms are yet to commence. In all of these cases, the implication for development is profound. Then there are the peculiar but important countries like Nigeria where political instability has impacted significantly on economic development. The retardation, stagnation or slow growth in Nigeria, depending on how one views it, continues to affect the economic development of West Africa. But the world awaits the effect of the return of the military to the barracks and the economic agenda of the new but fragile civilian government.

For there to be meaningful progress in ameliorating the debt crisis in SSA, a meaningful policy will have to be directed at the multilateral and bilateral debt obligations. This is because private debts are relatively small while most of the commercial bank debts have been rescheduled or been subject to write-offs or buy backs in secondary markets. The major problems are the bilateral debts which though not large in size yet carry pernicious rescheduling terms which do not allow for interest write-off or deferment. As has been rightly observed, interest payments which fall due and are not paid are usually capitalised thereby increasing the stock of outstanding debts[30].

Obaseki and Bello[31] proposed five crucial steps towards resolving Africa's debt crisis. These are - rescheduling of outstanding debts owed to multilateral institutions by a removal of the non-rescheduling claim in the agreements and a stoppage of the capitalisation of interest payment. Furthermore, rescheduling should cover both principal and interest. The general reason for not rescheduling multilateral debt is because they are relied upon for recycling to fund new programmes[32]. In Nigeria for instance, multilateral debts are treated as senior debts and are always promptly settled[33]. Donor agencies could however provide new credits to fund new programmes as a commitment to the growth of the world economy.

[29] ibid.
[30] Obaseki P.J. and Bello B.C. "A Framework for Resolving Africa's Debt Crisis" CBN Economic and Financial Review Vol. 33 No.3 at p.248.
[31] op cit.
[32] ibid.
[33] see Omoruyi S.O. "Debt Rescheduling and Re-Negotiation" in External Debt and Financial Management in Nigeria Ayua and Owasanoye ed. pp 145-182.

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Secondly, debts owed to multilateral institutions ought to be subject to refinancing through the purchase of such debts by a third party at a discount with a mechanism which reduces the debt burden of debt distressed countries. Thirdly, the group of industrialised countries should promote massive flow of investments to Africa on the basis that non-resolution of the debt crisis in developing countries generally but in Africa in particular would impair global economic growth which affects not only Africa but the world in the long run. Fourthly, there is a need to relax the rules under Paris Club to allow for a rescheduling of interest as well as principal. The Club must also consider genuinely the debt write off and forgiveness as a way of enhancing debt service capacity by debt reprieve and technical improvement. Finally, there must be internal restructuring in Africa in a way which allows domestic savings to grow so as to reduce the need for massive foreign capital and whatever foreign capital is procured must be used for self-executing development projects. If these amongst other measures are honestly pursued Africa's debt problem will be resolved as a first crucial step to achieving development on the continent.

The other hard truth that must be told to Africa is that development finance will naturally move towards more stable rather than unstable economies. Therefore, it behooves political leaders to pursue peace without which there can be no development. Furthermore, the cost of corruption to development must be counted[34]. For an international investor, corruption increases the risk of investment and the uncertainty and cost of doing business in a corrupt country. Corruption affects and diminishes the benefit which developing countries would have derived from foreign aid programmes and assistance. Many developing countries, who are the most hit by the scourge of corruption, cannot keep track of the exact flow of money, goods and services coming in the form of aid from developed countries into their country. This is not as a result of corruption in their own country alone but as a two-way affair involving the biggest bilateral and multilateral aid agencies.

[34] see generally Helping Countries Combat corruption: The Role of the World Bank. September 1997; see also Bolaji Owasanoye, "Corruption: The Enemy Within" paper presented at a Roundtable on Impact of Corruption on the Political and Economic Recovery of Nigeria, Nigerian Institute of Advanced Legal Studies, March 1999.

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A principal unseen factor in many failed projects in developing countries is the hand of corruption involving the public servants in charge of these projects, the multinational companies and their local subsidiaries handling the usually technical projects and the international consultant usually appointed by the multilateral lending agency[35]. The sad commentary is that whether or not these loans are profitable, the country is obliged to pay back. The country has to use scarce foreign exchange, which could be put to more productive use to service loans on failed projects. In consequence of such predicament, the President of the World Bank said recently that there is a strong positive relationship between corruption and economic growth[36]. He said countries with high corruption levels that fail to do something about it risk being left perpetually out of the world economy[37]. In other words, even though the corruption associated with multilateral loans involves all parties it is expected that the host country that is affected will do something about it. A word, as they say, is enough for the wise.

[35] on the impact of external loans on development see Bolaji Owasanoye "Development and External Loans: Paradox of the Incompatibles" Nigerian Current Law Review, (1995) at p.110.
[36] Guardian Wednesday, March 17,1999 at p.25.
[37] ibid.

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THE ROLE OF THE LAWYER IN THE INTERNATIONAL DEBT OPERATIONS OF DEVELOPING COUNTRIES [1]

by Professor Daniel D. Bradlow

I. Introduction

The purpose of this paper is to describe the role that lawyers can play in the international debt operations of developing country borrowers. The central point that the paper seeks to make is that lawyers can make a significant contribution to both the borrower's debt management and the negotiating and structuring of its debt transactions. Borrowers who include lawyers, with an understanding of international financial law, in their debt management teams are likely to find that their debt planning is improved because they have an enhanced understanding of:

1. the regulatory and legal environment applicable to the debtor;
2. the legal and regulatory environment applicable to each of its creditors;
3. a more detailed understanding of the contractual terms of each of their debt obligations and the implications thereof for their operations.

In addition, borrowers who include lawyers as active participants in the process of negotiating and structuring their debt transactions can, over time, obtain more satisfactory debt contracts.

In order to establish this proposition, the paper will first briefly discuss the role lawyers can play in debt management. Thereafter, it will break a loan transaction down into five different stages and discuss the role that the lawyer can play at each of these stages. For the purposes of this paper, we will assume that the borrower is either the sovereign itself or a public sector entity from a developing country which engages in regular and ongoing external debt operations. It is important to note that the description of the role of the lawyer in debt transactions would not change significantly for a lawyer advising a private sector borrower with large ongoing debt operations.

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[1] This article has been written by Daniel D. Bradlow (Professor and Director, International Legal Studies Program, American University, Washington College of Law, Washington D.C.) for UNITAR following his participation as a resource person in a joint UNITAR/WAIFEM Sub-Regional Workshop on the Mechanics of Loan Agreements for West African Nations (Banjul - The Gambia, 3 to 7 May 1999).

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II. The Lawyer's Function in Debt Management

An essential part of any borrower's debt management operations is the determination of the debtor's borrowing requirements for the year. While this decision is essentially a strategic business or economic decision, it may raise some legal issues. For example, if the borrower is the sovereign, there may be limits on the executive's borrowing authority or, each year, the executive may need to request new borrowing authority from the legislature. In either of these cases, lawyers may be needed to interpret the applicable statute and assist the executive to obtain this authority. In the case of other public sector borrowers, there may be restrictions in their enabling statutes, their documents of incorporation or in their internal operating rules and procedures. In the case of both types of debtors, there might also be some contractual provisions in the borrower's existing debt obligations that might constrain future borrowing operations. For example, existing loan covenants may require the borrower not to borrow more than a stipulated debt ceiling, to maintain certain financial ratios or to limit its borrowing to unsecured credits.

Once the debtor establishes its borrowing requirement, the borrower needs to determine from whom to borrow and for what purposes. Once again there may be some fundamental issues that require legal interpretation. For example, in the case of a sovereign borrower, there may be issues arising from the existing statutory requirements for allocating government revenues and from restrictions on the funding of certain activities. In the case of other public sector entities, the legal issues would relate to whether or not the law places any restrictions on their ability to borrow and to any restrictions that might exist in the operating policies of the company. The lawyer's role at this stage is therefore focused on ensuring that the borrower's proposed borrowing plan does not violate any existing laws, contracts, or operating procedures.

The lawyer can also play a useful role in identifying appropriate sources of funds from whom to borrow and the most effective debt instruments to be used to access this source for each particular borrowing purpose. This function is discussed in more detail in Section III (B) which deals with preparing debt transactions.

III. The Stages of a Debt Transaction and the Role of the Lawyer[2]

Any debt transaction can be divided into the following stages:

- ***Identification:*** the borrower identifies the purpose for which it intends to borrow money.
- ***Preparation:*** the borrower prepares the request for funding and decides which sources of funds to approach for money.
- ***Appraisal:*** those sources of funds that have been approached by the borrower assess the borrower's proposal and decide whether or not to fund the proposal.

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- ***Negotiation and Approval:*** the two parties negotiate the terms of their financing arrangement and draft the agreement. This stage also involves the submission of this agreement to whatever approval processes the borrower requires for the agreement to become a legally valid and binding commitment.

- ***Implementation:*** the loan contract is effective and the borrower is able to access the loan proceeds provided it meets all its contractual obligations. The stage ends when the contract is fully performed.

A. Identification:

In this stage, the borrower determines the purpose for which it intends to borrow and begins to assess the feasibility of that purpose. The decisions that the borrower must take at this stage are strategic business or economic decisions. Given the strategic nature of the decisions being taken at this stage, the lawyer's role is limited. The lawyer's advice may be needed in regard to some initial questions relating to the feasibility of the purpose or to specific aspects of the proposed financing strategy.

Despite his/her limited role, it is useful for the lawyer to participate in the discussions at this stage of the transaction for a number of reasons. First, if the lawyer is party to these discussion, he/she will have a better understanding of the borrower's business or economic objectives in the transaction and will be better equipped to advance these concerns at the later stages of the borrowing process. In addition, the lawyer's explanation of the legal consequence of the borrower? different financing options may help the borrower make key decisions at this stage.

Second, if the lawyer participates in these discussions, he/she will be able to identify legal issues that may arise if the transaction proceeds and can advise the borrower about how to address these issues in the most effective and least costly way. For example, if the borrower's plans require government approval the lawyer can explain the process for obtaining this approval and give the borrower some idea of the potential impact of this process on the borrower's plans. In addition, if the borrower plans to use the funds for a project that will have significant social and environmental impacts, the lawyer can begin advising the borrower on what measures it should take to assess these impacts and to deal with the associated risks.

B. Preparation:

The borrower's ultimate objective in this stage is to prepare an information memorandum or project document that the borrower can use to try and persuade lenders to support the project or purpose for which the borrower is hoping to raise the money. This memorandum will contain a detailed description of the borrower and its financial situation and of the purpose for which the borrower intends to use the borrowed funds. A lawyer can perform a number of functions in regard to the preparation of the memorandum. Each of these functions are discussed in more detail below.

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(i) Feasibility Studies The key issue that the feasibility studies are designed to resolve is whether the project or purpose for which the borrower is planning to borrow money is realistic. "Realistic" in this context means that me borrower can achieve its purpose in a way that will allow it to generate at least sufficient funds to cover all the costs associated with the project, including the servicing of the debts it plans to incur to fund the project or purpose. Answering this question requires the borrower to determine the technical, financial, environmental, economic, and social feasibility of the project. An additional aspect of this process is determining the legal feasibility of the project. Legal feasibility, requires the borrower to address such issues as:

1) Does the borrower have the legal power to undertake this type of activity? If not, what steps must it take to obtain this power? How difficult will it be to do so? What will it cost to obtain this power?
2) Does the borrower need to obtain any governmental authorization to undertake this activity? If so, how easy will it be for the borrower to obtain this authorization? How much will it cost to do so?
3) Does the borrower have clear legal title to all the assets and property that it plans to use in the project? If not, what kinds of challenges will it face in obtaining clear legal title? How easy will it be and how expensive will it be to overcome these challenges?
4) What kinds of actions (legal and otherwise) can those who oppose the project take that may cause delays in the project and increase its cost? How easy will it be for the borrower to overcome these challenges? It is important to note that these challenges may arise from issues that are traditionally viewed as outside the scope of project "costs". For example, these challenges could relate to resettlement issues, rights of indigenous people, or the environment.

In order to answer these questions, the lawyer will need to be well versed in the domestic law of the place of the borrower and of the project. The lawyer will also need to have some familiarity with the international legal commitments of the borrower's home country. These commitments, embodied in the international treaties and agreements which the country has signed, may influence the obligations of the borrower and may create rights which those who oppose the project can utilize to block or delay the project. For example, countries which have signed environmental treaties or agreements may be required to undertake environmental impact assessments for each project that they undertake.

In addition, if the country is a signatory to certain human rights treaties, there may be legal fora (for example the African Court of Human Rights or the United Nations Human Rights Committee) that opponents of the project may be able to utilize to block or delay the project. The fora available to project opponents may also be influenced by the choice of creditor. For example, if the World Bank provides funding for the project, the opponents of the project may be able to use the Bank's Inspection Panel to challenge the Bank's performance in regard to the project. Even though this does not directly affect the borrower, it can affect the price and timing of the project.

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In addition, to knowing the applicable domestic and international law, the lawyer might want to review some "soft" law, such as the relevant social and environmental policies of international organizations like the World Bank. Investors and other creditors might view these policies as constituting the "best practices" that prudent project sponsors and their creditors should follow. Compliance with these policies may, therefore, help the borrower and its creditors limit the opportunities for opponents of the project to take dilatory actions against the project and to limit their exposure to the risk of future liability for injuries allegedly caused by the project.

***(ii) Identification of Sources of Funds*:** One part of preparation involves identifying the funding sources that the borrower wishes to approach for funding. The potential sources of external financing that a borrower could approach include:

- commercial banks which could lend it money either through a single bank or syndicated term loan agreement.
- investment banks which could underwrite a bond issue, that could be issued either through a public or a private placement. These investment banks would therefore either privately approach institutional investors such as insurance companies, mutual funds, or pension funds to purchase the bond issues of the borrower or make a public offering that would be available to any investor, including both private individuals and institutional investors.
- multilateral development banks such as the World Bank and the regional development banks.
- official bilateral sources of funds which includes both official development assistance and such other official sources as export credit agencies.

Deciding which of these sources to tap is ultimately a business decision that depends on a number of variables. These variables include the ease with which the borrower can access each particular source, its overall borrowing strategy, the relative costs and terms of each funding source, and the ability of each source to lend to the borrower for the particular purpose for which the borrower wants the funds. However it is important to note that each of these variables have a legal dimension to them. Each funding source is governed by a specific legal regime that will influence or even determine to whom the source can extend credit, how much it can extend to a particular borrower, what the capital and other cost implications to the creditor might be for extending credit to the borrower, and the form in which the source will extend the credit to the borrower. For example, commercial banks may be required to maintain specified levels of capital against specified types of loans; export credit agencies may be precluded from funding certain activities such as the purchase of armaments; the International Bank for Reconstruction and Development, a member of the World Bank Group, can only lend to member states or to borrowers who have a government guarantee; and sources of credit are subject to lending limits to individual borrowers. The creditors institutions are also likely to have certain reporting and other prudential obligations towards their supervisory authorities that may be of interest to the borrower.

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Given this reality, lawyers can help borrowers to identify the most suitable sources of funds. They can do so by advising borrowers on the laws and regulations applicable to each source of funds and on the legal implications of utilizing each source under the borrower's own governing legal regime. This should help borrowers identify the most appropriate funding source or sources and should enhance the borrower's efficacy in its negotiations with the source.

The borrower's lawyer can only effectively perform this role if he/she has some knowledge of the legal regimes governing each of the borrower's potential financing sources. This means that the lawyer may need to have access to information about the Articles of Agreement and internal operating rules and procedures of the multilateral development banks, the relevant statutes and implementing regulations and procedures of the official bilateral funding sources, and the laws and regulations that govern the borrower's commercial sources of funds. Clearly, it is very difficult for an individual lawyer to have detailed knowledge of all the different legal regimes that may be applicable to the borrower's potential funders. Nevertheless, the lawyer can have some general knowledge about the laws applicable to each of the borrower's key creditors. This knowledge should be sufficient to provide general guidance to the borrower and to enable the lawyer, when appropriate, to evaluate the advice he/she obtains from local counsel in the creditor's own jurisdiction. If the lawyer is able to provide the borrower with this information, the borrower will be able to make a more informed borrowing decision and to be better prepared to negotiate with the chosen funding source.

(iii) Preparation of the Information Memorandum

The information memorandum is essentially a specialized marketing document whose purpose is to convince the reader to fund the borrower and the project or purpose described in the memorandum. This means that, even though the potential lender is likely to do its own credit analysis of the borrower, it may be relying on this memorandum in making its credit decision. As a result, the borrower (or more precisely the issuer of the memorandum) could be held responsible for the accuracy and the adequacy of the information contained in the memorandum. This means that the lawyer has to ensure that the memorandum conforms to the standards of any duties of care that the issuer may owe to the recipients of the memorandum. The borrower's failure to satisfy these standards of care may expose it to potential liability to the lender for such torts as fraud or misrepresentation. In addition, the lawyer needs to make sure that the memorandum complies with the disclosure and other legal requirements in any jurisdiction in which the memorandum is made available to potential creditors of the borrower. Finally, the lawyer should advise the borrower on what steps it can take to limit its potential liability. These steps would include placing prominent disclaimers on the memorandum and qualifying the information contained in the memorandum to make clear to the reader that there are uncertainties and therefore risks associated with the information contained in the memorandum.

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C. Appraisal:

In this stage of the debt transaction, the potential creditors evaluate the funding proposal of the borrower and decide whether or not to extend credit to the borrower. The fundamental objective of the potential creditors at this stage is to determine if they wish to extend credit to this particular borrower and for this particular purpose. The creditors also need to decide how much credit they wish to extend to the borrower.

In many ways the lender's job at this stage is similar to the job that the borrower performed in the preparation phase. The lender needs to evaluate the data contained in the information memorandum and all other relevant information to see if the proposal meets its lending criteria. This means that the creditor's lawyers will need to assess the legal feasibility of the borrower's stated project or purpose. They will also need to determine if the lender under, the applicable law and pursuant to the lender's own operating rules and procedures, is allowed to lend to this type of project or for this purpose and in the requested amount. The lender will also need to make some assessment of the types of financing instruments it could use to provide the funds to the borrower and the best way to structure the financing. Finally, the lender's lawyer will need to assess if there might be any legal issues arising from the applicable law that could adversely affect the loan.

D. Negotiation and Approval

This stage consists of two distinct phases. The first phase is the negotiation of the terms of the debt transaction. Assuming that the debtor and creditor can reach agreement on these terms, the parties will sign the contract and each will submit it to their own internal approval processes. The second phase therefore involves the internal approval process that the borrower must follow in order for the loan to become effective. Each of these phases will be discussed separately.

(i) Negotiation of the Loan Agreement - It is important to note that in reality the parties have been engaged in negotiations from the moment that they first began discussing the possibility of a loan. However, the negotiations become more intense and focused once the parties have decided to enter into a loan agreement.

The primary purpose at this stage of the negotiations is to convert the agreement in principle of the debtor and the creditor to enter into a financing transaction into a workable and legally binding and enforceable contract. During this phase of the transaction, the parties will spell out the precise mechanics of the way in which the lender will disburse funds to the borrower and the borrower will pay the lenders the interest and fees associated with the loan and will repay the loan principle. The parties will also stipulate the terms and conditions associated with the debt and will assign all the identifiable risks associated with the transaction to one or the other party[3].

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[3] The issues that arise in the drafting of the provisions of the loan agreement and the precise arguments that the parties may raise during the drafting of these clauses are outside the scope of this paper.

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At the end of the negotiations the parties should have reached an agreement that provides the borrower with funds for the period of time, at the price, and on the conditions that the borrower considers consistent with its basic business, policy or strategic objective. The agreement must also provide the lender with a transaction that produces an acceptable rate of return at a manageable level of risk. If both these objectives cannot be satisfied the parties are either unlikely to be able to successfully conclude an agreement or, if they do reach an agreement, there is a high risk of it not being satisfactorily executed.

The lawyer can play a number of different roles during the negotiation of the loan transaction. The lawyer's fundamental task is to draft the terms of the contract. This involves, first Grafting precise language that stipulates how the loan will operate. It also requires the identification of all the risks associated with the transaction and, through the provisions of the contract, the allocation of these risks to one of the parties to the transaction. The borrower's lawyer will be most effective in performing this function if he/she fully understands the transaction and his/her client's objectives in the transaction. If the borrower's lawyer has such an understanding he/she should be able to help identify all the risks associated with the transaction and to give advice on the alternative ways in which these risks can be allocated. In this regard, it should be noted that while the norm is that most of the risks associated with loan transactions are allocated to the borrower, the borrower can attempt to limit the scope of its assumption of these risks through the precise language used in the provisions of the loan contract. A borrower's lawyer who understands financial transactions, the borrowers objectives and the concerns and interests of the lenders may be able to negotiate and draft contractual terms that limit the scope of the borrower's assumption of the risk to acceptable levels, while still addressing the legitimate concerns of the lenders. For example, while the borrower may need to accept restrictions on its ability to pledge its assets against future debt obligations, the clause can be drafted to limit its application to only certain types of debt transactions.

In discussions over the drafting of the provisions of the loan contract, the lawyer should keep in mind the basic dynamic that operates in any financial transactions. A loan agreement differs from many business arrangements in that the performance of the parties' obligations are substantially separated in time. The lender fully performs its obligations at the beginning of the loan when it disburses the funds to the borrower. The borrower, on the other hand, does not fully perform its obligations until the end of the loan when it has fully repaid the principal of the loan to the creditor. This means that the essential characteristic of a loan transaction is that the lender is converting its hard asset-cash-into the borrower's promise that it will repay the cash, with interest, at some time in the future.

The result of this temporal separation of the parties' performance of their contractual obligations is that the lender is very nervous about giving up its cash. Consequently, a key function of the loan agreement is to bolster the lender's confidence in the borrower's promise and in the lender's ability to protect itself in the event that the borrower proves to be unable to live up to its promise.

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Given the above, the inclination of the creditor, when giving up its hard asset-cash-in exchange for the borrower's promise is to restrict the borrower's use of the money to placing it in a fixed bank account for the term of the loan at an interest rate that at least equals the rate that the lender is charging. Similarly the tendency of any borrower is to believe that, if allowed to use the money as it pleases, it can make the most profitable use of the borrowed funds. Both parties clearly recognize that their natural tendencies are not conducive to a sustainable debt transaction and that, in order to reach an agreement, they will have to compromise.

Thus the basic negotiating dynamic in loan negotiations is that the lender is constantly trying to restrict the borrower's freedom of action and to maintain as close a vigil as possible over the borrower. Conversely, the borrower is constantly trying to broaden its freedom of action by loosening the requirements of the covenants and other restrictive clauses in the loan. An agreement is struck at the point where, given the context of the debt transaction, the borrower feels that it has the flexibility it needs or can reasonably expect to receive, and the lender is persuaded that it has adequate safeguards against unduly reckless or discriminatory conduct by the borrower.

In order to begin addressing the lender's concern, loan contracts will have conditions precedent that the borrower must satisfy before the lenders commitment to disburse the funds becomes binding. These conditions are designed to assure the lenders that the loan agreement is legally valid, binding and enforceable against the borrower and that the borrower is still as creditworthy and as likely to live up to its promises as it was when the lender made the decision to enter into this transaction with the borrower. The borrower's failure to satisfy these conditions precedent will excuse the lender from disbursing the funds it has committed to lend.

The agreement will also have a set of "representations and warranties" that are the factual assertions that the borrower made and the underlying assumptions about the borrower that the lender held about the ability of the borrower to perform its contractual obligations when they entered into the transaction. The borrower will be required to verify these representations and warranties as part of the conditions precedent to each disbursement and at other specified moments in the transaction. The purpose is to reassure the creditors that the conditions that induced it to enter into this transaction still applies.

A breach of these representations and warranties may constitute a default of the loan agreement. Consequently, the borrower and its lawyer should carefully assess the representations and warranties to ensure that complying with these representations and warranties is neither unduly burdensome nor intrusive into its internal affairs. However, in making these calculations the borrower and its lawyer also need to take into account the lender's reasonable expectation of having the borrower, at certain critical moments in the life of the loan, verify the validity of the basic facts and assumptions underlying the transaction.

In order to protect itself once the money has been disbursed and the lender is totally reliant on the borrower's promise, the lender incorporates a set of covenants and events of default into the loan agreement. The purpose of the covenants is to impose oversight, reporting and inspection requirements and certain restrictions on the borrower's activities during the course of the loan. The oversight requirements are

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designed to give the creditors adequate knowledge about the borrower so that they can assess its financial condition and: make an informed judgement about the borrower's likelihood of performing its contractual obligations in a timely manner. The restrictions are designed to limit to reasonable levels the borrower's ability to incur future debt; to preserve the quality and the quantity of the borrower's assets, and to prevent the borrower from discriminating against this creditor by treating other present or future creditors more favorably than it treats this creditor.

The borrower's lawyer needs to help ensure that the covenants are drafted so that their requirements are reasonable from the borrower's perspective. This means that they should not impose reporting requirements that the borrower cannot meet (for example, requiring quarterly financial statements, when the borrower only prepares semi-annual statements) or that are unduly burdensome, (for example requirements that the borrower's statements to the creditors contain more information than the borrower would incorporate into such reports in the normal course of its business[4]). In addition, the covenants should not be so restrictive that it impairs the borrower's ability to undertake its normal business operations or to maintain its normal relations with its other creditors and business partners.

An event of default clause is designed to give creditors the ability to call the loan and obtain their funds before the maturation of the loan. This means that this clause includes the borrower's actual failure to meet its payment obligations in a timely fashion and those events that indicate that the risk of nonpayment has increased to unacceptable levels because the borrower has done something (or failed to do something) that it had promised not to do (or to do). The occurrence of these events of default gives the lender the opportunity to accelerate the debt and take whatever other actions it feels are necessary to recoup its money and reduce its exposure to the borrower.

The function of the events of default clause should guide the lawyers in negotiating and drafting the clause. Consequently, the lawyers should seek to limit the scope of the clause to those events that prove or that reasonably indicate to the creditors that the borrower is unable to perform its obligations in this transaction in a timely manner.

In addition, to the drafting function, the lawyer can perform some other functions during the negotiations[5]. These functions are:

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[4] If the lender viewed these reports as sufficient for making its initial decision to extend credit to the borrower, it should not need more information to assess the borrower's condition over the life of the loan.
[5] For an informative discussion of these additional roles that a lawyer can play in negotiations, see Lee C. Buchheit, "The Lawyer in Negotiation" in Lee C. Buchheit, How To Negotiate Eurocurrency Loan Agreements (Euromoney Publications, 1995).

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(i) Preparation of Client: As was suggested in the above discussion on the preparation phase of the transaction, the lawyer can help the borrower to better understand its own objectives in the loan transaction and to prioritize these objectives. The lawyer can also help the debtor develop a strategy for the negotiations and formulate the arguments that it can use to obtain its objectives in the negotiations. In this regard, it is useful to remember that negotiating is similar to the advocacy function that lawyers perform in court in the sense that both activities involve developing persuasive arguments to achieve the client's objectives. This requires understanding the client's objectives and relative priorities well enough that the lawyer can identify what the acceptable compromises and trade offs are and when it is time to reach agreement, (settle a case) or to break off negotiations (proceed to litigation).

(ii) Secretary: During the negotiations, the lawyer can keep notes, record the agreement that the parties reach on each issue raised during the negotiations, and make sure that each issue that should be addressed during the negotiations is actually addressed. While this function could be performed by any participant in the negotiations, the lawyer has a particular interest in ensuring that it is performed accurately and comprehensively: the lawyer will have to reduce these agreements to writing when he/she drafts the loan documentation.

It is also important to note that it is advisable for each party to have their own "secretary" to ensure that they have their own record of the negotiations and that they are not reliant on the other party for these records. If each party has a note taker, the two note takers can regularly confer with each other to ensure that the records of the negotiation are accurate. This will prevent either party from seeking to re-open previously resolved issues for further discussion or from attempting to reformulate previously reached agreements.

(iii) Interpreter: In any negotiation it is useful for the borrower to have a member on its negotiating team who understands the context in which the lender operates. This person should be able to help the borrower understand the lender's argument on each issue and identify what interests the lender is seeking to protect with these arguments. These explanations should help the borrower to formulate effective responses to the arguments of the lender and to make proposals that are more likely to be acceptable to the lender. This member of the borrower's negotiating team, because of his/her understanding of both the borrower's and the lender's position in the negotiation, is also well placed, when appropriate, to explain the borrower's interests and concerns to the lenders. In this sense, this member of the borrower's team is acting like an interpreter for the borrower.

From the above description it should be clear that any person on the borrower's negotiating team who is knowledgeable about the lender and its operating environment can perform this interpreting function. In principle, however, lawyers are well placed to perform this role. The reason is that the borrower's lawyer, in order to perform his/her function in the planning stage of the loan transaction process, needs to understand the legal and regulatory context in which the lender operates and the legal characteristics of the lending instrument that the borrower is seeking to use in the loan transaction. This means that the lawyer will have a well-developed understanding of

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many of the creditor's concerns and the constraints within which it must operate. Consequently, the lawyer should be well placed to act as the interpreter or at least to play a significant role in this regard.

(iv) Strategic Planning of Contractual Provisions - Another role that the lawyer can play, is to help the borrower see this loan transaction as part of a borrowing process. This means that each transaction should be seen as being built on all previous transactions and as establishing the "floor" for all future transactions. Thus, the borrower can use the provisions of previous loan contracts as precedents to convince the lenders to grant the borrower at least comparable terms in this transaction. In appropriate cases, the borrower can also use these prior contracts to make the case that it should be granted more favorable contractual terms in this transaction. In this way, the lawyer, over time, can use the borrower's ongoing debt operations to improve the terms of the borrower's loan agreements.

One implication of the above observation is that there is great advantage to be gained when the borrower establishes guidelines on what constitutes acceptable clauses for its loan agreements. The reason is that the guidelines establish a clear "floor" of acceptable terms and conditions for the borrower. The negotiators can point to these guidelines to justify rejecting the lender's attempts to impose less favorable clauses and to justify their own efforts to obtain more favorable terms.

(v) Outside Lawyer as "Experimenter" - All of the above functions can be performed by either an in-house legal advisor to the borrower or an outside counsel retained by the borrower specifically to advise it on these negotiations. There is, however, one other function that an outside counsel can perform but which an in-house counsel, because of his/her status as an employee of the borrower, would find more difficult to perform. The function is to act as "the guinea pig" during the negotiations.

During the course of a loan negotiation, the borrower may want to know how the creditors might react to certain ideas but without the borrower formally having to propose the ideas. The borrower might be concerned that the lender might so strongly oppose the proposal that merely raising it risks poisoning the relations between the parties or risks having the lender perceive the borrower as being unduly compliant. One way to avoid this outcome is for the borrower to have an "outside" advisor, such as an outside legal counsel, raise the issue with the lenders. This can be done during the course of formal negotiations or informally over coffee or drinks. The borrower can then watch the lender's reaction. If it is clear that the proposal does not receive a good reception, the borrower can then "disown" the proposal as the individual initiative of the outside lawyer. While the proposal in this case will have failed, the borrower will have gained useful information that it can utilize in the negotiations. If the proposal receives a favorable reception, the borrower can "adopt" it as its own and proceed to negotiate on this basis. In this way the lawyer can act as an "experimenter" for the borrower, drawing the heat when necessary or facilitating an agreement when appropriate.

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Once again it is clear that this experimental role can be played by any outside advisor. However, a lawyer may be well placed to play this role for a number of reasons. First, the drafting role that the lawyer plays requires the lawyer to raise very specific and often difficult issues. Consequently, the lawyer is a credible party to raise these issues. Second, since the outside counsel has a lower stake in the negotiations than the other participants, he/she can afford to take more adventurous positions. Third, he/she may be the only outside advisor on the borrower's negotiating team.

(vi) The Intertwining of Legal and Financial Terms - The legal issues and the financial issues in a loan transaction are closely intertwined. This means that there are often tradeoffs between the legal and the financial terms that can be made in the course of the negotiations. For example, the lenders might be willing to agree to a less restrictive set of covenants if they are compensated with a higher interest rate or greater fees. Similarly the lenders might be willing to accept lower rates in return for more comprehensive reporting requirements or a more generous assignments clause or the lender might be prepared to extend the term of the loan in return for more restrictive clauses. Consequently, the lawyer needs to make sure that the borrower does not make any firm commitments on the financial aspects of the loan transaction until all potential tradeoffs between the financial and the legal terms have been explored. In order to make this determination, the lawyer must have a good understanding of what the creditors perceive the function of the legal terms of the agreement to be and the relationship between these clauses and the risks that the lender is assuming in the agreement. This knowledge will enable the lawyer to determine what possible tradeoffs might exist between these clauses and the financial return to the lender.

(vii) Approval of the Loan - Once the parties have reached agreement on the terms of the loan, each party will need to have the loan agreement approved by its principals. Depending on the identity of the borrower, this process may require the approval of the board of directors or, in the case of the sovereign, the approval of the cabinet or parliament. In either case the borrower will be required to follow some pre-established procedure to obtain formal approval for the loan. Failure to follow the appropriate procedures, may result in the lender refusing to recognize that the loan has been approved. This would enable the lender to conclude that one of the conditions precedent to the loan becoming effective have not been satisfied and that, as a result, it is relieved of its obligation to lend. The borrower's lawyer can help ensure that the appropriate approval procedures are followed and that the loan is formally approved. The lawyer can also help ensure that the approval is conveyed to the lenders in the appropriate form.

E. Implementation

Once the conditions precedent to loan effectiveness have been satisfied, the loan is ready to be executed and the borrower can access the funds.

It is important to note that one of the conditions precedent will be the issuance of legal opinion letters. These letters, the terms of which will have been carefully negotiated by the borrower and the lenders, will usually require competent legal counsel, inter alia the borrower's counsel and the lender's local counsel, to opine that the loan agreement is a legally valid, binding and enforceable agreement. In giving this

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opinion, the borrower's legal counsel will need to determine that the agreement is consistent with the existing commitments of the borrower; that the borrower has the legal capacity to enter into the transaction; that it has complied with all the procedural requirements for it to enter into this binding agreement; and that there are no existing laws or rules that are inconsistent with the terms of the agreement or that may render the agreement unenforceable. In determining that he/she can issue this opinion, the lawyer will need to carefully research the borrower's existing agreements and the applicable law. Failure to do so will increase the risk of issuing a flawed opinion letter and may render the lawyer vulnerable to claims of malpractice or to serious damage to his/her professional reputation.

The consequence of the lender receiving an inaccurate opinion letter may be that the borrower will later be stopped from denying the validity and enforceability of the loan agreement. Consequently, it is in the borrower's interest that the lawyer exercise great care before issuing the opinion letter and that he/she refuses to issue any opinion letter which he/she cannot confidently state is accurate. This means that the borrower and its lawyer should pay great attention to the terms of the opinion letter during the negotiation of the loan agreement.

After the loan becomes effective, the lawyer plays a limed role during the implementation phase. If the implementation of the agreement proceeds as envisaged, the lawyer may only be called upon, from time to time, to interpret specific provisions of the loan contract.

If the implementation of the agreement does not proceed as planned, the lawyer's role may become more significant. In this case the lawyer may be called on to perform the traditional lawyering function of representing the borrower in a dispute. This may involve defending the borrower in a court action or helping it negotiate a settlement before the matter reaches the court.

In this regard it is useful to remember that a well drafted agreement should cover as many of the possible issues that can arise over the course of the agreement as possible and should determine how these issues are to be resolved. In this limited sense, any issue that results in a dispute that could lead to litigation can be seen as a failure of the drafting process.

IV. Conclusion

A lawyer who is well versed in financial law and who has a good understanding of financial transactions can play a constructive role at each stage of the loan transaction. Borrowers who allow lawyers to function as fully fledged members of their negotiating teams will find that the value the lawyer can add to the debt team will exceed the cost, both in money terms and in terms of the difficult issues that the lawyer might raise in the course of the structuring and negotiating of the transaction. Any borrower who doubts this should take note of the fact that its creditors almost always come to the negotiating table with their own lawyers. If there is no lawyer on the borrower's side, the borrower will be forced to defer to the lender's lawyer on all legal issues that may arise in the course of the negotiating and drafting of their loan agreement.

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JOINT WAIFEM/UNITAR REGIONAL WORKSHOP ON MECHANICS OF LOAN AGREEMENTS ORGANISED IN BANJUL, THE GAMBIA FROM 3rd TO 7th MAY, 1999

COMMUNIQUE

A joint UNITAR/WAIFEM sub-regional workshop on the Mechanics of Loan Agreements was held between 3rd to 7th May, 1999, at Tafbel Maisonettes, Banjul, The Gambia. The principal objectives of the workshop were to:

1. provide an overview of current developments in international finance and their implications for African countries;
2. provide an understanding of the primary sources of international finance available to African countries;
3. provide an understanding of the documentation utilized by each source.

The workshop provided the participants the opportunity of learning about sub-themes on trade restrictions and other procurement issues and how they affect loan agreements. Other salient issues covered by the workshop included the Highly Indebted Poor Countries (HIPC) initiative and its qualifying criteria and the Nigerian Export Credit Institutions and their operations.

The workshop also examined the various provisions which could form points for negotiation in a loan agreement, as well as their legal, financial and economic implications.

Participants exchanged views and applied the lessons learned in an exciting simulation exercise.

Participants noted that many Sub-Saharan African countries have failed to reap the full benefits of sourcing cost effective external funds due to their inability to fully negotiate better terms as a result of:

1. inadequate preparations before proceeding for negotiations;
2. limited technical skills of the negotiating team,
3. inability to fully comprehend the clauses and terms of the contracts.

In order to address these weaknesses and lapses and ensure the realisation of maximum benefits from external loans and credit facilities, participants recommend that West African countries should:

1. adopt a multidisciplinary approach in the composition of their negotiation teams;
2. research and gather sufficient information in preparation for the negotiations;
3. in particular, legal expertise should be adequately utilised to recognise, interpret and negotiate provisions which could be disadvantageous to the interest of the borrower.

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Participants further recommend:

1. that a follow-up to this workshop should be organised with a view to developing a blue print of guidelines for negotiations for Sub-Saharan African countries,
2. that this training be extended to top policy makers - ministers, politicians, permanent secretaries and other public sector officials involved in the borrowing process;
3. that IMF and World Bank personnel be involved in the exchange of views in subsequent workshops; and
4. that subsequent workshops should be of longer duration.

Participants express deep appreciation to the government and people of The Gambia for their hospitality and kindness. Our special thanks to the Governor of the Central Bank of the Gambia and Chairman of the Board of Governors of WAIFEM for finding time to declare the workshop open.

We also want to thank the organisers of the workshop, UNITAR/WAIFEM, for the excellent co-ordination. We also want to express our appreciation to the facilitators and the resource persons Dr. Bolaji Owasanoye and Prof. Daniel Bradlow.

We also wish to note the warm reception and cooperation of the management of Tafbel Hotel for making us comfortable and for more than adequately providing for our every need. Finally, we wish to congratulate WAIFEM/UNITAR for this successful workshop.

DONE IN BANJUL, THE GAMBIA, THIS 7™ DAY OF MAY, 1999

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PROFILE OF THE AUTHORS

Bolaji OWASANOYE has fourteen years of professional experience as a legal practitioner, lecturer and researcher (from 1985 to 1999) as well as Undergraduate and Graduate teacher and Tutorial Master. As a Research Fellow of the Nigerian Institute of Advanced Legal Studies (NIALS) he has researched several aspects of law and served as faculty member of the Institute's Continuing Legal Education Programmes on Legal and Legislative Drafting, Negotiation of International Contracts, Legal Aspects of Debt and Financial Management, Human Rights, and Judicial Education and Capacity Building Programmes for Financial and Capital Market Operators. Since 1995, he is also a UNICEF consultant on the Implementation of the UN Convention on the Rights of the Child involved in developing Children Legislation for Nigeria. Since 1995, he has also been Head of the Department of Commercial and Property Law which is responsible for packaging and implementing programmes on Economic and Regulation Laws in Nigeria. He is also an Associate Research Professor since 1998. Mr. Owasanoye has published several articles and books relating to debt and financial management issues.

Daniel D. BRADLOW is Professor of Law and Director of the International Legal Studies Programme at the Washington College of Law, American University, Washington, D.C. where he specializes in international economic law. His current scholarship focuses on the international financial institutions, the international legal aspects of sustainable and equitable development, and the legal aspects of debt and financial management. He has been a Senior Special Fellow of the United Nations Institute for Training and Research (UNITAR) and serves as an advisor to the Rethinking Bretton Woods Project. In 1996 he was a Visiting Professor at The Community Law Centre at the University of Western Cape, South Africa. He has lectured in many countries in Africa, Asia and Latin America on international financial law and international business law issues. Prior to joining WCL, Professor Bradlow was a Research Associate at the International Law Institute and a consultant to the United Nations Centre on Transnational Corporations, as well as an attorney in private practice. He has edited books and published articles on international financial law, the international financial institutions, foreign investment, the World Bank Inspection Panel, and the changing responsibilities of the World Bank and the IMF in the management of the global economy. Professor Bradlow holds degrees from the University of Witwatersrand, Northeastern University and Georgetown University and is a member of the New York and District of Columbia Bars.

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About UNITAR

UNITAR is an autonomous body within the United Nations which was established in 1965 to enhance the effectiveness of the UN through appropriate training and research. UNITAR's programmes in the legal aspects of debt, financial management and negotiation are among a wide range of training activities in the field of social and economic development and international affairs carried out, generally, at the request of governments, multilateral organizations, and development cooperation agencies. UNITAR also carries out results-oriented research, in particular research on and for training, and develops pedagogical materials including distance learning training packages.

UNITAR's **Training and Capacity Building Programmes in the Legal Aspects of Debt, Financial Management and Negotiation** are conducted for the benefit of over 35 partner countries mainly from sub-Saharan Africa and Vietnam. These programmes aim at meeting the priority training needs of senior and middle-level government officials through a wide range of seminars, workshops, and training of trainers workshops. In parallel to training activities, the programme also assists in strengthening local capacities of governmental and academic institutions through distance learning training packages, up-to-date publications as well as networking activities.

During 2001, the programme will focus on:
- Training government officials through short-duration regional seminars and workshops on various aspects of debt, financial management and negotiation;
- Developing On-line Training Courses (in parallel with its traditional regional training) with a view to tapping a wider audience and reducing cost of training per participant;
- Strengthening existing ties with regional training centres and offering joint courses with partners in the field;
- Creating awareness among senior government officials of the importance of the legal aspects in the borrowing process and of putting together a multidisciplinary team for loan management and public administration;
- Providing in-depth training and skills development for accountants, economists, financial experts and lawyers coming from government ministries and departments involved in negotiation, financial management and public administration; and
- Developing and disseminating training packages and 'best practice' materials directly related to the practicalities of legal aspects of debt and financial management, with a view to strengthening existing human resources and institutional capacities at the national level.

A description of UNITAR's latest activities and training programmes in the area of debt and financial management is available on its website at: www.unitar.org/dfm.

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