How Public Interest Litigation Led to Invalidation of Illegal Mozambican Debt

By:

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The Mozambican case of odious debt is an illustration of several similar cases around the world whereby consultants from multinational corporations identify development countries with something of value, such as minerals, and persuade the authorities of these countries to secretly take on huge development loans with banks. In most cases, the money never reaches the countries. Rather, the money is transferred directly from the banks to contractors and the countries are then left with massive debts. Resources and companies from developing countries are given as collaterals for these loans. Therefore, the resources that countries should use to invest in development are transferred to service these odious debts. In summary, this is what happened in Mozambique.

In 2013, two London-based banks, Credit Suisse and Russian VTB lent $2 billion to three state-owned enterprises (SOE) that did not exist at the time. These

companies—Ematum, Proindicus, and Mozambique Asset Management ("MAM")—were created to facilitate the fraud and never generated any profit. These entities were owned by the Mozambican security and intelligence services. Credit Suisse agreed to make available up to $850 million for Ematum. For Proindicus, a loan of $623 million was arranged jointly by Credit Suisse and VTB. Both banks additionally financed MAM with a $535 million loan. The three loans were not approved by the Parliament of Mozambique, thus violating both the Mozambican Budget Law and the Constitution of Mozambique.

This is a complex case involving three different loans across multiple jurisdictions. As the scale of these loans became clear, in 2016, the International Monetary Fund (IMF) suspended its programme with Mozambique in line with its disclosure policy. Other donors followed suit, and all 14 donors who provided direct support to the state budget halted their disbursements. The country found itself facing a severe budget deficit. The loans have thus led to an economic and social crisis in Mozambique, with the local currency falling by 50% against the dollar and cuts being introduced to government spending. Consequently, the loans have drastically affected the already fragile provision of basic services, including health, education, water and sanitation.

Voidable Contracts

Pressure from different actors, such as civil society, development partners and the media, led the Attorney General in Mozambique to commission an audit on the three loans in 2017. According to the Kroll Audit Report, among several other detected irregularities, the banks lent the money knowing that the loans had not received parliamentary approval as required under the Mozambican Constitution. Furthermore, the banks did not carry out due diligence on the SOEs or on the guarantees provided by the government. The loans were given to three state-owned companies which had no revenue and no contracts in place to generate any future profits. The ships and equipment being supplied were massively overpriced and there had been no competitive bidding for the contract – the whole idea was presented by the contractor and the banks rather than being solicited by the Mozambican Government. Also, the money went directly from the banks in London to the contractor, Privinvest, in the United

Arab Emirates, rather than to the SOEs in Mozambique. All of these irregularities were in collusion with Mozambican Government authorities.

In addition, the process followed by the arranging banks was not compliant with various legal and international standards, including the U.S. Foreign Corrupt Practices Act; U.K. Bribery Act; Mozambican Anti-Bribery Law; OECD Convention on Combating Bribery of Foreign Public Officials in International Business; and the FATF Recommendations which set an international standard on anti-corruption for countries to implement through measures adapted to their particular circumstances. This fraud was also in violation of the U.N. Convention Against Corruption; 2015 G20 High Level Principles on Private Sector Transparency and Integrity; and 2017 G20 High Level Principles on the Liability of Legal Persons for Corruption.

International and domestic law make contracts by corruption and bribery voidable. However, the complication with the Mozambican case is that the government took too long to declare all the loans void and null. There are indications that a pending legal action in London might provide some relief, but the legal strategy would have to consider various aspects including the political economy of debts resolution, the laws governing underlying contracts, and the cost of voiding the contracts. It is unlikely that the contracts can be voided within a short-term period in the U.K. jurisdiction.

Indictments and Arrests

In 2019, as part of the U.S. investigation into the loans, three former employees of Credit Suisse were arrested in London, and a former employee of the United Arab Emirates company Privinvest, which supplied boats as part of the loan deal, was arrested in New York. The former Mozambican Finance Minister, Mr. Manuel Chang, was previously arrested in December 2018 in South Africa on charges of conspiracy to violate anti-bribery laws, money laundering and securities fraud on an Interpol warrant. Immediately after his arrest, Mozambique filed a request to extradite Mr. Chang to Mozambique. The U.S. indictment provides compelling evidence of the bribes and kickbacks that were paid as part of the loan deals. The indictment also presents evidence that Credit Suisse failed to prevent this fraud from happening. The bank clearly did

not have adequate procedures in place to prevent the dubious transactions.

The pressure from advocates, Mozambican citizens and these arrests by the U.S. prompted the Mozambican government to finally take action. The Attorney General has indicted and arrested 19 people on charges of abuse of power, abuse of trust, and swindling and money laundering. These individuals include the former head of intelligence and the son of former President of Mozambique Armando Guebuza. The Mozambican indictment outlines a clear case of criminal conduct by various parties and the full extent of corruption and fraud conducted by various partners involved, providing evidence for challenging the loans.

Litigations and Actions

We, the N'weti Organization, launched two applications in the Mozambican Constitutional Court to have the three loans declared illegal as they complied with neither the Mozambican budget laws nor the Constitution. The petitions were signed by 2000 citizens requesting the court to rule the debts illegal. In response to our filling, the Constitutional Court of Mozambique declared the three loans null and void. The top court ruled that all acts inherent to the contracted loans were illegal and therefore null.

The decision by the Constitutional Court, as well as the advocacy campaign and opposing voices from the Mozambican citizens, has triggered action from relevant authorities. For example, the General Prosecutors Office filed a court case in the High Court in London against Credit Suisse, VTB and Privinvest – the corporation behind these frauds. Another court case was filed by the Central Bank of Mozambique against the same defendants last month also in London.

The General Prosecutor of Mozambique built on our legal argument requesting the cancelation of the loans to the Constitutional Court. The Mozambican state claimed that the then-Minister of Finance, Mr. Manuel Chang, did not have the authority to sign the sovereign guarantees because the Mozambican Parliament had not approved the loans. Through this case, Mozambique sought: (1) A declaration that it is not liable to pay any of the debt on one of the three deals, namely the $623 million loan to Proindicus; (2) Compensation for the losses due

to past or future debt payments concerning the loan (and the restructured loans in the case of the Ematum bond); (3) Compensation for all fees and expenses incurred in the restructuring of the Ematum bond; and (4) Compensation for macroeconomic losses resulting from the financial crisis and loss of donor funding which followed the revelations about the loans in 2016.

In December 2019, Jean Boustani, the architect of the illegal debts, was acquitted of the charges by a jury following a federal court trial in Brooklyn, U.S. It is common cause that at least $200 million was paid for bribes, $200 million was paid as fees for arrangers, and more than $700 million is unaccounted for according to the Kroll Audit report. We have campaigned for over three years against the "illegal debt" and have consistently argued that the beneficiaries of these debts, namely corrupt officials in Maputo, together with employees of Privinvest and international banks (Credit Suisse and VTB), must be held accountable for the debts. The debt crisis caused great harm to an already weakened Mozambican society and economy, and further triggered a macroeconomic and social crisis in the country. We argue that the people of Mozambique should not have to pay these debts that they had no say over and no benefit from.

In 2018 in South Africa, the former Ministry of Finance, Mr. Manuel Chang, who illegally signed off the state guarantees for these loans was arrested on his way to Dubai. He remains in prison in South Africa for more than a year awaiting a decision by the South Africa Minister of Justice on a dispute from the U.S. and the Mozambican Government over his extradition. In representation of the Mozambican civil society, we have intervened in this case by exposing to the High Court of South Africa, to the Constitutional Court and also to the Appeals Court that Mr. Chang (1) enjoys immunity; (2) there is no indictment launched in Mozambique; therefore, justice will not be served in Mozambique. He enjoys immunity as of the time of his arrest because he was a member of parliament.

More recently in Switzerland, the Swiss Money Laundering Reporting Office responded to a 2018 request by the Mozambican General Attorney for mutual legal assistance. The authorities in Switzerland finally started an investigation in January this year.

Transparency of Loans to Governments: The Transparency Lending Covenant

The Mozambican illegal debt raised one fundamental question: How to stop governments from borrowing behind their peoples' backs. The assumption behind this question is that the public has the right to know about their nations' debts. The recently approved Transparent Lending Covenant (TLC) by the G20 in Japan in June 2019 does not address this problem. The TLC is a response triggered by the Mozambican illegal debts, among other similar cases, which prompted discussion within the G20 on the need for new rules to make loans to governments transparent.

The TLC is a set of voluntary Principles for Debt Transparency by the Institute of International Finance (IIF) and are applied only to lending from the private sector, not from states where lenders are invited to voluntarily disclose loans they make to low-income governments or state firms in a publicly accessible registry. The ideal structure would be a public debt registry searchable by the lender and borrowing government and is accessible to media, civil society and other people. The information should be disclosed within 30 days of contract signature and should include the value of the loan; fees, charges and interest; the law governing the debt obligations; any available information on the use of proceeds; the payment schedule; and information on whether there is any security or collateral attached to the loan, and if so, on what terms. Although the endorsement of the TLC might have some weight with the private sector, the policy is voluntary. Lenders are still reluctant to share information they consider commercially sensitive.

My view is that the transparency of debt information is beneficial to everyone. It gives lenders more certainty about the basis upon which they are lending, it gives borrowers lower interest rates, and it allows citizens to subject lending and borrowing by their governments to more scrutiny, including through holding public debt audits into borrowing and lending decisions. The more transparency there is over government debts, the better decisions lenders and investors can make. Transparency ensures all stakeholders have a clear idea of the countries' debt burden, which decreases the risk attached to lending and could, therefore, enable countries to secure lower interest rates.

Transparency is also a key step towards loans being used responsibly and to prevent public resources being wasted, diverted or stolen. Without transparency, it is not possible for civil society, media and parliaments to hold governments accountable on how much is being borrowed, the terms of contracts, what loans are being spent on, how they will be repaid and on what timeframe.

The Importance of this Decision and How it Could Catalyze Similar Cases in Africa

The people have the right to know about debt being taken on by governments in their name.

1. African countries should commit to accountable debt contracting processes, where Parliaments approves all borrowing plans. Such plans should be agreed upon through an open process before contracts are signed so that civil society and the media can scrutinize them and the decision-making process. Such scrutiny is vital to ensure loans to governments are used productively towards Sustainable Development Goals.
2. African countries need to push for changes in the policy framework for borrowing and lending. Most international loans are made under New York or British Law — so tweaking the rules in these two jurisdictions would be a good start.
3. We need policies that establish that lenders should only lend if a transparent and accountable government debt contracting process is in place, including scrutiny by citizens, CSOs, oversight bodies of all government and information about borrowing plans, before contracts are signed.
4. In addition, lenders should only lend if they can and will disclose the existence of a loan within 30 days of contract signature, do so on a globally accessible registry, and include key information about the loan.

Final Remarks

Available information suggests that illegal loans were conceptualized elsewhere, with various parties in more than three jurisdictions targeting Maputo officials who consented to the projects knowing that they are in contravention of Mozambican and international laws. While it is appropriate to hold Mozambican government officials accountable for their role in the crisis, it is imprudent to absolve the main actors and architects of the illegal loans of their responsibility. I believe that a perfect overlap between domestic and global corruption created an ideal environment for the Mozambican debt scandal. Additionally, it is clear that international banks were acutely aware that limited penalties would be applicable to them in this case, suggesting that the rewards of breaking global standards, policies and procedures far exceeded fees that could be applicable for their role and non-compliance with international financial regulations.

It is more than clear that these debts have human costs, and litigation in various jurisdictions might not yield desired results for the people. I think that political and legal challenges were presented in this case. Impediments to a successful legal outcome include (1) the conduct of the Mozambican government that has failed to provide clear communication on the three loans; (2) Mozambique's failure to timely declare the three loans null and void; (3) the fact that "odious debts" have never been successfully challenged in a court of law before; (4) the crimes having occurred in various jurisdictions, all of which might not cooperate on resolving the underlying crisis; and finally (5) the absence of a globally accepted sovereign debt resolution framework.

We need a combination of domestic and global reforms that can address glaring weaknesses in the international financial system. Such weaknesses are a threat to social, political, economic and even environmental sustainability, affecting billions of people living in emerging and developing countries. Failure to reign in large international banks can set the global economy up for the next global crisis. It is in our collective interest to ensure that we mitigate against such risks.

A Final Note on the Strategy of the FMO: A Model for Other Countries?

The Budget Monitoring Forum (*Forum de Monitoria do Orçamento*, FMO) is a coalition comprising of Mozambican civil society organizations working on transparency and accountability in public finance management that has engaged the Mozambican government, development partners, governments, and members of parliaments in several jurisdictions to seek a sustainable solution to the Mozambican debt crisis. FMO's work on public sector accountability and fiscal transparency are informed by our collective understanding of the centrality of public sector governance to collective futures of the Mozambican people. This report summarizes FMO' activities and results from its advocacy and policy influence work on the illegal debts issue in 2019.

The FMO's vision for its advocacy efforts was to contribute to restoring Mozambique's public debt sustainability by increasing the costs of the illegal debts on responsible parties and their key stakeholders, including those holding responsible parties accountable, thereby contributing to sustainable development for Mozambican people. The FMO advocacy strategy for the illegal debt campaign was anchored in the following approach: The key strategies included:

Strategy 1. Awareness building about the sovereign debt crisis in Mozambique – using a dynamic communication strategy to systematically disseminate information on the crisis locally and globally.

Strategy 2. Advocacy for debt cancellation in Mozambique and in all the relevant jurisdictions – using research findings and partners to approach decision makers across various jurisdictions.

Strategy 3. Litigation against responsible parties – pursuing various legal means to nullify the loans, hold responsible parties to account and repatriate the funds.

Strategy 4. Campaigning for better global policies and standards – sustained global advocacy for improved global standards and policies to prevent future debt crisis, especially in low income countries.

A public campaign has the possibility of distributing the social costs of the illegal debt crisis beyond just a few individuals. As such, the primary target groups of this strategy were decision makers including financial sector regulators, investigative agencies, judicial and legislative arms of governments in Mozambique, the United Kingdom (U.K.), U.S., Switzerland, Netherlands and Norway. Although France was initially included as a primary target country, the FMO decided to exclude it from the 2019 advocacy efforts due to concerns regarding risks and security of the leading members of the platform. These are some of the countries through which proceeds from the crimes were distributed and/or which have regulatory or oversight responsibility for the international banks.

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