



Prudent Debt Management and Lessons from the Mozambique Constitutional Council

By:

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About eight years ago, the government of Mozambique formed two companies, Proindicus and the Mozambique Asset Management. These two companies entered into loan agreements, valued at approximately \$2.2 billion, with creditors including Credit Suisse and VBT Bank. Even though these debts were obligations of the state, some of these debts were hidden from the Mozambique parliament and public. Their existence was exposed in 2016 and precipitated a debt crisis in the country.

The state is now taking legal action to avoid having to repay the debts. In May 2020, the government won a big victory. The Mozambique Constitutional Council, in Case No:05/CC/2019, held that the loans made to these companies by Credit Suisse and VBT were null and void because they were unconstitutional and incurred in violation of the country's budget law. The basis

for the decision was that, although these loans were obligations of the state, they have not been presented to and approved by Parliament as required by the applicable statutes.

This decision should not have come as a surprise to these banks. A former Credit Suisse banker has already pleaded guilty to paying bribes in connection with these transactions. In addition, the country's former Minister of Finance is in jail in South Africa fighting a request for extradition to the US, where he has been charged with bribery and corruption. Also, Mozambique has sued Credit Suisse in English courts to have the loans set aside.

There are four points which can be made about the legal and practical significance of the decision.

First, the decision is an important victory for the rule of law in Mozambique. The Constitutional Council has ruled that even the most senior government officials must comply with the requirements of the Constitution and the relevant statutes or risk having their commitments declared null and void. The decision, by insisting that the law be respected also empowers Parliament which, pursuant to the laws of Mozambique, is required to approve the state's debts.

By upholding the rule of law, the Constitutional Council has also improved Mozambique's credibility and negotiating space in any future international transactions. It has sent a powerful message to all Mozambique's potential business partners that if they want to do business with the government of Mozambique, they should make sure to follow the stipulated legal procedures or they run the risk of having their transactions declared void. This should provide a disincentive for unscrupulous creditors like Credit Suisse or VBT from seeking to bully or entice Mozambique officials into entering into transactions that do not clearly comply with domestic law. In addition, it empowers all government officials to argue in their negotiations with potential creditors or other business partners that unless the correct procedures are followed and the proposed terms of the transaction are adjusted so that they are acceptable to the Parliament, there is no point in them entering into a contract.

Second, it is important to recognize that the Constitutional Council decision is

not the final word on the matter. It is not dispositive of Mozambique's [Case against Credit Suisse](#) in the English courts. The Case is being brought in English courts because the loan agreement stipulates that it is governed by English law and the governing forum is English courts. Unfortunately, the decision of the Mozambique Constitutional Council is not binding on the English court. Moreover, the Case in the English court, in practical terms, will be more important than the decision of the Constitutional Council in deciding if Mozambique ends up having to pay its debt to Credit Suisse. The reason is that if Credit Suisse wins the Case in England, it will be in a position to try and enforce the judgement against Mozambique around the world and to complicate Mozambique's efforts to access international financial markets.

It is not easy to predict the outcome of this case. The most pertinent precedent in the English courts is [The Law Debenture Trust Corporation PLC v Ukraine](#). In this case, Russia was seeking to compel Ukraine to pay what it owed on its outstanding US\$3 billion worth of bonds held by Russia. The government of Ukraine argued that the bond agreement should not be enforced by the courts because the officials who signed the agreement did not have the requisite authority. It claimed that the Ukrainian borrower had not obtained the necessary authority to enter into the transaction from the Parliament and the creditor knew or should have known this. Unfortunately, the English courts ruled against Ukraine. It held that that under English law, the courts will follow the lead of the English government which has decided that if the state is recognized as a sovereign state by the UK, it must be deemed to have the capacity to enter into valid contracts. Ukraine is recognized as a sovereign state by the UK. In addition, its officials have entered into 31 prior valid agreements that bind the state. Consequently, it was not unreasonable for the Russian creditor to assume that it was dealing with a duly authorized government official in this particular transaction.

This precedent suggests that the courts in England will uphold the Credit Suisse contract. Mozambique is a state recognized by the UK government and so it is deemed to have the capacity to enter into valid contracts. It should also expect the English courts to respect this capacity and uphold its agreements. However, in the Mozambique case, unlike the Ukraine case, there is no prior history of the state having entered into valid debt agreements. The fact that this was the first

time Mozambique was entering into such a contract should have put the creditor on notice that it needed to do adequate due diligence to establish the validity of the agreement under Mozambique law. Moreover, the fact that a Credit Suisse official involved in the transaction has pleaded guilty to bribery in connection with the transaction suggests that it did not do adequate due diligence.

Mozambique can further strengthen its argument by pointing out that both it and the UK are signatories to the [UN Convention Against Corruption](#). This means that they both should have a strong interest in fighting against corrupt transactions. Consequently, the English court should support the efforts of the Mozambique Constitutional Council to uphold the rule of law and defeat corruption by following its decision that the contract is null and void.

It is important to note, however, that the English courts tend to uphold the sanctity of contract even if doing so works an injustice. This can be seen from their decision in [Donegal International Ltd. V Zambia](#). In this case, one of the first involving vulture funds, Donegal was seeking to enforce the original terms of the debt contracts that it had procured at steeply discounted prices. Even though the court understood that the transaction was exploitative, it upheld the contract and ordered Zambia to comply with its original terms.

Third, the Mozambique saga provides a lesson to African sovereign borrowers on the risks of borrowing without adequate planning from private creditors. The relevance of this lesson follows from the fact that many African countries cannot raise adequate funds from their own domestic resources plus official sources to fund all their developmental needs and so need to borrow from other sources, particularly private commercial sources. This is not necessarily a problem, so long as the transactions are entered into with careful planning and prudence. Ideally, they should also be used to support activities that will generate the funds needed to repay the debts.

In this regard, it is important to note that sovereign borrowers often incur these debts in order to fund policies and projects that inevitably have social, political, and environmental impacts as well as financial and economic implications. This suggests that prudent debtors need to approach these debts holistically and

make sure that they fully understand all the impacts of their proposed transactions before they enter into them. This highlights the importance of doing rigorous and complete impact assessments *ex ante*. Such assessments depend on the decision makers being transparent in their planning and borrowing process. This helps ensure that all affected these parties have access to all relevant knowledge and are able to understand how the transaction will affect them. They can then inform the decision makers, about their views on the transaction and their possible reactions to it. Consequently, it helps ensure that the decision makers make fully informed decisions and that their decisions are consistent with all applicable legal requirements, including the state's international obligations.

The need for such planning underscores the importance of the borrower having clear laws and procedures to govern its debt management policies and procedures. These laws can act as both a discipline on the borrower and as a signal to the creditors about the borrower's determination to follow prudent and responsible procedures in its debt transactions. It is important to note that in developing these procedures, African states should draw on all the relevant international norms and standards relevant to developing their borrowing laws and practices. These standards include the [UNCTAD Principles on Promoting Responsible Sovereign Borrowing and Lending](#), the [Principles for Responsible Investing](#), the [UN Guiding Principles on Business and Human Rights](#) and the [Equator Principles](#). While they are all soft standards, they are useful in informing borrowers about what is viewed as best practices on particular issues. Moreover, if borrowers take them seriously and incorporate them into their own laws and regulations, they can help improve their own practices and their bargaining position with their creditors and business partners.

Finally, the case highlights the important role that lawyers can play in sovereign debt transactions. They can help ensure that both the borrower and the creditors understand the relevant laws in the borrower's jurisdiction and what they must do to comply with the law. In addition, they can advise the borrower about identifying the impacts of, and risks associated with its transactions and how to manage both of these most prudently and effectively. Needless to say, lawyers will only be able to play this role if they have made an effort to acquire the requisite understanding of international finance, the legal

aspects of international financial transactions, and the international standards applicable to them.

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