



# **Introduction: Sovereign Debt Under Domestic and Foreign Law: Lessons from the Mozambique Constitutional Council Decision of May 8, 2020**

**By:**

[James Thuo Gathii](#)

August 3, 2020

On May 8, 2020, the Mozambique Constitutional Council decided that non-concessional loans totaling 622 million USD borrowed from two London-based banks - Credit Suisse and Russian VTB - was illegal, null and void. The Mozambican borrowers were three State Owned Enterprises that at the time had not been formally constituted. The basis of [the Constitutional Council's decision](#) was that this loan was obtained without approval of Parliament. Further, the Council held that amount was in excess of the borrowing limit permissible under the Constitution and laws of Mozambique.

On June 8<sup>th</sup>, 2020 Afronomicslaw.org convened a panel of experts to discuss that case in webinar titled: [Overturning Sovereign Debt for Violating National Law: Lessons from a recent Mozambique Constitutional Council Decision](#). This written symposium carries forward the conversation from that webinar.

The first contribution in this symposium is [Denise Namburete](#), the Executive Director of [N'weti](#) in Mozambique. Denise and N'weti and a coalition of civil society groups the [Budget Monitoring Forum](#) (FMO), were critical in pressurizing the Mozambican government to commission an audit once the secret loans and how its proceeds were given to entities that had no revenue or contracts in place. Mozambican civil society groups were crucial in highlighting how the loans exacerbated domestic economic turmoil. These groups also put pressure on authorities in the United Kingdom and the United States to commence anti-bribery proceedings against the individuals and entities involved in the procurement of the illegal loans. As Denise's contribution notes, there were arrests in London, New York and South Africa. The success of pressure outside Mozambique finally triggered domestic consequences with indictments of 19 individuals charged with abuse of power and trust including the son of a former Mozambican President.

N'weti also filed the successful case in the Constitutional Council. Denise's essays updates us on the various efforts to hold the actors involved in the procurement of the illegal loans inside and outside Mozambique. As her essays shows, prosecutorial and accountability mechanisms outside Mozambique do not always guarantee successful outcomes. Denise ends her essay by noting the formation of the Budget Monitoring Forum (*Forum de Monitoria do Orçamento*, FMO). The FMO is a coalition comprising of Mozambican civil society organisations 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.

In his essay for this symposium, [Daniel Bradlow](#), one of the leading scholars on sovereign debt, examines the challenges raised by the Mozambique Constitutional Council decision outside Mozambique. Although Bradlow notes that decision will nudge Mozambique's potential creditors to follow the correct

procedures, the decision is far from the final word on the matter. This is because the loan agreement is governed by English law, the Mozambican Constitutional Council's decision is not binding on an English Court. That means that an English Court is likely, though not inevitably, to uphold the loan contracts even if doing so 'works an injustice.' Bradlow advises African governments to follow prudence and responsible procedures in their debt transactions and to draw on all the relevant international norms and standards relevant to borrowing laws and practices such as 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](#).

The next essay in this symposium is co-authored by Stephen Connelly, Celine Tan, Karina Patricio Ferreira Lima and Chris Tassis. They begin their contribution by noting the high indebtedness of Sub-saharan African economies and how the COVID-19 pandemic has worsened the region's economic outlook. They note the particular concerns raised by the rapid accumulation of private debt through the issuance of Eurobonds and the limits of the two most significant international initiatives aimed at reducing the debt burden of low-income countries: the [IMF's Catastrophe Containment and Relief Trust \(CCRT\)](#) and the [Debt Service Suspension Initiative \(DSSI\)](#) involving the G20 and Paris Club creditors and a limited number of private creditors.

They overcome the limitations of English law that Bradlow observes in his essay. [Stephen Connelly](#), [Celine Tan](#), [Karina Patricio Ferreira Lima](#) and [Chris Tassis](#) propose giving legislative effect the statutory standstill on all DSSI-eligible qualifying debt governed by English law. The proposal covers sovereign bonds, and qualifying debt corresponding to [90 per cent of the bond contracts](#) owed by countries covered by the DSSI. The proposal is based on the content of and rationale that underpinned the [Debt Relief \(Developing Countries\) Act 2010](#), which prevented creditors of beneficiary countries of the Heavily Indebted Poor Countries Initiative (HIPC) Initiative from recovering an amount of debt in excess of that consistent with the HIPC Initiative. The resources that would otherwise have gone to debt servicing would then be available to support health, humanitarian and social and economic measures during the COVID-19 pandemic. As they note, the proposed legislation does not directly intervene in

a contract to suspend debt payments, and as such it is still open to creditors to declare a default under the relevant contract. Instead, the legislation mirrors existing insolvency legislation in suspending the link between contractual default and the execution and enforcement of contractual rights, including with the aid of the English courts.

The premise of their proposal is that without enshrining debt standstills and/or cancellation into law, private creditors are unlikely to participate fully and give effect to multilaterally organised debt relief initiatives.

Underlining the significance of their proposal that would blunt private creditors threats to sue, Stephen Connelly, Celine Tan, Karina Patricio Ferreira Lima and Chris Tassis argue that since most DSSI eligible private debt is governed by English law, if the DSSI is not accompanied by a statutory standstill for private debt, English courts (more than any other jurisdiction) could end up enforcing the debts of private creditors free-riding on the DSSI, CCRT and other debt relief measures funded by the UK taxpayers. They conclude by acknowledging that their proposal does not address the [broader systemic issues](#) relating to unsustainable debt burdens in developing countries and the gaps in regulation of the international financial architecture that enable the accumulation of such debt burdens. Yet, as they correctly note, this proposal would be useful in staving off opportunistic litigation to give African countries relief to from unprecedented health, social and economic crisis set in motion by the COVID-19 pandemic.

In his contribution to the symposium, [James Mabuti Mutua](#) asks why indebted countries like Mozambique and their creditors continue the debt cycle no matter how a poor Sovereign borrower's credit ratings and their ability to repay. He calls this the phenomenon, following [Lee Buchheit](#), the assumption of refinancing - both debtors and creditors at the international capital markets have systematically developed an ingrained presumption that the perpetual benignity of the market will enable a debtor to borrow because another lender will always be ready to allow them to refinance the loan. However this assumption of refinancing is fragile could be affected by, among other factors, domestic economic circumstances that undermine that possibility, or because interest rates in developed country markets begin to rise, as was the case in

1994. As Mutua notes, the Mozambican case perfectly illustrates this fragility of the financial markets. Here money borrowed by one government becomes the problem of a subsequent government. Like Bradlow, Mutua notes that the implications of the Mozambican Constitutional Council requires creditors to perform their due diligence to ensure compliance with domestic law. Mutua ends his essay by reflecting on the adverse impact that the loan had on poverty levels in Mozambique which the UNDP in 2019 noted [decreased at a slower rate than anticipated](#).

[Richard Messick](#) concludes this symposium with five proposals. First, that the Basel Committee on Banking Supervision should issue an international standard requiring complete transparency in loans to sovereign governments. Second, the financial regulatory agencies in all capital exporting nations should write the Basel Committee standard into their regulations. Third, New York State and the United Kingdom should amend their laws to provide any loan extended in violation of the Basel Committee's international standard is void. Fourth, that the African Development Bank, the IMF, the World Bank, and other international financial institutions should advocate for the development and adoption of an international standard on irresponsible lending. Finally, he proposes, the laws of capital exporting countries should be amended to permit citizens of countries harmed by an irresponsible loan to bring an action for damages.

[Afronomicslaw.org](#) thanks the contributors to this important symposium and it's sovereign debt webinar. There will be additional Afronomicslaw.org led-sovereign debt initiatives coming soon. Stay tuned.

## **Contributors**

[Denise Namburete](#): [How Public Interest Litigation Led to Invalidation of Illegal Mozambican Debt](#)

[Daniel Bradlow](#): [Prudent Debt Management and Lessons from the Mozambique Constitutional Council](#)

[Stephen Connelly](#), [Celine Tan](#), [Karina Patricio Ferreira Lima](#) and [Chris Tassis](#): [Staying Claims: Debt Moratoria Beyond the Debt Service Suspension Initiative](#)

[James Mabuti Mutua: Hell Breaks Loose in Mozambique: Is this the beginning of the end of irresponsible Sovereign Borrowing? Or a wakeup call to address Benignity of the International Capital Markets?](#)

[Richard Messick: No More Hidden Debts!](#)

View online: [Introduction: Sovereign Debt Under Domestic and Foreign Law: Lessons from the Mozambique Constitutional Council Decision of May 8, 2020](#)

Provided by Afronomicslaw