

## MOZAMBIQUE RESEARCH NOTE

## The Constitutional Court ruling - a bolt from the blue

On June 3rd the Constitutional Court declared **null and void** not only the sovereign guarantees on whose basis the banks approved the EMATUM loan in 2013, but **“all acts arising from the contracting of said loan.”**

*This coup de théâtre would appear to call into question the revised agreement-in-principle reached with bondholders last week and greeted with such euphoria by the market.*

1) As was to be anticipated, **the position of bond holders**, who have bid the price of the Republic's 2023 eurobond up to 99% of par, is that **their instrument is** legally distinct from the fraudulent loan to EMATUM (the Netherlands Antilles special purpose company), and therefore **completely unaffected by the ruling**.

However, there can be no debate about the robust - indeed **organic - chain of continuity between the two instruments**. Arranged in total secrecy, the original loan was immediately securitized into loan participation notes<sup>1</sup> that were then exchanged into the ill-fated sovereign bond, in April 2016.

2) The circumstances warrant highlighting **a few milestones** in the tainted evolution of this shape-shifting obligation:

- The Auditor-General's report for 2013, noted that **“the government had, without proper authorization, issued sovereign guarantees for MT 28.35 billion (i.e. USD 850 million), an amount far in excess of the MT 183 million (i.e. USD 5.4 million) ceiling established in that year's Budget Law.”**
- The long-secret EMATUM<sup>2</sup> loan was quietly included in the list of the Republic's external obligations that appeared in the Statement of Account<sup>3</sup> for the Republic, for fiscal year 2014<sup>4</sup>.
- In August 2016, in a transparent attempt to preempt any legal action that the resulting furore might inspire, the Frelimo-dominated National Assembly<sup>5</sup> adopted Resolution 11/2016 that approved the Republic's Statement of Account for 2014.

3) In 2017, a constellation of **civil-society groups filed suit seeking a ruling on the constitutionality of this resolution** that purported to confer retroactive legality on the presumptively fraudulent loan agreement. The Constitutional Court has now ruled in favour of the petitioners<sup>6</sup>, rejecting the borderline frivolous arguments advanced by the National Assembly<sup>7</sup>.

<sup>1</sup> The lenders took this step - over the strenuous objections of the Mozambican authorities - in order to remove the relevant credit exposure from their balance sheets.

<sup>2</sup> I.e. a private company, incorporated in the Netherlands Antilles.

<sup>3</sup> I.e. Conta Geral do Estado.

<sup>4</sup> When the government submitted this report in June 2015, the purported recognition of the odious claim provoked a furious reaction on the part of Mozambique's civil society and political opposition alike, who pointed to its numerous constitutional and statutory infirmities.

<sup>5</sup> The session was boycotted by RENAMO, the main opposition party.

<sup>6</sup> Within hours of the Court's ruling, its president Hermenegildo Gamito abruptly announced his resignation, citing the fact that he will be turning 75 this September. But it is also worth recalling that it was the the Maputo law firm of Gamito, Couto Associados that provided the legal opinion (attesting to the validity and enforceability of the sovereign guarantee), upon which EMATUM's bankers chose to rely.

<sup>7</sup> Viz.: 1) The relevant Resolution was a quasi-political declaration rather than a piece of legislation and as such, not subject to review by the Constitutional Court. 2) Since the loan in question was arranged by international lenders, it was not subject to the Court's jurisdiction.

4) This unexpected decision raises the question, **why the sudden pivot** away from the government's dogged insistence on recognizing – if not actually servicing – the problematical financing<sup>8</sup>.

Last week-end, however, Maputo hosted an international **donor conference with a target of USD 3.2 billion** in commitments for post-cyclone relief and reconstruction. In the event, the Republic received pledges of 'only' USD 1.2 billion. It seems oddly coincidental that **the resulting shortfall is almost an exact match for the \$2 billion total borrowed via the three once secret loans**<sup>9</sup> ... which the authorities have, until now, insisted on recognizing.

5) What happens next is impossible to predict. But, in a system as monocephalic as Mozambique's, it is **hard to believe that the apex Court would have issued such a ruling without the blessing of President Nyusi**<sup>10</sup> – or that said ruling will be without practical consequence.

A propos, it is worth noting that the relevant petition was filed by the same civil-society groups whose vociferous protests forced the government to drop the VRI provision<sup>11</sup> from the agreement-in-principle reached with bond holders in November 2018. It seems **inconceivable that an umbrella organization like "Eu no pago!"**<sup>12</sup> will have been placated by this token concession<sup>13</sup>.

Nor should one lose sight of the fact that Mr. Nyusi faces a tough battle<sup>14</sup> for re-election on October 15th. For this reason alone, we can **dismiss out of hand the closing date targeted** for the restructuring transaction: **"no later than September 1<sup>st</sup>"**.

But, **beyond this simple prediction, all bets are off** - even though the 2023 eurobond is now trading<sup>15</sup> as though the restructuring transaction were a *fait accompli*.

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<sup>8</sup> As illustrated throughout the protracted negotiations with bond holders that culminated in last week's revised agreement-in-principle

<sup>9</sup> I.e. ProIndicus and Mozambique Asset Management, in addition to EMATUM.

<sup>10</sup> Given that, in Mozambique the separation-of-powers principle has generally been honoured in the breach.

<sup>11</sup> I.e. the value-recovery instrument that provided for a variable pay-out to bond holders, contingent on the size of Mozambique's LNG export revenues during a specified time-frame. As finance minister Maleiane has acknowledged, *"It was difficult for society to accept this instrument."*

<sup>12</sup> Literally, *"I am not paying!"*

<sup>13</sup> Especially since the new arrangement simply substitutes the stochastics of an option-like instrument for the certainty of 3.125% p.a. in additional interest income – derived from the same hallowed exports of LNG.

<sup>14</sup> As a result of the economic collapse triggered by the revelation of the USD 2 billion in secret loans, the ruling Frelimo party is widely regarded as an avatar of corruption. Indeed, the flurry of arrests and indictments that the Prosecutor-General has announced since January strongly suggest a piece of political theatre intended to demonstrate to the jaded electorate that the local authorities are as resolute as the US department of justice in their determination to hold to account those responsible for the fraud. Another target of this thespian caper may be the S. African authorities whom the Mozambican authorities are trying to persuade to repatriate former minister Manuel Chang - rather than extradict him to the US, where he would have a compelling incentive to spill the beans on the giant procurement fraud originally code-named ProIndicus.

<sup>15</sup> I.e. 99 - 100.

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