Oil-Backed Loans in Congo Brazzaville:

Potential Legal Remedies Using the Odious Debt Concept in the French Legal System

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Introduction

On 17 January 2009, shortly before passing away under mysterious circumstances, Bruno Jacquet Ossebi, a Franco-Congolese journalist, published an article in a French-based Congolese online newspaper, Mwinda.org. Entitled "Oil for a Handful of Dollars,"[1] this article reported that the Republic of the Congo and the French group BNP Paribas were about to transact a deal involving an oil-backed USD 100 billion loan. The report was significant given that, to benefit from International Monetary Fund (IMF) and World Bank (WB) programmes, the Republic of the Congo had agreed on several occasions to no longer resort to this type of financing.

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What are oil-backed loans? How does the practice of using oil-backed loans aggravate the indebtedness of the Republic of the Congo? What legal remedies can be used to tackle this phenomenon? This paper will attempt to answer these many questions.

I. Presentation of the Facts

A. What Are Oil-Backed Loans?

An oil-backed loan is a loan granted by a private creditor (bank or buyer of crude oil) to a public entity (state or public company) that is secured with future oil production.[2] In other words, a sovereign borrower pledges forthcoming barrels of crude oil as collateral for a loan. The debt is thus secured against the collateral and, if the borrower defaults, the creditor takes possession of the oil and can sell it to satisfy the debt by regaining the amount originally lent to the borrower.

Developed by oil trading companies during the 1970s, this technique for securing loans underwent a swift boom due to the combined effect of Northern countries' marked energy dependence and developing countries' significant financing needs. Tired of the conditions imposed by multilateral funding agencies, states that are rich in natural resources, such as the Republic of the Congo, Iraq, and Angola, but poor in other areas, saw it as a means of quickly satisfying their liquidity needs.

B. Oil-Backed Loans or Financing for Underdevelopment

Although there is nothing illegal about this technique per se (it is neither more nor less than a contract), the conditions under which these secured loans take place constitute a serious constraint to the development of Southern economies.

Oil-backed loans create an environment that favours corruption and bad governance of public resources, because, in such arrangements, sovereign borrowers are not bound to indicate the end-use of the borrowed funds or to account for their use.[3]

This problem is aggravated by the fact that the oil prices secured by creditors are generally significantly lower than the market price. In other words, thanks to the pre-financing technique, a private creditor can acquire a much higher quantity of oil than it could have purchased on the market with the identical investment. The combination of these two factors accelerates both the pillage of Southern economies' oil resources and their accumulation of debt.

C. Oil–Backed Loans in Congo Brazzaville[4]

In 1985, while the price of oil was tumbling, the Republic of the Congo found itself short of funds and was no longer able to honour its debts. Having met with refusal from the IMF, which made aid conditional on democratisation of the country and good governance of public revenues, General Denis Sassou Nguesso decided to turn to oil-backed loans and found, in the French oil company Elf (now Total) in particular, a partner he could rely on.

Notably, Elf is not the only oil company to have enriched itself on the Republic of the Congo's debt. The U.S. company Occidental Petroleum (Oxy) and the Italian group ENI (via its subsidiary Agip) benefited widely from the practice of securing loans with oil. Similarly, several banks, many of them French, took part in these operations: Crédit Agricole, Société Générale, Crédit Lyonnais, and Banque Paribas (now BNP Paribas). Large oil brokerage companies, such as Glencore or even Trafigura, also made enormous profits by organising the sale of oil on behalf of contracting parties.

Aside from the details of each specific oil-backed loan, the scheme is substantially the same in every case. First, one or several offshore companies receives a loan at preferential interest rates from a bank or buyer of crude oil. Then, these offshore companies lend to the sovereign state at significantly higher rates. The difference between the interest rates is ultimately collected by the original creditor, while the representatives of the regime and their close associates receive a juicy commission, as do various other middlemen. This arrangement is designed in such a way that the offshore company appears as the sole debtor for the loan and, thus, shelters the country, in this case the Republic of the Congo, from criticism by the IMF.

According to the IMF, nearly seventy-five percent of loans contracted by the Congolese government between 1995 and 2000 were secured with oil.[5] To benefit from the Heavily Indebted Poor Countries (HIPC) programme,[6] the Republic of the Congo has agreed on several occasions since 2001 to no

longer rely on oil-backed loans.[7] In reality, however, this agreement has not been respected. In a judgement by the British High Court of Justice that was made on a dispute between the Republic of the Congo and one of its creditors, the firm Kensington International Ltd.,[8] it was revealed that from 1999 to 2003 the state oil company Société nationale des pétroles du Congo (SNPC) concluded a series of oil-backed loans with Glencore amounting to USD 200 million.[9] Similarly, in March 2006, a U.S. federal court received a complaint against SNPC, its director, and the BNP Paribas group in which Kensington International Ltd. claimed that between 1999 and 2004 SNPC agreed to a series of secured loans with BNP reaching a value of nearly USD 650 million.[10]

Given the volume of liquidity generated by these loans, it is legitimate to question the end-use of the funds. Apparently, these loans were not assigned to the renovation of social and health infrastructure, although such infrastructure is cruelly lacking in Congo Brazzaville. This lack of infrastructure is evidenced by the significant number of schoolchildren who continue to receive their lessons while sitting on the ground due to a lack of sufficient tables and benches. It is also evident in a health sector that has not fared better. For instance, in the country's only large hospital (Centre hospitalier universitaire de Brazzaville), where it is common knowledge that patients are transported on people's backs because the lifts have been out of use for years, only the morgue operates at full tilt.[11] Further, over half of the population lacks access to drinking water and electricity cuts are an everyday occurrence. Finally, Congo Brazzaville remains one of the few countries in the world with no asphalt road network; three quarters of all roads are deteriorated for want of maintenance, and rural roads are often unusable, leaving many villages cut off.

According to the IMF, "rather than contributing to the welfare of the Congolese population, the proceeds from oil-collateralised borrowing may have been used to finance combat operations during the civil war."[12]

There are also strong reasons to believe that part of the funds and commissions resulting from secured loans were used to enrich Denis Sassou Nguesso and his family, which have together built a considerable fortune throughout the world.[13] A police investigation conducted following a complaint filed by Association Sherpa and two other NGOs in 2007, established that the Congolese ruling family owns 112 bank accounts and eighteen properties in France.[14]

In late 2004, the total outstanding debt for the Republic of the Congo was about USD 9.25 billion, four percent of which pertained only to debt secured with oil (i.e., USD 378 million).[15] Interestingly, these figures do not take into account the SNPC debts.[16]

II. Application of the Law

The debt secured on Congolese oil fits the criteria of odious debt:[17]

It was contracted without the full consent of the Congolese population.

It was used contrary to the interests of the Congolese people.

The private creditors could not ignore the odious destinations of the funds.

Is it therefore illegal? And, if so, what legal arguments can be used to support this claim?

The following paragraphs will focus on possible civil remedies (tort and contract litigation), the intention of which is less to sanction private creditors than to identify legal means that make it possible to lighten Congo Brazzaville's debt.

In theory, contracts that link a state or public authority to a private entity are state contracts and as such are subject to international law. But it happens frequently in loan contracts that parties elect to have their contracts governed by private law.[18] Such cases, be they contractual or extra-contractual, must be settled using the rules of private international law for determining the competent jurisdiction and the applicable domestic law.

In this article, which is based on French law, I rely on the following points:

In contractual disputes: The loan contracts are subject to French law (choice-of-law clause) and the parties recognise French courts as having jurisdiction over disputes arising from the contracts' execution (forum selection clause).

In extra-contractual torts: By virtue of Article 2 of the Brussels I Regulation of 22 December 2000, the courts of the state of the territory where the defendant is domiciled are competent. Therefore, if the action was directed against a French company, French courts would be competent. French courts would then apply their own choice-of-law rule, which provides that in matters involving extra-contractual liability the law of the place where the tort was committed (France) or the law of the place where the damage occurred (Congo Brazzaville) are both applicable. French law could therefore be applied.

A. Nullity of the Oil-Backed Loan Contracts Due to the Illegitimacy of the Cause

Under Article 1131 of the French Civil Code, "[a]n obligation without cause or with a false cause or with an unlawful cause may not have any effect." All agreements must have a lawful cause on pain of nullity. The cause must not be "prohibited by law" or "contrary to good conduct [or] public policy" (Article 1133 of the French Civil Code).

The lawfulness of the cause is assessed subjectively and depends on the motivations that led each party to conclude the contract. The relevant case law also speaks of "impulsive and determining cause"[19] (i.e. the reason that led a party to enter a specific contract—the real, and sometimes hidden, motivation).

It is not necessary for the unlawful motive to have been known to both parties for the nullity to take effect. In fact, since a judgement rendered by the First Civil Chamber on 7 October 1998, French judges consider that a contract may be cancelled for unlawful cause, even where one of

the parties to the contract was not aware of the unlawful nature of the motives of another party to the contract. Furthermore, the cause of a contract is likely to be unlawful when the operation contemplated constituted a criminal offence.

In the present case, on the Congolese side the subjective cause of these agreements consists in the end-use of the borrowed funds, that is to say the personal and illicit enrichment of Denis Sassou Nguesso and his family. Such acts are criminally reprehensible (illegal taking of interest, embezzlement of public funds, breach of trust, corruption). One can find a strong condemnation of corruption in a judgment issued by the Paris Court of Appeals on 10 September 1993: "Whereas under French law, [...] contracts tending to corruption or peddling of influence are cancelled due to the immorality or unlawfulness of the cause and the object, whereas a contract the cause or object of which is the exercise of peddled influence via the payment of bribes is, as a result, contrary to French international public policy, as well as to ethics in international affairs, as conceived by the greater part of the states in the international community."[20]

The burden of proof regarding the unlawful nature of the cause is on the claimant and may be fulfilled through various means. The unlawfulness of the cause is sanctioned by nullity, which is to say retroactive abrogation of the contract. In practice, in matters involving loans, for the borrower cancelation of the contract results in the restitution of the remaining capital owed and for the lender it results in the restitution of interests already received. The unlawfulness of the cause is a nullity of public interest (i.e. an act that violates a rule of public order) that may be invoked by any person who has standing to sue.

Unlawful cause is a useful remedy in several regards. First, it is not necessary to produce evidence that the private creditor was aware of the end-use of the funds for the contract to be cancelled.[21] Second, the action is not reserved exclusively for the parties to the contract; thus, action by Congo's creditors is possible,[22] as is action by the Congolese population. Naturally, the Congolese population has an interest in requesting the cancellation of a contract the effect of which was to aggravate state debt while mortgaging the country's oil resources. Lastly, the sanction is effective because it ultimately puts the parties in the same situation they were in before the conclusion of the contract, i.e. things return to the position they would have been in if the loan agreement had not taken place.

B. Contractual Liability of Banks for Granting Abusive Loans

Banks must comply with their duty to warn, which consists of warning uninformed borrowers about the risks involved in loans and indebtedness. This obligation is the fruit of a judicial decision. In a judgement dated 27 June 1995, the First Civil Chamber of the Court of Cassation ruled that "lenders did not justify, nor even did they al-

FOTOLEGENDE Bruno Jacquet

lege having warned borrowers on the significance of the indebtedness that would result from these loans; what the court of appeal has been able to deduce is that the credit institutions had failed in their duty to advise and triggered their liability towards the Garcia spouses."[23]

Can the Congolese government be considered an uninformed borrower? Does the mere fact that it has applied several times for loans suffice to make it an informed borrower? This question has to be linked to the issue of good faith in excessive indebtedness. The Court of Cassation, applying the principle that a presumption of good faith is always present, does not automatically view a debtor who has abused the recourse to credit as having acted in bad faith. Thus, by analogy one may consider that a debtor applying for a new loan while already heavily indebted is not necessarily an informed debtor.[24] On the contrary, it may even be that banks have an enhanced duty to warn in these particular cases, which may result in a duty to refuse the requested loan. Some decisions go as far as implying that banks open themselves to liability when they conclude excessively risky contracts. For example, in a judgment rendered on 12 July 2005, the Court of Cassation clearly stated that a bank's liability results from its failure to verify financial standing and granting the credit; thus it follows from this holding that the bank should have refused the loan.

The failure to comply with the duty to warn (and, more specifically, the granting of a manifestly excessive loan)[25] constitutes a breach of contract for which the bank is responsible under Article 1147 of the French Civil Code (breach of the duty of good faith). This is a contractual liability; thus, only the borrower may seek remedies for the harm caused by the bank's breach of its duty to warn, a harm consisting in the loss of the opportunity to avoid excessive indebtedness.[26] It follows that in the present case only an action brought by the Congolese government or SNPC would be admissible. Such a case could force the Republic of the Congo's private lenders to compensate the Congolese government through the payment of damages (Article 1142 of the French Civil Code). In principle, the damages must cover the cost of the harm; however, in a case involving a loss of opportunity, the recovery must perforce be partial. The damages paid could not be equal to the advantage provided by the opportunity to avoid excessive indebtedness had this opportunity been seized.[27]

What must happen when a contractual breach harms a third party? It has been accepted, since a judgment rendered by the Plenary of the Court of Cassation on 6 October 2006, that a third party to a contract may invoke, based on the law of torts,[28] a contractual breach as soon as that breach has caused her prejudice. In such cases, any contractual breach is sufficient to establish an intentional tort, such that the third party is not obliged to provide evidence of a distinct wrong (i.e. does not have to show that it suffered a special prejudice, distinct from the contractual breach). In accordance with this case law, any third party affected by oil-backed loans could have the ability to commence proceedings, provided that the breach committed by the private creditor caused that third party harm. In the present case one could argue that the population suffered damage due to the failures of the banks.[29] Provided that a plaintiff presented evidence of the damage suffered and demonstrated a causal link between the damage and the failure of the bank, the bank would be bound to compensate the prejudice by paying damages. Again, for the same reasons described above, this reparation would likely only be partial, because the prejudice suffered by the Congolese population consists in the loss of an opportunity, i.e. the opportunity to avoid being subjected to the burden of debt.

Although it is difficult to conceive of an action by the Republic of the Congo based on contractual breaches, one can envision the possibility of an extra-contractual proceeding commenced by Congolese citizens. Such an action could be successful, provided that judges recognise that: (1) the Congolese government or SNPC was an uninformed borrower; (2) the loans were manifestly excessive in relation to the country's financial standing and, thus, the banks should have refused to grant them; and (3) the Congolese citizens have standing. With this triple proviso, this remedy offers interesting potential and has the further advantage of avoiding debates on the end-use of the funds.

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The two grounds discussed above may only be implemented where the oil-backed loan was concluded directly between a private creditor and the Congolese government or SNPC. As we have seen, however, in most cases parties have the ability to hide inside complex financial schemes to conceal the nature of their transactions. In cases where transactions are not transparent or clear, banking legislation offers interesting possibilities for seeking solutions.

C. Breaches of Banking Regulations

Under Article L. 562-1 of the French Monetary and Financial Code, credit institutions feature among those professional institutions subject to the anti-money laundering regulations (AMLR). Therefore, these institutions are bound by the obligation to act with due diligence.

First, under Article L.563-1 of the Monetary and Financial Code, "[t]he financial entities or the persons referred to in Article L.562-1 shall, before entering into a contractual relationship or assisting a client with the preparation or execution of a transaction, confirm the identity of the co-contracting party through production of any probative document. [...] They determine the true identity of the persons with whom they enter into a contractual relationship or who request their assistance with the preparation or execution of a transaction when it appears to them that those persons might not be acting on their own behalf [...] ."

Next, Article L.563-3 of the Monetary and Financial Code imposes a duty on banks to proceed with a special examination of operations with a nominal or total amount in excess of EUR 150 000, appear-

ing under unusually complex conditions and not appearing to be economically justified or to have a lawful cause. In cases fitting this description, the financial entity has a duty to find out from the client the origin and end-use of the amount, the object of the transaction, and the identity of the person who is to benefit from the transaction.

In the present case, it appears legitimately possible that the banks failed to comply with due diligence obligations. More specifically, if the banks had applied the due diligence obligations to which they were legally bound, they would not have proceeded with the transactions. A professional breach of this type constitutes a violation that triggers banks' civil liability. If it appears that by failing to comply with its obligations under the AMLR, a creditor caused prejudice to a third party, the party may invoke the bank's civil liability on the basis of Article 1382 of the French Civil Code. In the instant case it is possible that the Congolese population suffered prejudice due to the breaches committed by banks, said prejudice consists of the loss of the opportunity not to be subjected to the burden of debt. Supposing that the claimants present evidence of the damage suffered and the causal link between the damage and the failures committed by the banks, the banks would be bound to compensate the harm through the payment of damages. Nevertheless, for the same reasons explained above, such reparation could only be partial.

The latter action is substantially similar to the previous action discussed; however, this action is distinguishable from the former because it involves no debate on the quality of the borrower, as the AMLR regulations are applicable regardless of this point.

Conclusion

Civil litigation under French law offers interesting possibilities for relieving Congo Brazzaville's debt. Nevertheless, any potential legal action against the Republic of the Congo's private lenders should not serve to make one forget the personal liability of Congolese dignitaries for the accumulation of debt.[30]

1 Pétrole contre poignée de dollars: on gagerait toujours le pétrole au Congo, Mwinda Press, available at http://www.mwinda.org/index.php?option=com_content&view=article&id=275%3Apetrole-contre-poignee-de-dollars-on-gagerait-toujours-le-petrole-au-République du Congo-&catid=85%3Ajournal&Itemid=192.

2 This article restricts itself to the subject of oil-backed loans, but this type of secured loan can also be used with other resources, such as cotton, gas, or even customs revenue.

3 See International Monetary Fund (IMF), Assessing Public Sector Borrowing Collateralized on Future Flow Receivables, points 57 to 59, June 2003, available at http://www.imf.org/external/np/fad/2003/061103.pdf.

4 This article gives only a brief overview of the broad phenomenon of oil-backed loans in Congo Brazzaville. For a more in-depth account see: François-Xavier Verschave, Noir silence : Qui arrêtera la Françafrique? (Les Arènes 2000); Loîk Le Floch-Prigent, Affaire Elf, affaire d'Etat : Entretiens avec Eric Decouty (Le Cherche Midi 2001); François-Xavier Verschave, L'envers de la dette (Agones 2001); Global Witness, Time for Transparency: Coming Clean on Oil, Mining and Gas Revenues, March 2004; Xavier Harel, Afrique, pillage à huis clos: Comment une poignée d'initiés siphonne le pétrole africain (Fayard 2006); Yitzhak Koula, Pétrole et violences au Congo-Brazzaville: Les suites de l'affaire Elf (L'Harmattan 2006).

5 IMF, Report on the Republic of the Congo, at 33 (unpublished report) 2001.

6 Congo Brazzaville is a candidate for the Heavily Indebted Poor Countries (HIPC) initiative, a programme that enables eligible states to benefit from a substantial reduction of debt.

7 For example, the Republic of the Congo agreed: "For reasons of sound debt management and taking into account its particularly onerous nature, the government will not contract any new oil collateralized debt." Republic of theCongo: Letter of Intent, point 7, 3 May 2002.

8 Kensington International Ltd. is an American fund specialised in buying very low-priced debts from Southern countries. As it speculates on Southern countries' debt, this fund is also called a "vulture fund."

9 "Complex pre-financing schemes were concluded, such as the $200 million Glencore/SNPC scheme with banks, whereby funds were provided to SNPC and repayment was made by the utilization of oil cargo." (§101) *Kensington International v. Republic of the Congo,* High Court of Justice, London, 28 November 2005.

10 *Kensington International Ltd v. SNPC,* Bruno Itoua, BNP Paribas S.A., U.S. District Court, Southern District of New York, March 2006.

11 Life expectancy at birth does not go beyond fifty-two, while the infant mortality rate is eighty-one percent. Source: IMF, 2005.

12 IMF, Report on the Republic of the Congo, at 39 (unpublished report) 2001.

13 See Comité catholique contre la faim et pour le développement, Biens mal acquis... profitent trop souvent. La fortune des dictateurs et les complaisances occidentales, March 2007, available at http://www.ccfd.asso.fr/ewb_pages/d/doc_1641.php.

14 This complaint questions how an important number of assets were acquired in France by Messrs. Denis Sassou Nguesso, Omar Bongo Ondimba and Téodoro Obiang, and members of their entourage. The case is still pending.

15 IMF, Republic of the Congo: Enhanced Heavily Indebted Poor Countries (HIPC), April 2006.

16 Id.

17 See Jean Merckaert, Des cadavres dans le placard : Les préfinancements pétroliers français au Congo-Brazzaville, 30 January 2007.

18 Bernard Audit, Transnational Arbitration and State Contracts (1988).

19 For example, the cause of a loan agreement is illegitimate when it is contracted to enable a wife to flee with her lover. See Cass. req., 17 April 1923 : DP 1923, jurispr. at 172.

20 CA Paris, 10 Sept. 1993 : Rev. crit. DIP 1994, at 349, note V. Heuzé ; Rev. arb. 1994, at 359, note D. Bureau ; RTD com. 1994, at 703, obs. Dubarry and Loquin.

21 The claimant, however, must bring the evidence of the unlawful nature of the end-use of the funds, which, considering the murky environment in which oil-backed loan operations take place, may be difficult to establish.

22 This option is most probably not the best one, given that the creditor will seek nullity to get its own loan repaid. Nevertheless, one may consider that it is in the interest of Congo Brazzaville to satisfy its creditors as quickly as possible.

23 Cassation. 1st civ., 27 June 1995: Defrénois 1995, art. 36210, note D. Mazeaud ; JCP E 1996, II, 772, note D. Legeais ; RTD com. 1996, at 100, note M. Cabrillac.

24 See Guy Raymond, commentary number 259, Contrats Concurrence Consommation n° 11, November 2008.

25 A loan's excessiveness is considered on a case-by-case basis, taking into account the financial standing of the borrower and the amount of the loan.

26 Loss of opportunity consists in the current and certain disappearance of a favourable contingency. See Cass. Civ. 1st 21 November 2006: Bull. civ I , n° 498.

27 See Cass. Civ. 1st, 16 July 1998: Bull. civ I , n° 260.

28 Under Article 1382 of the Civil Code : "Any action whatsoever by a man causing someone else damage binds the one by whose fault he has managed to repair it."

29 It is also possible that a Congolese creditor suffered a prejudice as a result of a breach committed by a bank. But such an action is not of interest in the context of the present discussion, as the damages awarded would be intended for this single creditor. Nevertheless, as indicated above, one may consider that it is in the interests of Congo Brazzaville to satisfy its creditors as quickly as possible.

30 One may question how the Republic of the Congo managed to reach the decision point within the enhanced HIPC initiative on March 2006. The decision point is the point at which the IMF decides that a particular country is admissible for relief and the international community commits to bringing the country's debt back to the agreed viability threshold. This happens when the country has made sufficient progress towards fulfilling certain criteria or has fulfilled them. When a country reaches the decision point, it can immediately receive provisional relief on the payable servicing of its debt. Nevertheless, to receive the full and irrevocable reduction of its debt under the HIPC Debt Initiative, the country must: (i) continue to provide evidence that it is properly executing programmes supported by the IMF (ii) satisfactorily execute the basic reforms agreed at the decision point, and (iii) adopt and execute the PRSP for at least a year. When a country has fulfilled this criteria, it may reach its completion point. Creditors must now grant it the full debt relief promised at the decision point. Source: IMF; see also, Xavier Harel, Afrique, pillage à huis clos: Comment une poignée d'initiés siphonne le pétrole africain, at 80-81 (Fayard 2006) (commenting on the role played by France in the taking of this decision).