

# The Legal Profile of Russian Eurobonds

Engineered against Speed

*Juan P. Farah Yacoub*



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## Abstract

This paper provides an overview of the Russian Federation's default history, the legal characteristics of the bonds, and potential issues for litigation should a default materialize. The paper's main argument is that although it is not impenetrable, this Eurobond stock is more protective of the debtor than that of the usual emerging market country. It achieves this through preservation of all the defenses available under current law and the presence of broad language in key provisions. For instance, clauses providing for payment in a different currency if "reasons beyond its control" stop the debtor from paying in the denomination currency have drawn attention. The paper analyzes this and other

characteristics, providing initial assessments on how the issues could play out. While the bonds' characteristics could slow progress toward obtaining judgments when compared to other sovereign debts, they do not prevent them. Collecting on the judgments would be, as usual, the harder part. Ultimately, litigation over these debts could last a long time; other creditor versus foreign sovereign episodes involving less debtor-friendly instruments have lasted 15 years, and resolution and recovery would be highly contingent on political factors. Finally, the paper provides non-lawyers a general roadmap of debt litigation against foreign sovereigns in the United States and the United Kingdom.

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# The Legal Profile of Russian Eurobonds: Engineered against Speed

Juan P. Farah Yacoub\*

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\* World Bank Chief Economist's Office; Harvard Law School JD candidate (on leave); Harvard Kennedy School MPA/ID candidate (on leave)

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## 1. Introduction

The possibility of a Russian default has headlined financial news since an array of sanctions was imposed by countries including the United States, the United Kingdom, and the European Union, in response to what the Russian Federation calls a “special military operation” in Ukraine. A default has not yet materialized, and the paper takes no view on the probability of it materializing in the coming days. But as of this writing, the clock is ticking on a 30-calendar-day grace period expiring on May 4, 2022, for the 4.5% 2022 and 5.625% 2042 bonds’ payments (US\$649 million) due April 4, 2022. In recent weeks much attention has been devoted to individual legal aspects of these bonds such as the alternative payment currency clauses. Yet, no publication has taken an integral look at these bonds’ legal profile and the context against which they must be read to consider where they come from and what comes next. This paper constitutes the first approach. Note that only prospectuses are available for review, and the paper’s analysis is based on what can be gleaned from them.

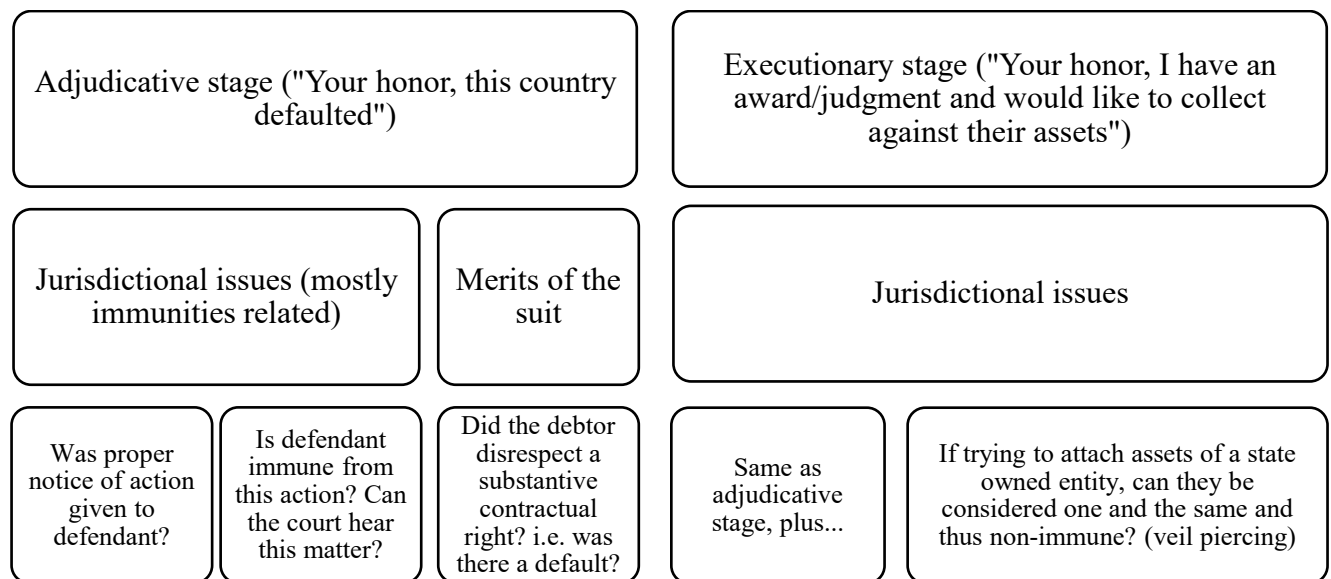
The paper considers key questions a holder of Russian Eurobonds or an interested observer may have about the issuer’s experience with default and the legal profile of these bonds. Any other debts of the sovereign are beyond the scope of the paper. Since its focus is to inform the non-lawyer audience, many of the technical details and caveats are spared or relegated to footnotes.

The task at hand is ambitious and there are many potential outcomes. Some scenarios could reduce Russian liability exposure. For example, investors in non-sanctioning countries could purchase the bonds with the option of ruble repayment, choose to receive the rubles, and even convert them to their local currency if there is a way to carry out the exchange. Russia could also find an alternative way to avoid default before the grace period ends. And, even if there is a default, litigation may develop in different directions. For example, Russia could choose to litigate only to

assert sovereign immunity (an early-stage issue) and if that is rejected, then withdraw from any further proceedings.<sup>1</sup> This could render the discussions on the subsequent sections of this paper, for example on the interpretation of alternative currency clauses, less relevant.

The scenario of default this paper examines is one in which the current grace period runs out and other creditors cross-accelerate, while Russia continues to make payments in rubles to the local securities depository. It assumes further that Russia argues its cases from beginning to end. Figure 1 presents a stylized overview of the stages and issues common in sovereign debt litigation.

Figure 1: Stylized outline of sovereign debt litigation



‘Know thy borrower’ is a key principle for creditors. Normally, that would mean analyzing the sovereign’s financial position and capacity to repay, as well as its history of defaults. In this case, this history extends over 100 years to the most recent episode, which spanned the 1990s and early 2000s.<sup>2</sup> Russia’s defaults and their resolutions are generally tied to political and geopolitical

<sup>1</sup> See e.g., *Agudas Chasidei Chabad of the United States v. Russian Federation*, Case 1:05-cv-01548-RCL, (D.D.C. 2009) (Statement from defendant Russia, withdrawing from further proceedings while asserting it does so in the interest of preserving its sovereignty).

<sup>2</sup> There seems to be misconception about Russia’s defaults. Recent financial press articles have asserted that a 2022 default would be Russia’s first foreign, or external, default in over 100 years. See e.g. [Russia stokes fears of first foreign currency default in more than a century as it attempts payment](#), CNBC, March 16, 2022; [Russia’s](#)

factors, as it is now. Like other countries, it seems to be balancing two opposing positions: First, *the country's aims dictate that it rely less on capital from abroad and it is ready to stand this ground for a long time.* Second, *the country would like foreign capital, so it will be making efforts to show its creditworthiness.* In other words, an autarkic stance competing with an integrationist stance. Russia's experience with debt issues, including lessons regarding the defensive value of time, and its gradual shift toward a more autarkic stance, seem to be reflected in the structure of its debts.

A thorough review of the prospectuses (offering circulars) of all 15 outstanding Russian Federation Eurobonds reveals that, in the aggregate, their legal profile is more protective of the debtor than other sets of emerging market Eurobonds (see table 1 on page 15 for a full overview of the bonds). The time prescribed before creditors lose their claims is short in most cases, so creditors would be likely to begin legal action sooner rather than later, if only to preserve their claim. The bonds also maintain all possible hurdles under existing sovereign immunities laws and potentially create doubt as to whether a default actually happened through broad language contained in the alternative payment currency and fiscal laws clauses. Significant changes taking place since 2014 suggests a degree of intentionality.

These characteristics are likely to increase the time spent in litigation rather than proving fatal for all claims. Remember, however, that in these situations, time can be a powerful weapon. In the past, Russia has been willing to eschew resolution for over seven decades, and upon settlement it offered no more than 10 percent of the value of the claims presented. In more recent

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[\*Default Risk Plummets After Dollar Coupon Payments\*](#), Bloomberg, March 22, 2022. [\*A Russian default looks almost inevitable\*](#), The Economist, April 6, 2022. This is likely incorrect, while the 1998 default was largely on ruble denominated instruments, many holders were external creditors – alas the LTCM debacle. Also, the same default included a relapse into default of previously restructured London Club debts denominated in USD contracted by Vneshekonombank, an instrumentality of the state charged with trade and development finance since the Soviet period.

times, it has faced creditor litigation for almost 15 years. Additionally, many of these bonds contain collective action clauses designed to mitigate potential holdout behavior in eventual restructuring negotiations – far away as they may be.

But there are factors that can complicate matters for the debtor. All the bonds can cross-accelerate if other bondholders in possession of 25 percent of the principal of one series choose to accelerate and the amount due is larger than US\$75 million. Four of the bonds are still at risk of facing holdout creditor behavior. Note, however, that a creditor, or a group of creditors, holding 25 percent of the principal for one of these bonds would have to be willing to take the risk of pursuing that strategy. Lastly, the breadth of *pari passu* clauses could also provide avenues of attack for creditors, though it is too early to tell under which scenario. The ability to collect on these debts through litigation depends on whether vulnerable *sovereign* assets can be found outside of Russia. To the extent that the only “vulnerable” assets outside Russia are not directly sovereign assets and are in fact owned by Russia’s state-owned enterprises, attachment through litigation depends on whether creditors can show that the relevant state-owned enterprises are one and the same as the Russian state (i.e. piercing the veil). But also importantly on whether the legal landscape changes in response to political factors.

The rest of the paper proceeds as follows. Section 2 provides a historical account of Russia’s previous defaults and experience with litigious creditors. Section 3 lays down a descriptive overview of the legal characteristics of current Eurobonds. Section 4 presents the assumed scenario of default to be analyzed. Section 5 explores the main potential legal issues that could arise in subsequent litigation, providing some detail on how the background legal system – U.K. or U.S. – could treat them. It is important to remark that the place where litigation is brought will depend on the contacts between each individual transaction and the place itself; for example,

where a creditor receives payment is consequential. Still, many of the issues presented would require the application of English law. Section 6 concludes, finding that several factors point towards a lengthy road to resolution.

## 2. Know thy borrower: A brief history of Russian debt and defaults

Russia is no stranger to external debt defaults and all their pains. Since the year 1900, Russia has defaulted three times on private external creditors if we consider the debts of the sovereign and its instrumentalities (i.e. the public sector at large).<sup>3</sup>

During the nineteenth century, Russia sought *to integrate* itself with Europe and was seen as one of the innovators of sovereign finance.<sup>4</sup> It was the first to issue a “Eurobond” – a security listed in multiple European exchanges – and, in the 1890s, it issued gold bonds to allow for their free and fungible circulation inside and outside Russia.<sup>5</sup> Its time as a sophisticated actor in global capital markets ended when the Soviet government repudiated all tsarist debts on January 21, 1918 and turned inward – *the autarkic stance*.<sup>6</sup> Despite numerous talks and agreements in principle, Russia only implemented solutions on the repudiated debt question in 1986 with British creditors and in 1996 with French creditors for pennies on the dollar.<sup>7</sup> In the interim, the USSR regained

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<sup>3</sup> It is worth noting that “external” default can be defined along three lines: residency of the creditor, currency of denomination, and governing law of the contracts.

<sup>4</sup> Andrey D. Ukhov, *Financial innovation and Russian government debt before 1918 (Working Paper No. 03-20)* [Electronic version]. New Haven, CT: Yale International Center for Finance, at 16-17 (2003).

<sup>5</sup> Russia also consistently monetized deficits during the nineteenth century, which though negative was also innovative for the period. It built a complex liability structure with a complete yield curve and issued domestic and foreign debt consistently. The mechanisms through which it issued bonds in foreign markets since the time of Katherine the Great became the standard for the period – placing a large loan with a finance house in a financial center which would then issue local, smaller face value bonds to investors collateralized by the Russian loan. Another notable innovation was the lottery bonds used to collect liquidity from the Russian population at large. For a complete accounting of Russia’s financial innovations prior to 1918. *See id.*

<sup>6</sup> Yulia Sinyagina-Woodruff, *Russia, Sovereign Default, Reputation and Access to Capital Markets*, *Europe-Asia Studies*, Vol. 55, No. 4, at 532 (2003).

<sup>7</sup> The resolution was in fact signed with the respective governments. With the British, the USSR agreed to forgo 5.5 tons of Nicholas II’s own gold in exchange for that government’s agreement to settle all the claims of private British holders of tsarist debt (10% of the value of claims presented). With the French, a similar agreement was reached for a measly US\$400 million (1-2% of the value of the claims presented). *Id.* at 535.



some access to small trade credits starting in 1924, scattered bilateral loans in the 1940s, and foreign commercial loans in the 1970s and 1980s.<sup>8</sup>

After the oil price collapse of 1972, USSR borrowing expanded rapidly. By the early 1990s, its total external debts were estimated to be between US\$66 billion and US\$90 billion.<sup>9</sup> Arguably, one could consider all external debt in a centrally-planned economic system to be at least constructively public.<sup>10</sup> Hence, this amount is much larger than Russia's current Eurobond stock, which sits at about US\$40 billion. In real terms, it is potentially larger than Russia's current total external debt stock (which includes private sector borrowing from foreigners): In 1992, the public debt stock sat between 2021-constant US\$117 billion and 2021-constant US\$158 billion versus US\$150 billion at the end of 2021.<sup>11</sup> This is the context for the next two defaults.

The Russian debt crises of the 1990s are still well remembered, though different authors take different views as to the dating of the default periods. Under a *substantive* definition of default, the appropriate dating for the default spells would be 1991-1995 and 1998-2000.<sup>12</sup>

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<sup>8</sup> *Id.* at 534-35; Vladimir Tikhomirov, *Russian Debt Problems in the 1990s*, Post-Soviet Affairs, 17:3, 262-284, at 262 (2001).

<sup>9</sup> James M. Boughton, *Tearing Down Walls: The International Monetary Fund 1990-1999*, International Monetary Fund (2012) at 288 for the lower bound estimate as of end 1991. Sinyagina-Woodruff (2003) p. 536 (citing A. Shokhin "Vneshii Dolg Rosii" ZAO Rasters (1997); B. Kheifets "Kreditania istoriia Rossii ot Ekateriny II do Putina" Editorial URSS (2001); V. Tikhomirov "Russian Debt Problems in the 1990s" Post-Soviet Affairs, 17-3 (2001)) for the other estimates for 1992.

<sup>10</sup> However, under the U.S. Foreign Sovereign Immunities Act of 1976 the inquiry as to whether a state-owned enterprise is an instrumentality of the government does not consider the political system. *See e.g. Edlow International Co. v. Nuklearna Elektrarna Krsko*, 441 F.Supp. 827, 831-832 (D.D.C. 1977). In that contemporaneous case the plaintiff sued a Yugoslav "workers' organization" for breach of contract. The court found *Nuklearna* to be legally separate from the Yugoslavian state and thus found itself lacking jurisdiction despite existing within a de jure socialist regime. *See* Joseph W. Dellapenna, *Suing Foreign Governments and Their Corporations: Sovereign Immunity (part 1)*, 85 Com. L.J. 167, at 171 (1980). In *Nuklearna*, however, the court's decision left room to draw a distinction between a socialist government like that of former Yugoslavia and a command economy like that of the former USSR, since the government of Yugoslavia provided no subsidies and was not involved in the management of the company. *See id.*

<sup>11</sup> End of 2021 total external debt stock statistics from the Central Bank of Russia using a residency definition for "external." Real terms adjustment performed by the author using the [US GDP deflator retrieved from FRED](#).

<sup>12</sup> Julianne Ams et al., *Sovereign Debt: A Guide for Economists and Practitioners*, Chapter 7: *Sovereign Default*, at 3 (explaining the different definitions of sovereign default).

In 1991 the Soviet Union disintegrated, Russia was facing a political crisis, and discussions on debt succession among former Soviet republics were in full swing since the prior year.<sup>13</sup> At the end of that year Russia held only US\$2.25 billion in net reserves against roughly 30 times as much debt.<sup>14</sup> In November 1991, Vneshekonombank declared insolvency, which largely affected debts incurred against the London Club of creditors.<sup>15</sup> In December 1991, Russia started debt restructuring talks with private creditors and postponing commercial debt repayments through a series of three-month deferrals that lasted until 1995, when it commenced goodwill payments into an escrow account pending final agreement with the London Club.<sup>16</sup> This behavior is evidence of Russia's willingness to engage constructively with creditors at the time – *the integrationist stance*. At this point, though there was no final agreement, the agreement in principle, consistent payments into escrow, and access to market in 1996 provide sufficient bases to consider the default resolved.

The third default is fresh in the memories of many.<sup>17</sup> In August 1998, Russia defaulted on short- and medium-term domestic-currency debts (commonly known as OFZs and GKO) and announced a 3-month moratorium of foreign commercial debt.<sup>18</sup> It stopped servicing the London and Paris Clubs obligations and principal on the third MinFin (domestic USD-denominated bond)

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<sup>13</sup> Tikhomirov, note 8 *supra*.

<sup>14</sup> Boughton, note 9 *supra*, at 288.

<sup>15</sup> Signyanina-Woodruff, note 6 *supra*, at 537. Vneshekonombank was the foreign trade bank of the USSR and thus one of the limited financial gateways traversing the Iron Curtain. The London Club is a group of banks which during the XX c. was very active in lending to sovereigns via syndicated loans.

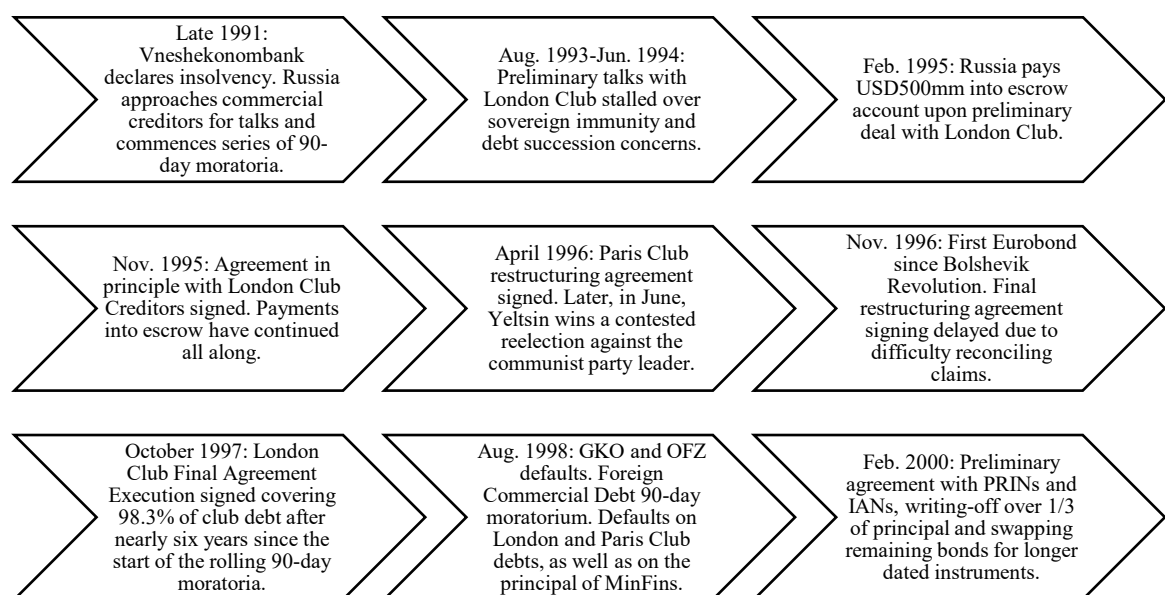
<sup>16</sup> See generally Tikhomirov (2001), note 8 *supra*; Signyanina-Woodruff (2003), note 6 *supra*; Boughton (2012), note 10 *supra*. See also The Financial Times (August 4, 1993) "Russia Secures Limited Debt Restructuring;" Reuters News (June 24, 1994) "Russian bank debt rollover seen but no talks soon;" The Financial Times (November 17, 1995) "Pact with Western Banks to Reschedule \$32.5Bn;" The Wall Street Journal (November 13, 1996) "Russia's Debt Deal with London Club is Delayed" (chronicling the saga of failed restructuring attempts over these years).

<sup>17</sup> The Financial Times (Aug. 24, 1998) "Stakes high in talks to restructure debt;" The Wall Street Journal (Dec. 31, 1998) "Moscow is Declared in Default on Debt."

<sup>18</sup> Signyanina-Woodruff, note 6 *supra*, at 537. Note that even the default on domestic debts could be considered a default on private external creditors, since about a third of GKO was held by nonresidents. Boughton, note 9 *supra*, at 322 fn. 100.

issue shortly after, while continuing to service other MinFins and Eurobonds.<sup>19</sup> In 2000, the London Club principal and interest-in-arrears notes (PRINs and IANs) and MinFin obligations in arrears were restructured, with haircuts estimated around 50%.<sup>20</sup> These restructurings substantially resolved Russia's default and two of the bonds from that time are extant today: The 12.75% 2028 bond and the 2030 step-up note (currently 7.5%) issued as part of the London Club (PRINs and IANs) restructuring.<sup>21</sup> Figure 2 summarizes these previous debt crises.

Figure 2: Stylized timeline of Russian Debt Crises 1991-2000



Sources: Tikhomirov (2001); Signyanina-Woodruff (2003); J.M. Boughton (2012) at 314-15

Still, the restructurings in 2000 did not mark the end of Russia's debt difficulties. Scattered restructurings and litigation with holdouts and other creditors continued until 2009.<sup>22</sup> One recent

<sup>19</sup> Signyanina-Woodruff, note 6 *supra*, at 537; Reuters "Russia Defaults on Soviet era Debt" Dec. 30, 1998. MinFins are local USD denominated securities of longer tenor, the first few issues were given to former holders of defaulted Vneshekonombank obligations. The remainder of the London Club restructured debts took the form of bonds called PRINs (Principal notes) and IANs (Interest arrears notes) under the 1997 deal.

<sup>20</sup> *All friends now*, The Economist (Feb. 17, 2000); Juan J. Cruces & Christoph Trebesch, *Sovereign Defaults: The Price of Haircuts*, American Economic Journal (database 2014u).

<sup>21</sup> Prospectus for the Russian Federation US\$ 907,788,786 Bonds due 31 March 2007 to 31 March 2030.

<sup>22</sup> Prospectus for the Russian Federation EUR 750,000,000 1.125 percent bonds due 2027 and the Russian Federation EUR 1,250,000,000 1.85 percent bonds due 2032 (issued 2020), at 206-07.

litigation experience embodies some of the most salient lessons reflected in the legal structure of current Eurobonds.

Ten years before Elliott Management's saga with Argentina, there was the Noga litigation episode with Russia.<sup>23</sup> The Swiss firm signed a deal with the Russian government in 1991 to export goods like medicine and pesticide in exchange for oil.<sup>24</sup> The contracts contained a waiver of sovereign immunity and a forced arbitration clause.<sup>25</sup> This is important because it allowed for faster access to court adjudication, and arbitration award enforcement actions generally enjoy weaker immunity defenses from both suit and attachment.<sup>26</sup> After the deal fell apart, Noga began legal actions across Europe in 1993, claiming a loss of approximately US\$100 million.<sup>27</sup> In 1993-94 Noga assigned portions of the proceeds for its receivables from the Russian government to the banks that financed the initial deal.<sup>28</sup> In 1996 Noga filed for bankruptcy, which committed the rest of its claims on Russia to the same creditors.<sup>29</sup> These banks agreed to finance the costs of the arbitration proceedings and established a collection mandate for Noga in the final bankruptcy compact.<sup>30</sup> An arbitral award was obtained in 1997.<sup>31</sup> The supplier, at the time reduced to a collection shell, found myriad ways to pressure Russia for restitution through legal actions: frozen bank accounts in Switzerland and Luxembourg; and threats of seizure for goods as varied as the

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<sup>23</sup> See R. Merle, [How one Hedge Fund made \\$2 billion from Argentina's Economic Collapse](#), The Washington Post, March 26, 2016; Robert W. Kolb, *Sovereign Debt: From Safety to Default*, John Wiley & Sons, Inc. (2011) at 10-11.

<sup>24</sup> *Id.* at 11; Memorandum Order S.D.N.Y. 00 Civ. 0632 at 3, Aug. 15, 2008. Note that the initial deal was signed with the Government of the Federative Socialist Soviet Republic of Russia, a predecessor of the Government of the Russian Federation. In defending against Noga's quest for restitution, Russia attempted to differentiate between "the Government" and "the Russian Federation" arguing that under the Russian constitution they were separate legal entities. The Second Circuit rejected that argument in *Compagnie Noga D'Importation et D'Exportation S.A. v. The Russian Federation*, 361 F.3d 676, 685 (2d Cir. 2004).

<sup>25</sup> *Compagnie Noga D'Importation et D'Exportation*, 361 F.3d 676, 677-680 (2d Cir. 2004).

<sup>26</sup> See e.g., 28 U.S.C. Sec. 1610(a)(6); State Immunities Act of 1978 (UK) Sec. 9, Sec. 13(4)(b).

<sup>27</sup> Kolb, *supra* note 23, at 11.

<sup>28</sup> Memorandum Order S.D.N.Y. 00 Civ. 0632 at 3, Aug. 15, 2008.

<sup>29</sup> *Id.* at 4

<sup>30</sup> *Id.*

<sup>31</sup> *Compagnie Noga D'Importation et D'Exportation*, 361 F.3d 676, 677-680 (2d Cir. 2004).

presidential airplane in France, art scheduled to go on exhibit in Belgium, and even nuclear warheads to be sent to the US for reprocessing.<sup>32</sup> But the temporary impounding of the tall ship *Sedov* in France in 2000 is perhaps the most emblematic parallel to the Argentinean saga; with the impounding of that country's tall ship, *Libertad*, happening 12 years later.<sup>33</sup>

The Federal Court for the Southern District of New York dismissed the award enforcement claim after the assignee banks sold their claims on the award to IPD Capital Inc., which revoked Noga's collection mandate in February 2006.<sup>34</sup> Additionally, the value of the claims on the awards owed by Noga to the assignees exceeded the amount of the award itself.<sup>35</sup> Without a collection mandate from its new creditor or any remaining monetary interest in the award, Noga could not continue its action.<sup>36</sup> IPD then sold all interests in the award to Vneshekonombank in 2007, which sold it to the Russian Ministry of Finance. More than 15 years later, Russia had completed a sort of pinball repurchase though it is unclear at what price.<sup>37</sup> Despite the effect of immunity waivers and treatment of arbitral awards, which allowed for more direct access to courts, it was Russia's ability to defend itself for longer than its creditors could pursue it that enabled it to protect its assets.

All of Russia's defaults happened during times of heightened national and international political tension. A default now would echo this observation from an international standpoint. The sovereign's behavior was also radically different in 1918 and the 1990s. This is ostensibly because Soviet Russia sought to veer away from the Western established order in the early twentieth century, while the Russian Federation was concerned with reintegrating in the 1990s. It would also

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<sup>32</sup> Kolb, *supra* note 23, at 11.

<sup>33</sup> Kolb, *supra* note 23, at 11; Merle, *supra* note 23.

<sup>34</sup> Memorandum Order 00 Civ. 0632, at 6 (S.D.N.Y. Aug. 15, 2008).

<sup>35</sup> *Id.* at 11.

<sup>36</sup> *Id.* at 11. More specifically, Noga lost its standing in the suit.

<sup>37</sup> *Id.* at 6.

be fair to assume that Russian debt management officers drew some lessons from the 1990s crisis. For example, time is a valuable ally to a sovereign debtor and, relatedly, that it can buy more time by maintaining the ability to use sovereign immunity defenses to their maximum extent. These lessons are reflected in Russia's liability structure today.

### 3. Russia's current Eurobond stock: Engineered against speed

Russia's US\$40 billion Eurobond stock is generally debtor-friendly. In particular, issuances since 2014 shift more of the risk to creditors. Key changes took place starting in 2014. Bonds started including alternative currency clauses (ACCs) and the newest vintage of collective action clauses (CACs). The latter change is unsurprising given that fourth generation CACs entered the scene in 2014 and have been promoted since then as the desired market standard.<sup>38</sup> But the innovation in bringing ACCs to the fore suggests a degree of intentionality in this defensive design. Table 1 presents a detailed overview.

Two additional factors not presented in the table: Since 2014, all Eurobonds were underwritten exclusively by Russian state-owned banks (VTB, Sberbank, and Gazprombank). Normally, the underwriters appoint all lawyers drafting the documents. There may be implications to a state-owned bank underwriting its owner's bonds, and the topic is perhaps best left to a separate study. But it suffices to highlight that this is a noticeable fact that may garner attention from studious observers. Additionally, the disclosures started explaining that the sovereign would treat the National Settlement Depository (NSD) – the central securities depository of Russia and local clearing agent – as the registered holder of the bonds and disclaimed responsibility for its payment and other practices. This is a key risk, but one that is difficult to untangle without the fiscal agency agreements.

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<sup>38</sup> See IMF, *The International Architecture for resolving Sovereign Debt involving private-sector creditors – Recent developments, challenges, and reform options*, International Monetary Fund, at 30 (2020).

The move towards more debtor-friendly contractual structures probably reflects three interrelated factors: Russia's aim to build a "financial fortress" to limit its dependence on foreign capital, the view that geopolitics demand it, and the lessons learned from its recent debt crises.<sup>39</sup> The geopolitical aspect is reflected in the "risk factors" sections for all bonds issued since 2014, stating that "[d]ifferences of views between the Russian Federation and certain other countries (including the United States and Member States of the EU) regarding events in Ukraine have resulted in ... [the mutual imposition] of economic sanctions."<sup>40</sup> They also address sanctions regimes and the risk of their expansion in more detail, in particular with respect to sovereign debt.<sup>41</sup>

The debt stock's contractual features seem to be designed to slow down progress towards recovery. The main aggregate characteristics working in favor of the debtor sovereign are:

- (1) short prescription clauses (13 of 15 bonds), which establish the time creditors have before the claim is voided;
- (2) the lack of appointment of an agent to receive service (all bonds), which complicates serving Russia with suit;
- (3) the explicit rejection to waive sovereign immunity (all bonds), which preserves defenses in establishing jurisdiction to the maximum extent allowed by applicable law;
- (4) alternative payment currency clauses (9 of 15 bonds), which, under the assumed default scenario, potentially introduce controversy over whether there is a default for a number of bonds;

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<sup>39</sup> See [Fortress Russia: Russia's economy is isolated from the global rout](#), The Economist (March 25, 2020); [Isolating Russia: How new sanctions could cripple Russia's economy](#) The Economist (February 27, 2022); Signyanina-Woodruff, note 6 *supra*, 531 (pointing out that leaders as different as Peter the Great and Stalin "had similar attitudes" on this matter).

<sup>40</sup> See, e.g., Prospectus for the EUR 500,000,000 1.125 percent bonds due 2027 and the EUR 1,000,000,000 2.65 percent bonds due 2036 at 11.

<sup>41</sup> See, e.g., Prospectus for the EUR 500,000,000 1.125 percent bonds due 2027 and the EUR 1,000,000,000 2.65 percent bonds due 2036 at 13. Additionally, the disclosures under the header "The Russian Federation, the Former Soviet Union and the CIS" describe the litany of problems between Russia and Ukraine since at least 2014. *Id* at 98-101.

- (5) broad clauses on the applicability of “[a]ny ... fiscal laws or other laws and regulations” (all bonds), which may also introduce controversy about the occurrence of default and the governing law; and
- (6) collective action clauses capable of aggregation across series (11 of 15 bonds), which deter holdout behavior.

Most of these clauses work to delay each step of a potential recovery by preserving issues for litigation. Meanwhile, the main aggregate characteristics working in favor of creditors are:

- (1) cross-acceleration clauses for amounts in default over US\$75 million (all bonds), which enable creditors to call the payments on their bonds if another one is accelerated;
- (2) broad *pari passu* clauses (all bonds), which establish the same level of seniority with all other unsecured debts and have caused freezes on other payments in the past; and
- (3) clauses designating English law to govern the agreements (all bonds), which probably provides better protection for creditors than the Sovereign’s own laws.

All of these characteristics, as well as some salient interactions and potential contradictions between them, are discussed in section 5 below.

These defensive features are not uniform across all bond issues. The oldest bonds – the 12.75% 2028 and the 7.5% 2030 – preserve some of the same defenses and potential controversies as the more recent issuances. But they contain longer prescription clauses and it is highly unlikely that they contain collective action clauses capable of aggregation.<sup>42</sup> The 4.5% 2022 and 5.625% 2042 bonds contain the shorter prescription clauses, but their collective action clauses are also incapable of aggregation. The most important gap, however, is the one currently at play:

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<sup>42</sup> The prospectuses for these bonds seem to only contain language specifying the quorum necessary in a meeting with the purpose of amending reserved matters. However, ambiguities in the language could mean that they contain first generation CACs with thresholds set at 75% of outstanding principal. The manner in which reserved matters (those which are economically material) changes would take place is likely to be specified in the fiscal agency agreement to which I have no access. It is likely that the threshold for these modifications is also 75% of outstanding principal in attendance of the meeting. However, CAC’s capable of cross-series aggregation do not enter the arena until much later and the risk of modification via cross-series aggregation would have been disclosed in the prospectus. See note 123 *infra*.



accelerated payment on one bond can become an accelerated payment for all bonds. Of course, it is possible on a bond-by-bond basis that if payment in rubles is appropriate, these accelerated payments could be discharged in rubles. But some controversy is likely to remain as to that appropriateness.

Table 1. Legal Characteristics of the Russian Eurobond Stock

Shorthand	Issue Date	Nearest payment	Curr.	Immunity Waiver	Service of Process	Exchange	Alt. Currency Clause	Pari Passu	Grace Period	Cross-Acceleration	Prescription	CAC	IMF Eligibility EoD	Fiscal Laws on Payments
12.75% - 2028	6/24/1998	6/24/2022	USD	No, explicitly rebuffed	No	London	No	Classic	15 business days	US\$75mm	10y principal/ 5y interest	Unclear, but no later than 1st Gen.	Yes	"Any applicable fiscal or other laws and regulations"
7.5% - 2030	8/25/2000	3/31/2022*	USD	No, explicitly rebuffed	No	Irish	No	Classic	15 business days	US\$75mm	10y principal/ 5y interest	Unclear, but no later than 1st Gen.	Yes	"Any applicable fiscal or other laws and regulations"
5.625% - 2042	4/4/2012	4/4/2022*	USD	No, explicitly rebuffed	No	Irish	No	Classic	30 calendar days	US\$75mm	3y principal/ 3y interest	1st Gen.	No	"Any applicable fiscal or other laws and regulations"
4.5% - 2022	4/4/2012	4/4/2022*	USD	No, explicitly rebuffed	No	Irish	No	Classic	30 calendar days	US\$75mm	3y principal/ 3y interest	1st Gen.	No	"Any applicable fiscal or other laws and regulations"
4.875% - 2023	9/16/2013	3/16/2022*	USD	No, explicitly rebuffed	No	London	No	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	3rd Gen.	No	"Any applicable fiscal or other laws and regulations"
5.875% - 2043	9/16/2013	3/16/2022*	USD	No, explicitly rebuffed	No	London	No	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	3rd Gen.	No	"Any applicable fiscal or other laws and regulations"
4.75% - 2026	5/27/2016	5/27/2022	USD	No, explicitly rebuffed	No	Luxembourg	Yes	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"
4.25% - 2027	6/23/2017	6/23/2022	USD	No, explicitly rebuffed	No	Irish	Yes	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"
5.25% - 2047	6/23/2017	6/23/2022	USD	No, explicitly rebuffed	No	Luxembourg	Yes	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"
4.375% - 2029	3/21/2018	3/21/2022*	USD	No, explicitly rebuffed	No	London	Yes, RUB	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"
2.875% - 2025	12/4/2018	12/4/2022	EUR	No, explicitly rebuffed	No	Irish	Yes, RUB	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"
5.1% - 2035	3/28/2019	3/28/2022*	USD	No, explicitly rebuffed	No	Irish	Yes, RUB	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"
1.85% - 2032	11/20/2020	11/20/2022	EUR	No, explicitly rebuffed	No	Irish	Yes, RUB	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"
1.125% - 2027	11/20/2020	11/20/2022	EUR	No, explicitly rebuffed	No	Irish	Yes, RUB	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"
2.65% - 2036	5/27/2021	5/27/2022	EUR	No, explicitly rebuffed	No	Irish	Yes, RUB	Tweaked	30 calendar days	US\$75mm	3y principal/ 3y interest	4th Gen.	No	"Any applicable fiscal or other laws and regulations"

#### 4. The hypothetical default scenario for analysis

Until recently, the U.S. sanctions regime maintained general license 9A as an avenue to service debts contracted by the Russian government before March 1, 2022. On April 6, 2022, it was superseded by general license 9B, and, on the following day by general license 9C.<sup>43</sup> The change foreclosed the possibility of debt service payments flowing directly from accounts in the name of Russian entities through U.S. financial institutions, which include the financial institutions' foreign subsidiaries, but still allows creditors to receive them. It expires on May 25, 2022. In the U.K., general license INT/2022/1495176 allows financial institutions to perform “any activity reasonably necessary” to effect debt service payments of non-ruble securities issued by Russia until June 30, 2022.<sup>44</sup>

The Russian Ministry of Finance has stated that it considers its obligations paid in full with the transfer of the amount in rubles to the NSD.<sup>45</sup> It seems possible for Russia to re-route payment through other institutions, maybe even including U.K. ones, and for bondholders to receive payment in the bonds' currency of denomination. But, unlike in prior weeks, when Russia was able to use otherwise frozen reserves to at least avert default; the new regulations forced it to choose between uses for declining hard currency reserves.

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<sup>43</sup> See [Russian Harmful Foreign Activities Sanctions](#); Russian Harmful Foreign Activities Sanctions [General License 9C](#). The only apparent change between general licenses 9B and 9C was the addition of notes to paragraph (1). In practice, the material changes to Russia's ability to pay using U.S. financial institutions initially stemmed from 9B.

<sup>44</sup> See [OFSI General Licenses](#); [General Licence INT/2022/1495176](#).

<sup>45</sup> See Morgan Lewis Lawflash, [Update: Russia Adopts Decree on Repayment in Russian Rubles of Debt to Foreign Creditors](#) (March 7, 2022); Harry Robertson, [Russia says it sent \\$650 million bond payment in rubles after US Treasury blocked dollar transfers](#), Yahoo Finance (Apr. 6, 2022); Prospectus for the EUR 500,000,000 1.125 percent bonds due 2027 and EUR 1,000,000,000 2.65 percent bonds due 2036, at 195-96 (2021) (Explaining the status of NSD as the central depository).

Still, Russia has maintained its position to pay in rubles.<sup>46</sup> Therefore, the default scenario assumed for this analysis is one in which the payments missed on April 4<sup>th</sup> triggers the initial default on May 4<sup>th</sup>, provided that creditors holding  $\frac{1}{4}$  of the outstanding principal choose to accelerate. Meanwhile, Russia is assumed to continue making payments in rubles on all bonds in order to maintain an argument on the merits of the default which could relate to both the alternative currency clauses and fiscal laws clauses.<sup>47</sup> From the vantage point of creditors, the event of default would be unequivocal – a missed payment.<sup>48</sup> From the debtor’s point of view, it is making payments, presumably in accordance with its own law.<sup>49</sup>

One caveat here is that fiscal agency agreements are only available for physical, on site, inspection and without them it is hard to ascertain if the operational payment risks are shifted from their common stance. Discharge of the obligations could happen with receipt of funds by the paying agent or another intermediary, notably in this case NSD in Russia, or when the creditor or their trustee receives them; the latter being the traditional setting. Upon acceleration, other bondholders would be able to cross-accelerate since the amount in default exceeds US\$75 million and the bonds in default are not part of excluded indebtedness under the prospectuses’ definitions. This scenario is fertile ground for litigation.

## 5. Potential legal issues

Given the short time allowed in the prescription clauses, most bondholders would probably find it advantageous to begin legal action. If they choose to wait too long, they risk losing their claim. Moreover, factors beyond the legal structure of the bonds would probably incentivize this

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<sup>46</sup> See Eshe Nelson, *S&P Global Places Russia in ‘Selective Default’*, The New York Times (Apr. 10, 2022) (“[T]he finance ministry said it considered its debt obligations to have been fulfilled ‘in full’” with ruble payment).

<sup>47</sup> “On the merits” here is just lawyer-language for “whether default actually happened.”

<sup>48</sup> Nelson, note 46 *supra*.

<sup>49</sup> *Id.*; Morgan Lewis, note 45 *supra*.

decision. Many creditors fear Russia could be excluded from the Western financial system for a long time and the international relations context for a default now would be more similar to the 1918 repudiation than it is to the 1990s debt crises. Consequently, a restructuring could be significantly delayed.

The bonds themselves provide the best summary for the contents of this section. In the prospectuses, the “no waiver of immunity” language, or similar, makes repeated appearances:

“The Russian Federation is a sovereign state and has not waived any rights to sovereign immunity it may have in any jurisdiction. Accordingly, the Russian Federation may be entitled to immunity from suit in any action or proceeding in any jurisdiction arising out of the Bonds, and the Russian Federation and its assets, properties and revenues may be entitled to immunity in any related enforcement action. The Russian Federation also has not submitted to the jurisdiction of any court, agreed that any disputes may be resolved in any forum or appointed any agent for service of process in any jurisdiction, in connection with any action or proceeding arising out of the Bonds. As a result of the foregoing, *it may be difficult or impossible for an investor to obtain a judgment against the Russian Federation in a foreign court and/or have such judgment recognised and/or enforced in any jurisdiction.*”<sup>50</sup>

This underscores the difficulties of recovery when facing sovereigns.<sup>51</sup> Still it happens – though it is worth remarking that judgments and enforcement actions most commonly serve as tools to strengthen restructuring negotiation positions.<sup>52</sup>

Legal actions could happen in many jurisdictions, but initial suits seeking judgments arising directly out of the bonds are likely to take place in England (the adjudicative stage). If

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<sup>50</sup> Prospectus for the EUR 500,000,000 1.125 percent bonds due 2027 and EUR 1,000,000,000 2.65 percent bonds due 2036, at 21 (2021) (emphasis added).

<sup>51</sup> If any creditor assumed collecting on sovereigns was easy, a long reading list would be prescribed. See e.g. Carmen M. Reinhart & Kenneth Rogoff, *This Time is Different*, Princeton University Press (2009), Juan J. Cruces & Christoph Trebesch, *Sovereign Default: The Price of Haircuts*, American Economic Journal: Macroeconomics, 5:3 (July 2013), Josefin Meyer, Carmen M. Reinhart & Christoph Trebesch, *Sovereign Bonds since Waterloo*, The Quarterly Journal of Economics (January 2022), among others.

<sup>52</sup> Filbert Lam, *Have the Rules Governing the Interpretation of Pari Passu Clauses in Sovereign Bonds Developed in Equal Step under English and New York Law*, 2019 Sing. Comp. L. Rev. 86, at 87 (2019) citing (Lee C. Buchheit and Elena L. Daly, *Minimizing Holdout Creditor: Carrots*, in Rosa M. Lastra and Lee C. Buchheit (eds), *Sovereign Debt Management*, Oxford University Press (2014))

payments are received in the United States, federal courts could establish jurisdiction. Eventual enforcement suits, which are related to, but not arising directly from, the bond contracts, could take place in diverse jurisdictions depending on the presence of assets, the ability to enforce judgments, and sovereign immunity laws (the execution or enforcement stage). This section tries to highlight potential controversies in the order in which they are likely to appear for suits in the U.S. and U.K.

a. Getting Russia *into* court: Jurisdictional considerations

There are two main issues to deal with here: serving the suit on the debtor and establishing jurisdiction (i.e. showing that the court can hear and adjudicate the suit). Russian Eurobond contracts do not appoint an agent to receive service in case of a dispute, nor submit to the jurisdiction of a court. But these issues are surmountable. The lack of an immunity waiver does not make Russia impervious to suits, as there are mechanisms under the laws of both the U.S. and the U.K. to serve and sue a foreign sovereign.<sup>53</sup>

i. Service of process

The U.S. Foreign Sovereign Immunities Act lays down two procedures that could be used here.<sup>54</sup> First, a creditor can send the summons, complaint and notice of suit with translations to the head of the debtor's ministry of foreign affairs via mail requiring a signed receipt.<sup>55</sup> The U.S. Supreme Court recently confirmed the appropriateness of this procedure.<sup>56</sup> If that method does not

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<sup>53</sup> Cf. *contra* J. Newman, [\*If Putin Owes You Money, Good Luck Collecting It\*](#), The Wall Street Journal, March 9, 2022. See Foreign Sovereign Immunities Act (1976) for the U.S. and State Immunity Act of 1978 for the U.K.

<sup>54</sup> 28 U.S.C. Sec. 1608(a)(3).

<sup>55</sup> 28 U.S.C. Sec. 1608(a)(3).

<sup>56</sup> *Republic of Sudan v. Harrison*, 139 S. Ct. 357 (2019).

yield a receipt within 30 days, the same documents can be sent through the U.S. State Department.<sup>57</sup>

The U.K. State Immunity Act of 1978 directly requires service through the U.K. Foreign, Commonwealth and Development Office (FCDO) and deems the foreign government served once documents are received in the ministry.<sup>58</sup> A recent U.K. Supreme Court decision confirmed that service must be performed through the FCDO unless another method of service was pre-agreed in the contract.<sup>59</sup> As remarked earlier, no method was pre-agreed to in these bonds.

Russia could still challenge the appropriateness of service (perhaps after temporarily ignoring it). This could cause delays, but serving the Russian Federation is possible and it is unlikely that a suit would be dismissed if the procedures set above were followed.

## ii. Jurisdiction

Assume next that Russia appeared in court and its challenges to the appropriateness of service have been resolved. All of Russia's bonds contain clauses rebuffing any waiver of immunity (see the above block quote on p. 18).<sup>60</sup> Versions of this language, whether as an explicit denial or part of the risk factors, are common, and they place hurdles by preserving defenses when compared to sovereigns making some concessions related to service, forum and jurisdiction. But these clauses do not preclude a creditor from suing.<sup>61</sup>

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<sup>57</sup> 28 U.S.C. Sec. 1608(a)(4).

<sup>58</sup> State Immunity Act of 1978 Sec. 12(1).

<sup>59</sup> *General Dynamics United Kingdom Ltd v. State of Libya* (2021) UKSC 22 at 37, 96.

<sup>60</sup> Prospectus, note 50 *supra*.

<sup>61</sup> Mitu Gulati & Mark C. Weidemaier, [Are Russian Sovereign Bonds Now Worthless?](#), Credit Slips (blog post, March 7, 2022).

Both the U.S. and U.K. accord restrictive immunity to sovereigns.<sup>62</sup> That means foreign sovereigns are presumed immune unless the activity for which they are being sued falls under one of the exceptions to immunity. Both sets of laws contain exceptions to immunity for commercial activities.<sup>63</sup> With respect to sovereign borrowing, they often yield the same result: The foreign state is not immune from suit.

Going back to the prospectuses, it seems a counterexample would be useful in this instance. Language stating that the debtor will submit to the jurisdiction of a court such as: “[Papua New Guinea will] irrevocably submit to the jurisdiction of any New York State or U.S. federal court in the Borough of Manhattan, the City of New York, and any appellate court thereof,”<sup>64</sup> should not be misunderstood for a full waiver of immunity. Those clauses are more akin to forum selection clauses and what they waive are arguments as to the court’s personal jurisdiction over the debtor-defendant in a potential suit arising from the bonds.<sup>65</sup>

Sovereign immunity is a defense a foreign nation can raise. For example, the same Papua New Guinea prospectus continues: “[Papua New Guinea] will reserve the right to plead sovereign immunity under the U.S. [FSIA] with respect to actions brought against it under United States of America ... laws ... In the absence of a waiver of immunity by the Government with respect to such actions, it would not be possible to obtain a [U.S.] judgment in such an action unless a court were to determine that the Government is not entitled to sovereign immunity under the U.S. [FSIA] with

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<sup>62</sup> See Mitu Gulati & Mark C. Weidemaier, *Differing Perceptions? Market Practice and the Evolution of Foreign Sovereign Immunity*, Duke Law School Public Law & Legal Theory Series No. 2016-21, at 11. See also, Dellapenna, note 10 *supra*, at 167-68; Mary Kay Kane, *Suing Foreign Sovereigns: A Procedural Compass*, 34 Stan. L. Rev. 385, at 385-86 (1982).

<sup>63</sup> See 28 U.S.C. Sec. 1603; State Immunities Act of 1978 Sec. 3.

<sup>64</sup> Prospectus for Papua New Guinea’s 2018 issue of US\$500mm 8.75% notes due 2028.

<sup>65</sup> I will spare the reader the Civil Procedure class. It is only necessary to know here that Personal Jurisdiction has to do with whether a court is sufficiently related to the defendant and the matter at hand to adjudge it, and Subject Matter Jurisdiction has to do with the type of matter the court can hear.



respect to that action.” In other words, the language in Russian Eurobonds simply states the law. It does not increase the level of protection accorded by default to a sovereign.

In the U.S. the FSIA is the sole conduit to assert jurisdiction over a foreign sovereign.<sup>66</sup> Generally, the creditor-plaintiff will have to demonstrate that the activity for which they are suing is commercial in nature.<sup>67</sup> The inquiry about the nature of the action falls to the courts, but unsurprisingly borrowing money normally qualifies.<sup>68</sup> If no clause submitting the debtor to the jurisdiction of a particular court exists, then the creditor-plaintiff would need to show that the activity and matter at hand have sufficient contact with the venue or a direct effect there.<sup>69</sup> Russia would likely to raise this issue, arguing that the controversy does not have sufficient contacts with the U.S. jurisdiction in which it is being brought. Marketing activities for the bonds, payments, and subsequent visits to creditors (roadshows) could be sufficient evidence under U.S. law.<sup>70</sup>

The U.K. statute yields the same result but takes a shortcut that avoids court interpretation for the term “commercial transactions” in the case of sovereign debt. Unlike the

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<sup>66</sup> *Argentine Republic v. Amerada Hess Shipping Corp.*, 488 U.S. 428, 434-35 (citing *Verlinden B.V. v. Central Bank of Nigeria*, 461 U.S. 480, 493 (1983)).

<sup>67</sup> See, 28 U.S.C. Sec. 1603(d) (“A ‘commercial activity’ means either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose”); see also *Republic of Argentina v. Weltover, Inc.*, 504 U.S. 607, 614 (“A foreign state engaging in ‘commercial’ activities ‘do[es] not exercise powers peculiar to sovereigns’; rather, it ‘exercise[s] only those powers that can also be exercised by private citizens’” citing *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682, 704)).

<sup>68</sup> See e.g., Bruce W. Nichols, *The Impact of the Foreign Sovereign Immunities Act on the Enforcement of Lender's Remedies*, 1982 U. Ill. L. Rev. 253, 255 (1982) (explaining that the congressional history makes it clear that contracting and repayment of sovereign indebtedness are to be regarded as commercial acts under the FSIA). See also, *Shapiro v. Republic of Bolivia*, 930 F. 2d 1013, 1018 (2d Cir. 1991).

<sup>69</sup> See 28 U.S.C. Sec. 1391(f); Kane, *supra* note 62, at 396 (explaining that some notion of minimum contacts still exists even when bringing suit under the FSIA, though there is some ambiguity as to the contacts are with the U.S. or the venue in particular). See also, *SerVaas Inc. v. Republic of Iraq*, 686 F. Supp. 2d 346, 356 (S.D.N.Y. 2010); *Capital Ventures Int'l v. Republic of Argentina*, 552 F.3d 289, 293 (2d Cir. 2009).

<sup>70</sup> *Republic of Argentina v. Weltover, Inc.*, 504 U.S. 607, 618-19 (explaining that New York being designated by some creditors as the place of payment and payments having been effectuated there meets the criteria for a direct effect).

U.S. statute, it practically spells out that suits related to sovereign borrowings serviced “wholly or partly in the United Kingdom” are not immune.<sup>71</sup> Four of the bonds are listed in London and the servicing structures flow through the same city for many of the other bonds, though creditors may generally elect to receive payments in other places such as New York. Additionally, in the U.S. the defense of *forum non-conveniens* (i.e. this court is less convenient than another one) would still be available to Russia at this stage.<sup>72</sup> Ultimately, obtaining jurisdiction in the U.K. should be possible and perhaps easier than in the U.S. The place would ultimately be contingent on the specific creditor and where the center of gravity is for the transactions.

b. The merits of the default claim

By paying in rubles, presumably in accordance with Russian law, and the presence of some sufficiently ambiguous language in the contracts, Russia may have opened the door to controversies as to whether it legally defaulted – i.e. the merits of the suit. This door is usually locked in cases arising from sovereign bonds. But before analyzing some of the issues, a few words on choice-of-law are warranted.

All the bonds contain choice-of-law provisions indicating they are governed by English law. Under U.S. law, these clauses are presumed valid and can only be ignored by showing that they stem from fraud, violate public policy, or deprive the plaintiff from his day in court.<sup>73</sup> It is hard to see any of these exceptions applying. That the law chosen is that of another sovereign is

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<sup>71</sup> State Immunities Act of 1978 Sec. 3(1).

<sup>72</sup> See *Verlinden B. V. v. Central Bank of Nigeria*, 461 U.S. 480, 490 footnote 15 (Expressing the Court’s view that the FSIA does not affect traditional doctrine of *forum non-conveniens*).

<sup>73</sup> *Mitsui & Co. (USA), Inc. v. Mira M/V*, 111 F.3d 33, 35 (5th Cir. 1997) (citing *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 115 S.Ct. 2322, 2329 (1995); *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 595 (1991); *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, at 10, 12-13, 15, 18, 92 (1972)).

not problematic.<sup>74</sup> So, in the case of a suit in the U.S., English law would apply to the interpretation of the contracts but not to establishing jurisdiction, which was explained in the previous section. And in the U.K., English law would apply as well. Therefore, the analysis proceeds on the two main potential controversies through the lens of English law.

i. Alternative payment currency clauses

Seemingly reviving its nineteenth century tradition of financial innovation, Russia introduced the now-controversial alternative payment currency clauses. Nine of its 15 Eurobonds contain them. Five are USD bonds and four are EUR bonds for a total of US\$19.4 billion and EUR5.25 billion. The clause states that if “for reasons beyond its control” Russia cannot pay in the denomination currency, then a cascade of alternate currencies can be used: U.S. dollars and Euros are each other’s first fallback, then Pound sterling, and then Swiss francs. In six of these nine, Russia reserves the further right to pay in rubles if payments in the other alternative currencies are not possible. It is worth noting that the bonds currently their grace period do not contain ACCs. But these clauses apply to all payments, including those due by operation of the cross-acceleration clauses.

The crux of the clause is the meaning of “for reasons beyond its control.”<sup>75</sup> In the early days of the ongoing crisis, an argument that sanctions made it impossible to pay in these currencies seemed fallible in consideration of the licenses provided earlier under the sanctions regimes. The change in the U.S. sanctions regime lends more credibility to a potential argument and indeed

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<sup>74</sup> See generally, Tanya Monestier, *When Forum Selection Clauses Meet Choice of Law Clauses*, American U. L. Rev. 69:2, Article 1 (2019); Matthew J. Wilson, *Demystifying the determination of foreign law in U.S. courts: Opening the door to a greater global understanding*, [Akron Law Publications 227 \(2014\)](#).

<sup>75</sup> Mitu Gulati & Mark C. Weidemaier, [The Alternative Payment Currency Event Clause in Russian Sovereign Bonds](#), Credit Slips (blog post, March 9 2022).

Russia seems to be considering legal actions against the sanctioning countries.<sup>76</sup> However, this language would probably still leave a high bar to clear for Russia.

In interpreting this clause, courts are likely to be informed by their prior construction of *force majeure* (FM) clauses since this seems to be at least a variant of one. The clause is atypically broad. FM clauses will generally delineate qualifying events in somewhat greater detail than was done here.<sup>77</sup> In fact, the definition of an “Alternative Payment Currency Event” is simply not being able to pay in the denomination currency for reasons beyond its control.<sup>78</sup> But what kinds of risks were shifted with such a broad clause? Does this mean Russia offloaded the risk of sanctions unto creditors?

The UKSC recently restated its general rule for contractual interpretation:

“The court’s task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. *It has long been accepted that this is not a literalist exercise focused solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole* and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning.”<sup>79</sup>

In looking at the contract as a whole, the courts could consider disclosures and statements about risk factors regarding sanctions in their construction of the clause.<sup>80</sup> Additionally, these are likely to be considered contracts between sophisticated parties who are likely aware of the presence

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<sup>76</sup> See Reuters, [Russia threatens legal action if forced into sovereign debt default](#) (Apr. 10, 2022). Though it is unclear what sort of recourse it has, it seems the argument it would make is as to the impossibility of making payments and showing it tried to the furthest extent possible.

<sup>77</sup> Rob Broom and Paul Brennan, [Invoking Force Majeure Due to COVID-19 Under English Law](#), at 1, Squire Patton Boggs UK (April 2020) (listing some events commonly seen in the definitions of FM clauses like Earthquakes, Military Actions, Coup d’etats, etc); See also Ben Giarretta, *COVID-19 Force Majeure Notices Under English Law: What Comes Next?*, [New York State Bar Ass’n, New York Dispute Resolution Lawyer](#), 13:2, at 47 (Summer 2020).

<sup>78</sup> See e.g., Prospectus for the U.S.\$ 2,500,000,000 5.25 percent Bonds due 2047 and U.S.\$ 1,500,000,000 4.375 percent Bonds due 2029 at 15.

<sup>79</sup> *Wood v. Capita Insurance Services Ltd* [2017] UKSC 24 at para. 10. (emphasis added).

<sup>80</sup> See Lam, note 52 *supra* (explaining that the “commercial context” must be considered and that it includes the words used in the parties documentary, factual, and commercial context); see also Prospectus for the U.S.\$ 2,500,000,000 5.25 percent Bonds due 2047 and U.S.\$ 1,500,000,000 4.375 percent Bonds due 2029 at 16, 20-21 (the disclosures themselves).

of sanctions since 2014.<sup>81</sup> And, lastly, English courts may favor more textual interpretations when contracts were professionally drafted.<sup>82</sup> On this front, the contractual structure would seem to favor Russia’s argument: This is a professionally drafted contract, the ACC was intentionally written, creditors were aware of the risk of sanctions and the clause should cover them because Russia does not control sanctions against itself.

The ACC language remains almost all-encompassing whether a textual or more contextually informed reading is applied. On a contextually limited read, if “reasons beyond its control” were to encompass all the risks in the disclosure, then events like oil price swings could give rise to payment in rubles.<sup>83</sup> A textual read would yield an even broader set of events. Therefore, it is unlikely that this is the objective meaning of the contract.

As such, the court may have to resort to the related doctrine of frustration – the English common law equivalent of *force majeure* – to inform its interpretation of the meaning of “beyond its control.”<sup>84</sup> To be clear, Russia would not be asserting the frustration defense as to the bonds containing ACCs. It may assert it for other bonds. But given the breadth of ACCs, the interpretation of “beyond its control” may have to rely on doctrinal underpinnings.

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<sup>81</sup> *Id.* at 94 (explaining that the factual matrix, i.e. the contextual knowledge that can be considered, should be determined according to what information is reasonably expected to be available to the parties at the time they enter the contract).

<sup>82</sup> *Id.* at 94.

<sup>83</sup> *See e.g.*, Prospectus for the Russian Federation EUR 500,000,000 1.125 percent bonds due 2027 and the Russian Federation EUR 1,000,000,000 2.65 percent bonds due 2036 (issued 2021), at 8-9.

<sup>84</sup> The distinction is as follows: Frustration, is a generally applicable doctrine available when the contract did not include an FM clause. *Force majeure* is an instrument of contract only, which means it must be bargained for. Another difference is that frustration will cancel the contract, while FM provisions provide temporary relief. *See* Mahmoud Reza Firoozmand, *Changed Circumstances and Immutability of Contract: A Comparative Analysis of Force Majeure and Related Doctrines*, 8 Bus. L. Int’l 161 (2007), at 173-74; *cf.* Giaretta, note 77 *supra* (stating that “at its root, the purpose of a force majeure clause is to provide an alternative to the [rigors] of the doctrine of frustration”).

The frustration defense is difficult to claim. The defendant must show that, without fault of the parties, the contract is impossible to perform because the circumstances to do so are “radically different from that which was undertaken by the contract.”<sup>85</sup> In this case, the payment structures for the bonds are laid down in contract, the circumstances changed, and perhaps the court could interpret the language to encompass the risk of sanctions as explained above. But could Russia be without fault? Few would answer affirmatively.<sup>86</sup> And, if alternative payment mechanisms are still available, is performance radically different?

Consider the *Super Servant* case.<sup>87</sup> In this case, the defendants owned two large barges used to transport heavy structures and had contracted to carry an oil rig from Japan to Europe using one of them.<sup>88</sup> They could choose which one to use, and committed one to this contract, *Super Servant Two*, while the other barge was committed to other contracts.<sup>89</sup> The *Super Servant Two* sank through no fault of the defendants before it could carry the rig.<sup>90</sup> The Court of Appeal decided that the contract was not frustrated by the sinking, but rather by the choice not to use the other ship.<sup>91</sup>

A showing that Russia has access to a different payment route would mean it has another barge to carry the oil rig.<sup>92</sup> Additionally, even if creditors were aware of the risk of sanctions, so

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<sup>85</sup> *Davis Contractors Ltd v. Fareham UDC* [1956] AC 696.

<sup>86</sup> Mitu Gulati & Mark C. Weidemaier, note 75 *supra*, (suggesting that a possible argument against “beyond [Russia’s] control” is the fact that these sanctions are rooted in Russia’s unilateral aggression). Their comments resound with additional equitable, i.e. fairness and fair-dealing-related, arguments that can be brought to bear on this question, but here I evaluate what would be the strongest version of a read for Russia before even getting into the equitable arguments.

<sup>87</sup> Firoozmand, note 84 *supra*, at 175 (citing *J Lauritzen AS v. Wijsnuller BV (The Super Servant Two)* [1990] 1 Lloyd’s Rep 1).

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> Bear in mind that the *Super Servant* case may not be exactly on point and is only used here to make an illustrative point. It can perhaps be differentiated in that the barge sank before performance began, while

was Russia – it was its own disclosure that informed the creditors – and the language is clear: “beyond [Russia’s] control.”<sup>93</sup> Having another barge means it can still perform and thus should not be paying in rubles into blocked accounts in Russia.<sup>94</sup> How courts ultimately interpret these novel clauses is uncertain and any decision would be highly consequential for sovereign debt markets. But the burden to show that their use was appropriate on this occasion is heavy.<sup>95</sup>

ii. Fiscal laws applicability clauses

The bonds are governed by the laws of England. Yet, they all contain provisions subjecting “[a]ll payments of principal and interest cases to any applicable fiscal or other laws and regulations.” Writing almost ten years ago, a group of experts remarked on similar language in English law Cypriot bonds, asking the question “Does this include Cypriot laws, regulations, and directives?”<sup>96</sup> The authors highlighted that this language is common among English law sovereign bonds; but in about three-quarters of the bonds containing it, the language is modified to state “in the place of payment.”<sup>97</sup> That all Russian issuances contain it, from 1998 to 2021, suggests that it has been copied-and-pasted for generations and carried on without a serious legal challenge. Therefore, this is probably a boilerplate clause.<sup>98</sup>

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performance had already begun using the contracted structures in the case of the bonds. Additionally, since the payment structures are laid in contract, Russia could argue that there is no other barge it can legally use. However, like in the *Super Servant* case, that Russia would have to disregard another contractual obligation may not be sufficient to show frustration.

<sup>93</sup> Prospectus, note 83 *supra*, at 11-12.

<sup>94</sup> See Morgan Lewis Lawflash, note 45 *supra*.

<sup>95</sup> Lastly, the reader should be reminded that the bonds currently in their grace period do not contain ACCs. Therefore, in the default scenario laid out above the ACC bonds would be cross-accelerated to which Russia would respond by making all accelerated payments in rubles.

<sup>96</sup> Lee Buchheit, Mitu Gulati, and Ignacio Tirado, *The problem of holdout creditors in Eurozone Sovereign Debt restructurings*, Butterworths J. of Int’l Banking and Financial L., 191 (April 2013) at 193.

<sup>97</sup> *Id.*

<sup>98</sup> Boilerplate clauses are broadly used clauses that appear in most contracts in a market. See Lam, note 52 *supra*, at 94.

So, are payments on these bonds subject, for example, to the Russian executive order requiring that creditors in *unfriendly* nations be paid in rubles?<sup>99</sup> A literal read would suggest so. But the general rule of contract interpretation cited above clearly states that a literal read is not the court's charge.<sup>100</sup> Additionally, boilerplate clauses are interpreted in the interest of "justice and commercial efficacy."<sup>101</sup> In other words, they are interpreted with an eye to maintaining the stability of the market, which needs to rely on consistent interpretations over time.

Following the UKSC's general rule and considering the United Kingdom's strong interest in maintaining market stability, a narrower interpretation should be favored. First, the language appears under the header "Payments Subject to Fiscal Laws," which is generally understood to mean taxation.<sup>102</sup> Second, the clauses often continue to describe other taxation to which payments may be subjected (for example in the U.S.) and cross-references the taxation condition, which contains Russia's pledge to make payments free of any levies on its part.<sup>103</sup> Third, a major inconsistency would obtain from a broad reading that allowed for application of the issuer-sovereign's laws when the parties bargained for the application of English law to what is the basic creditor right on a loan contract: receiving her money.<sup>104</sup> So, it is likely that the objective meaning of the clause refers to taxation and related laws.

As to the general context, consider the confusion that could follow if "hybrid law" sovereign bonds were suddenly birthed by a broad interpretation. At the London Commercial Court, "80% of cases involve a foreign claimant or defendant. Of course, that has a knock-on effect and the success of the legal services sector plays an unquantifiable role in helping London to

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<sup>99</sup> See Morgan Lewis Lawflash, note 45 *supra*.

<sup>100</sup> See *Wood v. Capita*, note 79 *supra*.

<sup>101</sup> Lam, note 52 *supra* at 95.

<sup>102</sup> See *e.g.*, Prospectus, note 81 *supra*, at 30.

<sup>103</sup> *Id.*

<sup>104</sup> A "substantive right" in legalese.



maintain its position as a major [center] for global commerce.”<sup>105</sup> It is therefore likely that English courts would consider the stability of the market and the United Kingdom’s public interest in any decision regarding these clauses.

Alternatively, consider the modification present in the other three-quarters of the sovereign issuances containing this language: “in the place of payment.” While this would suggest that the interpretation above can be weakened because a degree of intentionality may be implied by the omission, it also suggests that this language could be the result of drafter’s error. Within the general context of the sovereign debt market, it is easier to give credence to the error hypothesis for the same reasons supporting a narrower interpretation. Whether this alternative argument can be part of a court’s decision depends on the threshold question of the interpretation a court would give the broadly written clause as discussed above.

These clauses will probably give experts more to write about in the coming years. But the factors above would suggest that a narrower reading could be obtained and therefore, in this case, a judgment in favor of creditors on the question of default.

c. How does a bondholder collect on a sovereign?

Assume that a creditor has obtained a judgment. The *adjudicative* stage of the hypothetical suit is over and it is time for the *executionary* stage. Traditionally, in sovereign debt cases, this is where the most time is spent.

The first step in executing is finding attachable assets, which can entail a significant amount of detective work. If those assets are in a different jurisdiction, the prerequisite would be to file an

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<sup>105</sup> The Law Soc’y of Eng. & Wales, [England and Wales: The Jurisdiction of Choice](#), at 5.

enforcement suit to have the foreign judgment recognized. At least in the U.S.<sup>106</sup> and the U.K.,<sup>107</sup> each other's judgments should generally be enforceable. Establishing jurisdiction would be similar to what was laid out above in section 5(a), but the problem remains: Are the assets non-immune?

Central bank assets enjoy very strong protections except in special cases often related to terrorism.<sup>108</sup> Other assets of the sovereign will be immune except when they are used for commercial purposes. One key difference in this context is that the United Kingdom is more permissive than the United States. It allows creditors to enforce by attaching all commercial assets of the foreign state.<sup>109</sup> The U.S. requires a relationship between the commercial asset and the claim of the creditor.<sup>110</sup> Though "it is somewhat unusual [for U.S. courts] to block a creditor from attaching unrelated commercial assets."<sup>111</sup> Still, commercial assets are seldom held directly by the

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<sup>106</sup> In the U.S., enforcement of foreign judgments will depend on the law of the jurisdiction. See Melinda Luthin, *U.S. Enforcement of Foreign Money Judgments and the Need for Reform*, 14 U. C. Davis J. Int'l L. & Pol'y 111, at 115-16 (2007) (Explaining that the jurisprudential origin of foreign judgments recognition in the United States is *Hilton v. Guyot*, 159 U.S. 133 (1895) and that recognition is at the discretion of the states). In the Second Circuit, where most sovereign debt litigation takes place and assets could be located, a foreign money judgment would be recognized "unless (1) the foreign court lacked jurisdiction over the subject matter or the person of the defendant; (2) the judgment was fraudulently obtained; or (3) enforcement of the judgment would offend the public policy of the state in which enforcement is sought." *Ackerman v. Levine*, 788 F.2d 830, 837 (2d Cir. 1986). See also *cf.*, *Scheck v. Republic of Argentina*, No. 10 CIV. 5167 TPG, 2011 WL 2118795 (S.D.N.Y. May 23, 2011) (enforcing German judgments on German-law bonds); *SerVaas Inc. v. Republic of Iraq*, 540 F. App'x 38 (2d Cir. 2013) (enforcing French money judgment); *Mohammad Hilmi Nassif & Partners v. Republic of Iraq*, No. 117CV02193KBJGMH, 2021 WL 6841848 (D.D.C. July 29, 2021) (enforcing Jordanian money judgment); *SACE S.p.A. v. Republic of Paraguay*, 243 F. Supp. 3d 21 (D.D.C. 2017) (enforcing Swiss money judgments).

<sup>107</sup> For the U.K. enforcing U.S. judgments, see, *NML Capital Limited v. Republic of Argentina* [2011] UKSC 31 at Paras. 34-42 (Lord Phillips with whom Lord Clarke agreed, explained that the judgment obtained by NML in Argentina should be given effect in the U.K. because it stems from an exception to sovereign immunity equivalent to that which would obtain in the U.K. and under a broad interpretation of the State Immunities Act of 1978 Sec. 3(1) the suit arises from matters related to a commercial transaction) (Lord Mance with whom Lord Collins and Lord Walker agreed, sustained that the broad interpretation of the State Immunities Act of 1978 Sec. 3(1) was not warranted but that the Civil Jurisdiction and Judgments Act 1982 Sec. 31 along with Argentina's waiver of sovereign immunity provided sufficient bases to enforce the judgment). Note that Lord Mance's opinion could thus present a basis for Russia to challenge judgment recognition actions in the U.K.

<sup>108</sup> State Immunities Act of 1978 Sec. 14; 28 U.S.C. Sec. 1611, Sec. 1610(g). The recent controversy over whether assets belonging to the central bank of Afghanistan are liable to attachment is an example of this exception, however the outcome in that case is still uncertain and the exception seems likely inapplicable in this context. See Scott R. Anderson, [What's Happening with Afghanistan's Assets](#), Lawfare (Feb. 18, 2022).

<sup>109</sup> See W. Mark C. Weidemaier, *Piercing the (Sovereign) Veil: The Role of Limited Liability in State-Owned Enterprises*, 46 BYU L. Rev. 795, at 827 fn. 163 (2021); State Immunities Act of 1978 Sec. 13(4).

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

sovereign; they are held in state-owned enterprises and that necessitates veil piercing.<sup>112</sup> Veil piercing is the action of breaking through the legal separation of balance sheets between a corporation or entity and its owners.

i. Piercing the veil

Undoing the legal separation between the sovereign owner and its corporations is difficult. There is a presumption in favor of maintaining it in both jurisdictions.<sup>113</sup> Courts in both the U.S. and U.K. will consider multiple factors, but the compass of the exercise generally points to an inquiry about the extent to which the sovereign controls the firm.<sup>114</sup> Sovereign control of day-to-day operations and governing bodies staffed by government officials can be examples of evidence speaking to this main factor. Another important common factor is the level of independence granted to the SOE under the laws of the state that created it.<sup>115</sup>

The list of factors in the rule is, of course, more extensive than that. In the U.S., federal courts have considered whether the sovereign:

- “(1) uses the instrumentality's property as its own;
- (2) ignores the instrumentality's separate status or ordinary corporate formalities;

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<sup>112</sup> See Weidemaier, note 109 *supra* (detailed analysis of sovereign veil piercing in the U.S. and a critique suggesting that courts should care about whether a corporation's owner is a sovereign); Anne-Catherine Hahn, *State Immunity and Veil Piercing in the Age of Sovereign Wealth Funds*, *Schweizerische zeitschrift für wirtschaftsrecht* 2 (2012): 103-118, at 107-10 (broad comparative overview of sovereign veil piercing in varied jurisdictions).

<sup>113</sup> Weidemaier, note 109 *supra*, at 800 (2021) (citing *First National City Bank v. Banco Para El Comercio Exterior de Cuba (Bancec)*, 462 U.S. 611, 626 (1983)).

<sup>114</sup> See Weidemaier, note 109 *supra*, at 817-20 (2021) (Explaining the in U.S federal courts “[o]utcomes appear to turn on relatively minor distinctions, which supposedly illuminate the extent to which the state controlled the entity’s day-to-day operations”); Hahn, note 112 *supra*, at 109 (explaining that English courts have taken an approach similar to that of the U.S. with respect to control being the central question); *see also*, *First National City Bank v. Banco Para El Comercio Exterior de Cuba (Bancec)*, 462 U.S. 611, 629 (1983); *Walker International Holdings Ltd. v. Republique Populaire du Congo* [2005] EWHC 2813 at paras. 97-100; *Kensington International Limited v. Republic of Congo* [2005] EWHC 2684.

<sup>115</sup> Hahn note 112 *supra*; *see also*, *Walker International Holdings Ltd. v. Republique Populaire du Congo* [2005] EWHC 2813 at paras. 73-75.

- (3) deprives the instrumentality of the independence from close political control that is generally enjoyed by government agencies;
- (4) requires the instrumentality to obtain approvals for ordinary business decisions from a political actor; and
- (5) issues policies or directives that cause the instrumentality to act directly on behalf of the sovereign state.”<sup>116</sup>

In the U.K., the test has been phrased more broadly in recent litigation. In *Walker*, Morison J. wrote that “the question is whether [the state oil company of the Congo Republic] is to be regarded either as an organ of the State or, on the other hand, as a State owned [legally separate] commercial company.”<sup>117</sup> The veil between the state oil company and the Republic of Congo was pierced because the firm was controlled by a presidential representative who personally signed all documentation related to the transaction at issue; it paid for expenditures a government would, like elections, while it did not declare dividends or return profits to the state in cash as a corporation would to a shareholder; and it performed other activities which made it more akin to an extension of the government’s treasury, like collecting taxes and financing governmental projects.<sup>118</sup> In that same case, the creditor sought to pierce a second veil between the state oil company and the subsidiary against which it sought to execute.<sup>119</sup> That veil was also pierced based on evidence that it was incorporated as a shell only used to remove attachable assets from creditors’ reach, and that it was entirely dependent on, and created by, the state oil company.<sup>120</sup> In other words, not piercing that second veil would have resulted in an injustice borne of artful entity management.

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<sup>116</sup> W. Mark C. Weidemaier, *Piercing the (Sovereign) Veil: The Role of Limited Liability in State-Owned Enterprises*, 46 *BYU L. Rev.* 795, 816 (2021).

<sup>117</sup> *Walker International Holdings Ltd. v. Republique Populaire du Congo* [2005] EWHC 2813 at para. 93.

<sup>118</sup> *Id.* at 97-98.

<sup>119</sup> *Id.* at 4.

<sup>120</sup> *Id.* at 104-108.

Sovereign veil piercing between Russia and some of its largest SOEs would probably be a steep climb. The list includes Rosneft, Gazprom, and VTB Bank among others, and cases could be further complicated by additional layers of subsidiaries that could be more aptly structured and governed than the one in *Walker*. Ultimately, the outcome is uncertain and highly dependent on the specific evidence the parties can muster. Any further analysis would have to rely on information unavailable to the author at this time.

## ii. Restructuring

Historically, restructuring is the predominant means of recovery for sovereign creditors. Immunity, the absence of a bankruptcy regime, and the theoretically infinite existence of sovereigns underpin this observation. Even in cases of successful bondholder litigation against sovereigns, the ultimate outcome is a restructuring, and seldomly, a settlement. Consequently, no discussion about sovereign debt default or its legal aspects is complete without addressing restructuring – and, in recent times, collective action clauses (CACs).<sup>121</sup> So, it should be briefly addressed, far as it may sit on the horizon.

Most of the Russian bonds contain third and fourth generation CACs, which are capable of cross-series aggregation. This means that in a restructuring, the sovereign can call the holders of bonds containing these clauses to negotiate a joint restructuring. Normally, the sovereign would offer a menu of exchange instruments for all the convened holders that results in equitable

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<sup>121</sup> The recent literature on sovereign default and restructuring is remarkably dominated by CACs. See e.g., Chuck Fang, Julian Schumacher and Christoph Trebesch, *Restructuring Sovereign Bonds: Holdouts, Haircuts, and the Effectiveness of CACs*, IMF Economic Review (2021) 69:155–196; Anna Gelpern and Mitu Gulati, *The Wonder Clause*, Journal of Comparative Economics 41 (2013) 367-385; W. Mark C. Weidemaier & Mitu Gulati, *A People's History of Collective Action Clauses*, 54 VA. J. Int'l L. 52, 71(2014); Akshay S. Gohil, *The "Great Game" of Sovereign Debt Restructuring: Solving the Holdout Problem. A Critical Analysis of the Pari Passu and Collective Action Clauses in International Sovereign Bond Contracts*, 9 UCLJLJ 26 (2020).

treatment, but which does not require the same outcome.<sup>122</sup> That the menu offered is the same to participating creditors is normally sufficient. The voting thresholds to approve proposed deals differ between the CAC generations. In Russia's bonds, the third generation CACs (two of the bonds) require that 75 percent of the aggregated principal in the pool and 66 2/3 percent of the principal of each bond approve the deal. The fourth generation CACs provide two alternative thresholds at the discretion of the debtor: (1) 75 percent of the aggregated principal in the pool or (2) 66 2/3 percent of the aggregated principal and 50 percent of each bond. Whether it would be more convenient for Russia to launch two separate negotiations for bonds containing third and fourth generation CACs is unclear at this time.

But what about the four remaining bonds? These bonds are likely at the top of the list for creditors who may consider a holdout strategy. From the prospectuses, it is only possible to ascertain that two have first generation CACs, which can only be modified with the consent of 75 percent of the principal of the bond in question. The remaining two bonds only state the conditions for calling a bondholders' meeting and define a quorum, which, confusingly, is achieved with 75 percent of the holders of each bond. The mechanism for "reserved matter modifications" (i.e. restructuring) should appear in the fiscal agency agreement, which is unavailable to the author. However, it is highly unlikely that these clauses are capable of cross-series aggregation since that generation of the clause had not yet appeared.<sup>123</sup> More likely than not, they contain the classic first-generation English-law CAC threshold of 75 percent.<sup>124</sup>

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<sup>122</sup> This equitable treatment is technically embodied by the "uniformly applicable offer" requirement and is not without ambiguity. See Anna Gelper, [Imagine Riding the Ceteris Pari-bus into the Sunset ... in Argentina](#), Credit Slips (blog post, Nov. 5 2019).

<sup>123</sup> See Lee Buchheit and Mitu Gulati, *The Argentine collective action clause controversy*, Capital Markets Law Journal, Volume 15, Issue 4, October 2020, Pages 464–473 ([SSRN version](#) at 3).

<sup>124</sup> *Id.* at 2.

Ultimately any restructuring will be highly contingent on sanctions regimes, since these severely limit any financial transactions with the Russian Federation. Anyone willing to embark on this path probably needs a high tolerance for risk and much patience.

iii. *Pari passu* clauses

Lastly, a brief analysis of the *pari passu* clause seems warranted since the clause appears on all of Russia's contracts.<sup>125</sup> While it is difficult to speculate about the scenario in which these could present a threat to Russia or creditors, these clauses have featured prominently in recent sovereign debt litigation.<sup>126</sup> Translated literally, this clause means "[on] equal step" or "footing."

Over the years, there have been two interpretations of standard *pari passu* clauses in sovereign debt contracts. The *ranking* interpretation, which states that the clause only warrants equal legal ranking for the securities covered by the clause; and the *ratable payment* interpretation, which goes a step further and requires proportionate payments to all holders of debts covered by the clauses.<sup>127</sup> To clarify, all the ranking interpretation would create is a commitment not to discriminate against certain bondholders, overtly, intently, and as a matter of policy – for example by passing legislation stating that some bondholders will not be paid.<sup>128</sup> After causing much grief to Argentina by seemingly espousing a ratable payment interpretation, the federal court for the Southern District of New York clarified that, along with selective nonpayment, it was the presence

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<sup>125</sup> It appears in a mildly changed form in more recent issues, which adds "as at their date of issue," but the change seems immaterial in light of the contract and English rules of contract interpretation.

<sup>126</sup> See e.g., Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 Emory L.J. 869, at 877-83 (2004) (Describing multiple cases involving aggressive use of the clause in litigation against countries like Peru, Republic of Congo, Democratic Republic of Congo, and Nicaragua); *NML Capital, Ltd. v. Republic of Argentina*, 699 F.3d 246, at (2d Cir.2012) (*NML I*); *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230 (2013) (*NML II*); Lee C. Buchheit & Andres de la Cruz, *The pari passu fallacy – requiescat in peace*, 37 Int'l Fin. L. Rev. 32, at 33 (Summarizing the Argentinean controversies related to the *pari passu* clause).

<sup>127</sup> See Buchheit & Pam, note 126 *supra*, at 877-80; Financial Markets Law Committee (UK), *Analysis of the role, use and meaning of pari passu clauses in sovereign debt obligations as a matter of English law*, Issue 79 at 7 (March 2005).

<sup>128</sup> See Buchheit & de la Cruz note 126 *supra*, at 33; *White Hawthorne, LLC v. Republic of Argentina*, Not Reported in Fed. Supp., 2016 WL 7441699, at 2 (2016).

of aggravating factors and the passing of legislation excluding certain bondholders that deprived them of their equal ranking.<sup>129</sup> For practical purposes, this ruling equates to a ranking interpretation. Under English law, it seems the clause would also receive the ranking interpretation.<sup>130</sup>

In the Russian case this means, at the onset, that for a *pari passu* argument to exist there must be an attempt to discriminate bondholders by law. A scenario where there are holdouts to some future restructuring and Russia continues having some form of discrimination embodied in law could present an opening for this argument. This would be the same case as Argentina's Elliott saga, and it is unlikely to happen, not least because for a restructuring to happen much has to change, and Russia would be aware of this rule. Another scenario in which the argument could exist is if some Russian bondholders are receiving their payments, while others are blocked by law because the money cannot leave the local clearinghouse. Making that argument at this point is superfluous because not receiving the money should already be a default.

In the past, the *pari passu* clause has been used more effectively to block payments going to other creditors in order to pressure the debtor to settle.<sup>131</sup> Whether this strategy could yield similar results is unclear, experts in the United Kingdom seemed to conclude such injunctions would be undesirable under their laws.<sup>132</sup> One observer opined that U.K. courts would grant monetary relief as opposed to such injunctions.<sup>133</sup> In any case, these interdictions would only be relevant if the debtor was paying someone else in an amenable jurisdiction.

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<sup>129</sup> *See id.*

<sup>130</sup> *See* Financial Markets Law Committee (UK), note 127 *supra*, at 22 (March 2005); Lam, note 54 *supra*, at 92-96 (2019).

<sup>131</sup> *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230, at 238 (2013) (*NML II*) (affirming payment injunctions on Argentina).

<sup>132</sup> *See* Financial Markets Law Committee (UK), note 127 *supra*, at 16.

<sup>133</sup> Lam, note 52 *supra*, at 96 (2019).



## 6. Conclusion

If Russia were a corporation, it would be perceived as a golden opportunity for distressed debt investors. It has a substantial asset base and its debts trade at deep discounts because of nonfinancial reasons. But it is not, and that changes the calculus. Ultimately, a default now would be driven by geopolitical factors and so would resolution and recovery. Could Western countries enact legislation or use existing statutes to allow for the discharge of debts against frozen assets? That is an open question and there would be important considerations beyond creditor satisfaction. In the past, special tribunals have been formed to adjudicate creditor claims, for example with the Islamic Republic of Iran.<sup>134</sup> Such tribunals could become an option in this case as well.

Consider then the following facts: some of the litigation episodes involving sovereigns cited in this paper lasted about 15 years due to controversies over interpretations of ambiguous clauses despite maintaining less legal hurdles than Russian Eurobonds.<sup>135</sup> Current sanction regimes would preclude any restructuring attempt and some countries have been sanctioned in the U.S. for over 40 years.<sup>136</sup> In the past, Russia has faced creditor litigation for nearly 15 years stemming from contracts considerably more creditor-friendly than these Eurobonds. It has also shown a willingness to turn away from the Western financial system for over 70 years.

If Russia decides to appear in court and defend itself, the legal structure of the contracts in question provide it with tools to lengthen the legal process, though not necessarily to dismiss the claims. The duration of any potential litigation on these issues is uncertain, but the above factors suggest a long period of contention could ensue – perhaps longer than previous litigation episodes

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<sup>134</sup> See generally *Dames & Moore v. Regan*, 453 U.S. 654 (1981). (The case of Dames & Moore is one of a creditor who sought to collect on Iranian assets present in the U.S. and avoid removal of the claim to a special tribunal after receiving a judgment in Federal Court).

<sup>135</sup> See *NML Capital, Ltd. v. Republic of Argentina*, 699 F.3d 246, at (2d Cir.2012) (*NML I*); *NML Capital, Ltd. v. Republic of Argentina*, 727 F.3d 230 (2013) (*NML II*); *White Hawthorne, LLC v. Republic of Argentina*, Not Reported in Fed. Supp., 2016 WL 7441699 (2016); Merle, *supra* note 23.

<sup>136</sup> The Islamic Republic of Iran since 1979. See E.O.12170. [Cuba since 1962](#).

– and that a negotiated resolution under the current legal paradigm could be at least equally prolonged.

Lastly, even without the materialization of legal actions like those hypothesized above, this paper provides non-lawyers with a primer on sovereign debt litigation and points in important directions for future research. For example, researchers can evaluate, whether versions of the Alternative Currency Clause are a viable option for other sovereigns; whether the ownership of underwriters matters in sovereign issuance; and how meaningful the interactions of different legal characteristics in a debt stock are to sovereign debt crisis resolution.