LEGAL ANALYSIS

Sovereign Debt Enforcement in English Courts: Ukraine and Russia Meet in the Court of Appeal in US $3 Billion Eurobonds Dispute

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Abstract

This legal analysis examines Law Debenture Trust Corp Plc v Ukraine, in which summary judgment was given on a claim brought, in substance, by Russia against Ukraine for US $3 billion said to be due under sovereign bonds. The defences raised by Ukraine tested the boundaries of the doctrine of non-justiciability in commercial claims that relate to the foreign affairs of two sovereign states.

Whilst confrontation between Ukraine and pro-Russian separatists continues in the east of the country, the hostility between the two neighbours will soon find an unlikely outlet in the English Court of Appeal, which is shortly due to hear an appeal from Blair J's decision in *Law Debenture Trust*,[1] in which Russia was granted summary judgment in a claim for US $3 billion due under eurobonds issued by Ukraine.

The case revolves around sovereign bonds issued by Ukraine to Russia, on payment of which Ukraine subsequently defaulted. However, what would have otherwise been a straightforward banking case before an English court, became a case in which public international law arguments took centre stage, necessitating a judgment of almost 100 pages.

The reason? Whilst the claimant—a trustee bringing the proceedings on the direction of the Russian Ministry of Finance—argued that this was an "ordinary debt claim" (at [35]), Ukraine's defence argued that the claim arose from, and was part of, "a broader strategy of unlawful and illegitimate economic, political and military aggression by Russia against Ukraine" and that, inter alia, Russia had applied "massive, unlawful and/or illegitimate military, economic and political pressure to Ukraine" (amounting to duress) to force Ukraine to obtain financial support from Russia "on unique and onerous terms" (at [51]). It argued that a full trial was necessary to examine the matter in full, including looking into the legality of the annexation of Crimea by Russia and establishing whether Ukraine's default was a legitimate non-forcible countermeasure in respect of what were alleged to be internationally wrongful acts. In other words, Ukraine invited the court to assess the legality of Russian's acts, which were, of course, foreign acts of state. Blair J found Ukraine's defences to be non-justiciable in the English courts.

English courts, of course, are no strangers to public international law arguments. There are some larger questions underlying the case. Are international law arguments—outside the terms of the notes issued by Ukraine to Russia—relevant in adjudicating upon the rights of the parties? Can contractual arrangements governed by English law be rendered voidable by the operation of international law, for instance, internationally wrongful acts? Yet even if these questions can be answered in the affirmative, would an English court addressing them in these proceedings effectively have to decide matters of international law between two foreign states, in other words, venturing into a sort of "judicial no-man's land" in the language of Lord Wilberforce in *Buttes Gas & Oil*?[2]

The case (*Law Debenture Trust*) now going to the Court of Appeal is instructive in at least three ways:

(1) it reflects the complexity of cases reaching English courts today and the manner in which public international law subjects raising "legal questions of considerable difficulty" (at [372]) may become relevant in commercial cases;

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[1] *Law Debenture Trust Corp Plc v Ukraine* [2017] EWHC 655 (Comm); [2017] 3 W.L.R. 667. All references to paragraph numbers in the text refer to this case unless otherwise stated.
[2] *Buttes Gas & Oil Co v Hammer (No.3)* [1982] A.C. 888 at 938; [1981] 3 W.L.R. 787; [1981] Com. L.R. 257 HL.

(2) it will test the boundaries of the doctrine of non-justiciability in English courts in claims relating to foreign affairs of two sovereign states; and

(3) more specifically, it is a test of the suitability of English courts as a forum to deal with the politics inherent in sovereign lending and borrowing.

Ukraine's factual case

In 2013, Ukraine was preparing to sign an Association Agreement with the EU, laying the ground for eventual membership. Ukraine's case is that, in an effort to dissuade Ukraine from concluding the Association Agreement, Russia threatened:

- to impose trade sanctions, including boycotting of Ukrainian goods and suspension of the gas supply to Ukraine (at [200]); and
- to violate Ukraine's territorial integrity by intervening in support of its Russian-speaking minority, partitioning Ukraine and revising its frontier with Russia (at [202]).

In addition to threats, Russia allegedly offered certain incentives, including loans of up to US $15 billion and access to discounted gas, on condition that Ukraine declined to conclude the Association Agreement (at [208]).

In the course of autumn 2013, the then-president of Ukraine, Viktor Yanukovych, agreed to accept Russia's terms. On 21 November 2013, the Cabinet of Ministers of Ukraine (CMU) decided to suspend preparation for the conclusion of the Association Agreement. The CMU's decision triggered social unrest in Kyiv.

On 17 December 2013, the CMU announced that Russia had agreed to subscribe for up to US $15 billion of Ukrainian sovereign debt before the end of 2014, beginning with an initial tranche of eurobonds in the value of US $3 billion. On 18 December 2013, the CMU approved the first tranche of eurobonds and, on 24 December 2013, Ukraine issued the notes to Russia. This was done, as is usual, by the issuance of notes to a trustee (the Trustee), who was to represent the interests of noteholders. The notes were to fall due on 20 December 2015 and carried interest at 5% payable bi-annually (which was a better rate of interest than Ukraine could have achieved on the open market). Although the notes were issued to Russia in the first instance, albeit through the Trustee as intermediary, they were, in principle, transferrable to third parties (though, as it transpired, the notes remained exclusively held by Russia when they fell due).

In February 2014, prompted by continuing civil unrest, President Yanukovych fled the country. Shortly thereafter, Russia invaded Crimea and allegedly began to support separatists in eastern Ukraine.

During the course of 2014 and 2015, Ukraine paid a number of instalments of interest on the notes in the order of US $233 million. It was not until 18 December 2015, shortly before the notes fell due, that the CMU voted to suspend repayment of the notes (at [23]).

Under the Trust Deed, the Trustee was required to commence enforcement proceedings if one quarter of the noteholders so directed. Perhaps significantly for the purposes of this note, the Trustee appears to have had the right to elect between arbitration and English court proceedings (at [37(xi)]). Acting at the direction of the Russian Ministry of Finance, the Trustee elected to bring court proceedings to enforce the notes and duly applied for summary judgment against Ukraine.

Ukraine's defences

Ukraine raised four main defences to Russia's summary judgment application:

- the notes were issued ultra vires the capacity of the CMU and were therefore void;
- Ukraine issued the notes under duress from Russia, in the form of trade sanctions and threats to its territorial integrity, such that they were voidable;
- the notes were subject to an implied term that the noteholders would not impede the issuer from performing, which Russia wrongfully did by inter alia invading Crimea; and
- as a matter of public international law, Ukraine was entitled to refuse to honour the eurobonds as a lawful countermeasure to unlawful acts on the part of Russia.

Capacity

Ukraine argued that the CMU exceeded its capacity when it sanctioned the issuance of the notes in that:

- the notes infringed the Ukrainian budget law for 2013 (the "Budget Law"), which restricted the value of borrowing in which Ukraine could engage in that year;
- the CMU failed to observe certain procedural requirements, in particular that it should procure an expert opinion concerning the legality of the notes; and
- the CMU abdicated its responsibility to consider the detailed provisions of the eurobonds, some of which were unreasonable and oppressive, to the Minister of Finance, which it was not entitled to do.

It should be noted that, even if the eurobonds were void for lack of capacity, this would be unlikely to prevent Russia from obtaining restitution of the funds advanced

but, since Russia had not pleaded a claim in restitution, Ukraine did not need to address any such claim in order to avoid summary judgment.

Blair J noted that there is a crucial distinction between a contract that is void for lack of capacity and a contract concluded outside authority,

> "if an act is unauthorised, a number of legal doctrines come into play to mitigate the rigour of the outcome, such as usual or ostensible authority, and subsequent ratification. These doctrines are not available in the case of lack of capacity, which in principle invalidates a contract regardless of the knowledge or lack of it of the counterparty" (at [108]).

Blair J further observed that

> "neither party was able to point to any case law in which the question of the capacity of a state to borrow, or indeed to enter into other forms of contract, has been raised before" (at [110]).

On this issue, the Judge ultimately concluded that

> "once a state is recognised as such, as a matter of international law, it has unlimited capacity to borrow, and such capacity is recognised under English law…the reason for the absence of case law to this effect may simply be that the principle has never been questioned" (at [129]–[130]).

The Judge rejected an analogy with public authorities which do have limited capacity to enter transactions (at [188]) on the basis that, as a matter of public international law, states have the capacity to do anything that is not prohibited in public international law (at [126]–[129]).

With respect, the Judge's reasoning is open to doubt. It is clear that legislation restricting the powers of a Ukrainian public authority would be sufficiently fundamental to go to their capacity to contract rather than merely their authority to do so (*Haugesund Kommune*).[3] By parity of reasoning, the same should apply to legislation that restricts the powers of the state itself, such as the Budget Law, since there would otherwise be an irrational distinction between public authorities and states (*Law Debenture Trust* at [131]). It was, in our view, incumbent upon Russia to satisfy itself that the transaction complied with Ukrainian public law, which, being a matter of public record, should not have been difficult. Russia should not have been entitled to rely on the usual and apparent authority of the Ukrainian Minister to issue the notes (which it could not have done if the Judge had decided that the Budget Law went to Ukraine's capacity rather than merely its authority to enter the transaction).

Duress

First of all, the Trustee argued that, even if Russia had originally procured Ukraine to issue the eurobonds by duress, it had affirmed the transaction by, inter alia, making interest payments during 2014 and 2015. The Judge concluded (correctly, in our respectful view) that whether Ukraine's acts were sufficiently unequivocal to amount to an affirmation was a factual issue unsuitable for determination on a summary judgment application.

Blair J then went on to consider whether the eurobonds were, in fact, vitiated by duress, ultimately concluding that this issue was non-justiciable under the act of state doctrine. If the English courts were required to decide whether Russia had applied unlawful and/or illegitimate pressure by threatening trade sanctions and/or the use of force, they would have to adjudicate on "rights arising out of transactions entered into by independent sovereign states between themselves on the plane of international law" (*Law Debenture Trust* at [295(iv)], adopting the classic formulation in *JH Rayner*).[4]

The reference to "act of state doctrine" in the case may not be precise enough, as the case raised more narrowly the doctrine of "foreign act of state". In addition, the judgment did not adequately address the relationship between this doctrine and non-justiciability, which we submit is a distinct and broader notion. As F.A. Mann suggested, non-justiciability is concerned with cases of judicial inability to render a decision, whereas the act of state doctrine is concerned with propriety.[5] Indeed, Dicey, Morris and Collins describe the scope of the act of state doctrine as follows:

> "The courts will not investigate the propriety of an act of the Crown [or a foreign government] performed in the course of its relations with a foreign State, or enforce any right alleged to have been created by such an act unless that right has been incorporated into English domestic law."[6]

After all, as aptly pointed out by Lord Sumption, foreign act of state doctrine "does not depend on the absence of juridical standards".[7] Rather, it depends upon the principle of comity that the courts of one country will not sit in judgment on the sovereign acts of another.[8] Arguments concerning comity, however, were absent in the claim.

It must be true that, if the courts had gone on to rule on Ukraine's duress defence and had decided that Russia had acted perfectly lawfully and legitimately, that would have proved embarrassing to the British Government since it would have been out of step with the tenor of their foreign policy towards Russia. The avoidance of such hindrance to the activities of the executive is one of the principal rationales for the act of state doctrine. However,

[3] *Haugesund Kommune v Depfa ACS Bank* [2010] EWCA Civ 579; [2012] Q.B. 549; [2012] 2 W.L.R. 199 at [111].
[4] *JH Rayner (Mincing Lane) Ltd v Department of Trade and Industry* [1990] 2 A.C. 418 at 499; [1989] 3 W.L.R. 969; (1989) 5 B.C.C. 872 HL.
[5] F.A. Mann, *Foreign Affairs in English Courts* (Oxford: Clarendon Press, 1986), p.165.
[6] *Dicey, Morris and Collins on the Conflict of Laws*, edited by Lord Collins of Mapesbury et al, 15th edn (London: Sweet & Maxwell, 2012), para.5–043.
[7] Lord Sumption, "Foreign Affairs in the English Courts since 9/11", Lecture at the Department of Government (London School of Economics, 14 May 2012), p.6.
[8] Lord Sumption, "Foreign Affairs in the English Courts since 9/11" (2012), p.6.

we would have liked to have seen a greater consideration of the clarity of the position as a matter of international law. If it had been crystal clear that Russia had acted unlawfully or illegitimately then there would have been little prospect of a decision that would be embarrassing to the executive.

Conversely, if it were absolutely clear that Russia had not been engaged in unlawful or illegitimate activities, then it is hard to see why the executive should be protected from acknowledgement of that reality by the courts. It is in the grey middle ground, we suggest, where the act of state doctrine applies most strongly and, in our respectful view, there ought to have been more consideration of whether Ukraine's duress defence fell into that middle ground or raised issues of international law and foreign affairs that were near-indisputable. That approach is supported by *Kuwait Airways*,[9] in which the indisputability of the relevant breaches of international law was one reason given for the non-applicability of the act of state doctrine.

Blair J did state that in this case violations were disputed (by Russia at [308(vii)]) but that that should not necessarily be sufficient. The Judge, with respect, neither engaged with the "flagrant breach of international law" standard ("plain", "acknowledged") articulated in the *Kuwait Airways* case, nor with the "degree of international consensus" standard proposed by Lord Steyn in the same case. Blair J dismissed the *Kuwait Airways* case as "exceptional" (at [308]). Rather than addressing the clarity of the alleged breach of international law, he focused on the *subject-matter* of the alleged violation: on the use "central areas of abstention", "giving rise to core examples of issues upon which domestic courts should refrain from adjudicating" under the foreign act of state doctrine (at [307(x)]).

We would, however, welcome the Judge's acknowledgement that, if there had been a United Nations Security Council (UNSC) resolution condemning Russia's acts, the outcome might have been different (at [308(vii)]). Certainly, *R. v Jones*[10] (which the judgment referred to in a different way) is authority for such a proposition, stating (at [30]):

> "A charge of aggression, if laid against an individual in a domestic court, would involve determination of his responsibility as a leader but would presuppose commission of the crime by his own state or a foreign state. Thus resolution of the charge would (*unless the issue had been decided by the Security Council or some other third party*) call for a decision on the culpability in going to war … of … a foreign government … But there are well-established rules that the courts will be very slow … to adjudicate upon rights arising out of transactions entered into between sovereign states on the plane of international law." (Emphasis added.)

In our view, greater attention should also have been paid to the effects of non-justiciability or the drastic consequences of accepting Russia's plea of act of state: Russia's debt claim for US $3 billion succeeded and the Court was entirely precluded from considering Ukraine's duress defence. This merits two observations. First, the potential unfairness inherent in the act of state doctrine, which can effectively deprive parties of the right to rely on the full range of defences, is a compelling reason for confining its scope as narrowly as possible. Secondly, the act of state doctrine, which creates "forbidden zones" for the English court, should give rise to consideration of the suitability of English courts as the forum for resolution of these types of disputes; an issue that could have been considered by the court, as is discussed further below.

Summary judgment or stay of proceedings?

Having accepted that Ukraine's defence was non-justiciable as act of state, the Judge in *Law Debenture Trust* then went on to consider whether he should give summary judgment on Russia's claims or stay them (at [309]–[313]). Here, the Judge faced something of a Hobson's choice: if he gave summary judgment, he would be finding in Russia's favour without considering the full range of defences that Ukraine wished to advance but, if he stayed the proceedings, he would be keeping Russia out of a claim for US $3 billion that might well transpire to be wholly justified. The Judge declined to stay the proceedings but we submit that there may, in fact, have been a third way, as is developed below.

Implied term

The Judge rejected Ukraine's argument that it was an implied term of the notes that Russia would not impede its performance (which it allegedly did by invading Crime and eastern Ukraine, thereby hindering its ability to repay). The Judge's reasoning was, in outline, that it would be unfair on subsequent transferees if they were prevented from enforcing the notes by the breach of a previous noteholder, namely Russia (at [344]–[356]).

The solution, in our respectful view, is an implied term that would only prevent enforcement of the notes by noteholders who had themselves impeded Ukraine from performing its obligations; noteholders would not be prevented from enforcing the bonds by the conduct of their predecessors in title. The Judge ought not, therefore, to have given summary judgment on Ukraine's implied term defence.

Countermeasures

Ukraine argued that:

[9] *Kuwait Airways Corp v Iraqi Airways Co (No.6)* [2002] UKHL 19; [2002] 2 A.C. 883; [2002] 2 W.L.R. 1353.
[10] *R. v Jones (Margaret)* [2006] UKHL 16; [2007] 1 A.C. 136; [2006] 2 Cr. App. R. 9.

- non-payment of the eurobonds is action "directed against a State" (Russia) (at [360]);
- that non-payment constituted the non-performance of an international obligation of Ukraine (at [360]);
- that Ukraine refused to pay in order to induce Russia to cease its internationally wrongful act; and
- that it was proportionate, "given the severity of the effect of Russian interference on its territorial integrity and economy" (at [362]).

In substance, as the Judge acknowledged, the case on countermeasures was the same as the case on duress, placed in the context of non-payment (as a legal consequence to a wrongful act). Blair J held that "where the underlying acts concerned are non-justiciable, they cannot result in legal consequences through this route" (at [365]).

Novel in the contractual context as it may be (as pointed out by Ukraine) and having remained an aspect of the case that "was not developed at any length in oral submission", the definition of "countermeasures" as reflected in the judgment nevertheless is not accurate under international law. Ukraine's case defining countermeasures is summarised as follows (at [357]):

> "[C]ountermeasures are *unlawful actions* taken by one state against another in response to that other state having committed an internationally wrongful act in order to induce that other state to comply with its international obligations." (Emphasis added.)

It is not the case that countermeasures are "unlawful actions" in the referred context. As defined in *The International Law Commission's Articles on State Responsibility*,[11] a fundamental prerequisite for any *lawful countermeasure* indeed is the existence of an internationally wrongful act which injured the state taking the countermeasure, this point being made clear by the International Court of Justice in the *Gabčikovo-Nagymaros* case.[12] It is fair to say, however, that ultimately the decision on the arguments on countermeasures in the case was tied to the arguments on duress. Since the Judge found those arguments non-justiciable, the arguments on the legal consequences concerning the alleged duress could not be entertained either.

English Courts: a sort of forum non conveniens?

Are English courts a sort of forum non conveniens for resolving a claim which ultimately may turn on matters that are found to be "non-justiciable"? Professor Dapo Akande's observation that the "appropriate forum for resolving claims against foreign governments is not in the national courts of other states, but on the international plane", suggesting that the act of state doctrine may be a source of the forum non conveniens principle, supports this submission.[13]

Notwithstanding that Ukraine was prevented from relying on its defences by the doctrine of non-justiciability, the Judge ultimately declined to stay the proceedings, but we submit that there may, in fact, have been a third way. Under the Trust Deed, the Trustee appears to have had the option to elect between arbitration and English court proceedings (*Law Debenture Trust* at [37(xi)]). A defence of act of state would have been unavailable in international arbitration since it applies chiefly in domestic court proceedings (*Serbia v Imagesat*).[14] Further, there have been instances where recognition of the legitimacy of countermeasures has been examined in arbitral proceedings.[15] The Judge could have stayed the court proceedings on the basis that, if Russia wanted to enforce the notes, it could do so by commencing arbitral proceedings, in which Ukraine's full range of defences could be considered. This option, however, was not pleaded but it remains open to the Court of Appeal to consider it should it so wish.

Conclusion

Claims relating to foreign affairs of other states or public international law in English courts, often with little or no factual connections with the domestic system, as observed by McGoldrick in "The Boundaries of Justiciability", are a well-established legal phenomenon.[16] As noted by Whomersley, on the other hand,

> "the right of foreign states (or their surrogates) to bring claims in the English courts was first established in 1828 in *Hullet v King of Spain* (1 Dow. & Cl. 169) and was accepted as being available to a republic in *United States v Wagner* ((1866–67) L.R. 2 Ch. App. 582 CA)".[17]

It is clear—he asserts—"that as a general rule a state may bring proceedings to the same extent as a private person".[18]

In this case, two states faced each other, as private persons, in an English court.

[11] J. Crawford, *The International Law Commission's Articles on State Responsibility* (Cambridge: Cambridge University Press, 2002), Pt 3, Ch.II (Countermeasures), p.284.
[12] *Re Gabčikovo-Nagymaros Project (Hungary/Slovakia)* [1997] I.C.J. 7 at 55.
[13] D. Akande, "Transcript of British Institute of International and Comparative Law, Non-justiciability Reappraisal of Buttes Gas in the Light of Recent Decisions" (15 January 2007) quoted in H. Fox and P. Webb, *The Law of State Immunity*, 3rd edn (Oxford: Oxford University Press, 2013), p.60.
[14] *Serbia v Imagesat International NV* [2009] EWHC 2853 (Comm); [2010] 1 Lloyd's Rep. 324 at [120].
[15] Such as *Naulilaa (Responsibility of Germany for damage caused in the Portuguese colonies in the south of Africa)* (1928) 2 RIAA 1011 at 1025–1026, and others, as cited in Crawford, *The International Law Commission's Articles on State Responsibility* (2002).
[16] D. McGoldrick, "The Boundaries of Justiciability" (2010) 59(4) *The International and Comparative Law Quarterly* 981–1019.
[17] C.A. Whomersley, "Foreign states and British Courts" (2009) 125 L.Q.R. 227–233.
[18] Whomersley, "Foreign states and British Courts" (2009) 125 L.Q.R. 227–233.

In *Serbia v Imagesat*, Beatson J held that

> "in a commercial context not involving the sovereign acts of a state within its own territory the court need not refrain from deciding the disputed issue unless there is some indication from the executive that a decision will embarrass diplomatic relations between the United Kingdom and that state" (at [128]).

This is not a case where English courts have been called to look into the legal validity of the acts of sovereigns within their own jurisdiction but, centrally, on the legal validity of the acts of a sovereign state in its relations to another sovereign state under international law. Blair J held that this was non-justiciable in English courts. The Court of Appeal will have the opportunity to pronounce itself on the boundaries of the doctrine of non-justiciability in English courts in claims relating to the foreign affairs of two sovereign states. Should it find that English courts are prevented from ruling upon Ukraine's defences, it may be that a more appropriate forum available to the parties would have been arbitration.

Whatever the final outcome of the decision may be, the case neatly exemplifies the complexity and diversity of the matters litigated in the English courts which, as this case demonstrates, can include public international law arguments and foreign states litigating as private persons.