

UKRAINE AND RUSSIA: A PHONEY WAR

The Court of Appeal has ordered that Russia's claim against Ukraine for repayment of sums due on a Eurobond should go to a full trial. The Court rejected most of Ukraine's defences, but it decided that the question of whether Ukraine entered into the relevant agreements under duress required a full investigation of the facts. Beyond the special facts applicable to Russia and Ukraine, however, the decision will give comfort to participants in the sovereign debt markets.

Key issues

- Background
- Ukraine's capacity to borrow
- Ukraine's implied term
- Duress
- Conclusion

"All war", it was famously said, "is the continuation of diplomacy by other means". It seems that not only war performs this function - lawsuits can also do so. In *The Law Debenture Trust Corporation plc v Ukraine* [2018] EWCA Civ 2026, diplomatic and other relations between Ukraine and Russia lie at the heart of what is, on its surface, a simple claim for repayment of sums due on a Eurobond issued by Ukraine. The Court of Appeal has decided that Ukraine's defence that it only issued the Eurobond because of duress from Russia cannot be dismissed summarily and must, therefore, be the subject of a full trial. If the trial goes ahead, it will require an English court to determine what happened in Kyiv and Moscow in late 2013, as well as potentially to look into the insurrections in eastern Ukraine and Russia's annexation of Crimea.

This aspect of the case may attract the most attention, but the Court's rejection of Ukraine's other defences will reassure those in the more normal corners of the sovereign debt markets. The Court made it clear that it is, in general, difficult for sovereigns to escape their obligations on bonds and, in particular, that the ultra vires doctrine does not apply to sovereigns.

Background

In November 2013, Ukraine was scheduled to sign an association agreement with the EU at a gathering in Vilnius. Russia objected to Ukraine's plan to move towards the EU's orbit, and brought economic and other pressure to bear on Ukraine not to sign the agreement. Ukraine's President Yanukovich eventually succumbed to that pressure in return for a promise of cheap loans and gas from Russia. One of these loans was structured as a two-year \$3bn Eurobond, the documents for which were executed on 24 December 2013. These notes were structured in the usual way, were subject to English law and jurisdiction, and were listed on the Irish stock exchange. Russia was the only subscriber for the notes and remains the only holder (as was, it seems, always expected to be the case).

Ukraine's withdrawal from the proposed association agreement with the EU led to mass protest in Kyiv. In February 2014, President Yanukovich fled (to Russia), Russia invaded Crimea, and military interventions took place in eastern Ukraine, causing considerable dislocation and destruction.

Ukraine initially paid the interest falling due on the bond but, shortly before its maturity in December 2015, imposed a moratorium on repayment. Russia caused the trustee to bring proceedings in the English courts for the unpaid sums due. In *The Law Debenture Trust Corporation plc v Ukraine*, the trustee/Russia applied for summary judgment, i.e. judgment on the basis that none of the defences raised by Ukraine had any realistic prospect of success and, as a result, that the trustee/Russia should be able to enter judgment immediately without the delay and cost of a full trial. While Russia succeeded in defeating most of Ukraine's defences on this basis, the Court of Appeal decided that one defence, duress, required a full trial, thereby preventing judgment from being entered against Ukraine.

Ukraine's capacity to borrow

Ukraine argued that the bond was outside Ukraine's capacity and, as a result, void or, alternatively, that those who signed the documents for Ukraine had no authority to do so. This argument turned principally on quantitative limits in Ukrainian law on the debt that Ukraine could issue which, Ukraine argued, were violated by the issue of the bond to Russia.

The Court of Appeal decided that, as a matter of English law, foreign sovereign states have unlimited capacity, i.e. they can do anything that a natural person can do. Sovereign states are not in the position of companies or other corporate bodies established under national law that might be restricted in what they can do, with the consequence that acts beyond their competence could be ultra vires and void. A state itself cannot therefore rely on its constitution or other internal restraints as an automatic way out of obligations apparently freely undertaken.

A state can, however, question the authority of those who executed the documents on its behalf - in this case the Minister of Finance. Nonetheless, the Court of Appeal decided that, even if the Minister did not have actual authority under Ukrainian law, he had ostensible (or apparent) authority under English law (the law governing the bond documents). Ukraine had issued 31 tradeable bonds since 2003, each of which was executed by the Minister of Finance in accordance with Ukrainian law. While the trustee was taken to know that Ukraine had a debt ceiling, nothing in the transaction put the trustee on notice that this would be breached by the bond. Accordingly, the Minister of Finance's involvement was enough to bind Ukraine.

Ukraine was not, therefore, able to rely on the application of its internal laws to avoid its obligations where that application was unknown to the trustee.

Ukraine's implied term

Ukraine argued that a term should be implied into the documentation to the effect that Russia would not take steps that would deprive Ukraine of the economic benefit of the loan or make it impossible or impracticable for Ukraine to comply with its repayment obligations. Ukraine argued that by, for example, supporting rebels in eastern Ukraine and annexing Crimea, Russia had breached this implied term.

The Court of Appeal said that caution must be exercised regarding any argument that a term should be implied into tradeable bonds. In particular, an implied term must be derived from the contractual documentation that would be available to subsequent holders of the notes, not from information only available to the initial holder. Nothing could be implied from the relations between Russia (which was not even a party to the documents) and Ukraine at the time the notes were issued. The Court of Appeal considered that the terms Ukraine suggested should be implied would render the notes unworkable and untradeable and, as such, were inconsistent with the express terms of the notes.

As a result, the Court of Appeal rejected Ukraine's case on implied terms. The rights and obligations on bonds are generally to be found within the four corners of the documentation.

Duress

The basis upon which Ukraine defeated the trustee's/Russia's application for summary judgment was duress. Under English law, a contract can be avoided if illegitimate pressure has been applied to bring about the contract. The pressure does not necessarily have to involve illegal acts but must involve acts that are morally and socially unacceptable. There are very few cases in which a commercial contract has been avoided on grounds of duress.

The principal issue was whether it was appropriate for an English court to pass judgment on the conduct of one foreign sovereign state (Russia) regarding another foreign sovereign state (Ukraine), conduct that takes place in the realm of public international law rather than in the domestic law that courts are normally concerned with.

The Court of Appeal considered that there was sufficient "*domestic foothold*" for it to be able to make this judgment because the question arose in relation to a contract that was governed by English law and that gave jurisdiction to the English courts. Since the trustee's/Russia's claim arose in domestic law, Ukraine was entitled to raise all defences available in domestic law even if their determination required the courts to look into matters of public international law. The Court saw no difficulty in its considering these matters, not least because the allegations involved the use of force contrary to article 2(4) of the Charter of the United Nations.

The Court of Appeal considered that Ukraine had raised an arguable defence of duress on the facts which could not be determined on a summary judgment application. The issue therefore required a full trial, including witnesses. The Court observed that if Russia did not want an English court to decide the issue, it could accept Ukraine's suggestion that the issue be referred to the International Court of Justice, with the English proceedings put on hold until the ICJ reached a decision.

The Court of Appeal also said that, if it had decided that the issues raised by Ukraine's defence of duress were not ones that an English court could or should decide, the remedy would not be to give the trustee/Russia judgment, as the first instance judge had done, but rather to stay the trustee's/Russia's claim. It would be unfair to allow the trustee/Russia to proceed with its claim while at the same time depriving Ukraine of a defence otherwise available in English law.

Conclusion

The Court of Appeal's willingness to examine Russia's conduct in dissuading Ukraine from entering into closer relations with the European Union, as well as Russia's subsequent conduct regarding Ukraine, shows a robustness that English courts might not have displayed in the past when faced with disputes between sovereign states. But in structuring the sovereign financing as a conventional Eurobond and then causing proceedings to be brought in the English courts, Russia accepted all the incidents of English law and litigation. Russia could not invoke its private law rights but at the same time ask the court to dismiss Ukraine's defence of duress because it raised public international law issues.

That aspect of the case is, however, unlikely to be replicated in other sovereign bond issues. It is the English court's robustness on questions of capacity and authority, as well as implied terms, that will have wider relevance. The decision that the ultra vires doctrine does not apply to sovereign states is helpful in preventing states from relying on internal restrictions to avoid sovereign obligations. Similarly, an internal restriction (in this case, on debt levels) will not deprive signatories of ostensible authority to bind the state if breach of that restriction would not have been apparent at the time. The focus on the express terms of an issue, and an unwillingness to imply terms from circumstances not obvious to subsequent holders, means that, as a matter of English law, what investors see is what they get.

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