

## Why Investors May Pursue Int'l Arbitration On Russian Default

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On June 27, Russia defaulted on two series of foreign-currency sovereign debt — a U.S. dollar denominated bond due to mature in 2026 and a euro denominated bond due to mature in 2036 — when it failed to remedy missed \$100 million interest payments for these bonds within the 30-day grace period.

Sanctions imposed by the international community in response to the war in Ukraine complicated Russia's efforts to transmit the required interest payments to foreign bondholders through recognized depositaries, such as Euroclear.[1]

So long as such sanctions remain in effect, future defaults on other bond series are likely. Moreover, missed payments of principal may trigger cross-default and cross-acceleration provisions in Russia's foreign currency debt, giving rise to claims for payment by investors around the world.

As investors consider their options for bringing claims against Russia, the English courts may be top of mind, given that the 2026 and 2036 bonds are governed by English law.

However, international investment arbitration is a compelling alternative for investors owning Russian sovereign debt including, but not limited to, the 2026 and 2036 bonds.

International investment arbitration is a dispute resolution system based on international treaties that, subject to various conditions being met, allows foreign investors to bring claims and seek monetary damages and other relief directly against a sovereign state.

Notably, in the wake of the sovereign debt crises in Argentina and Greece, bondholders invoked rights under international investment treaties in an effort inter alia to recover the value of their investments in sovereign debt through international arbitration.[2]

This treaty-based system is available to investors from countries that have entered into investment treaties, the majority of which are known as bilateral investment



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treaties, or BITs, due to their bilateral nature between two countries.[3]

With more than 60 investment treaties currently in force between Russia and other countries, including Canada, the Netherlands, Singapore, Switzerland, the United Arab Emirates and the United Kingdom, international investment arbitration is available to investors in Russian sovereign debt from a large number of countries.

While there is no BIT currently in force between the U.S. and Russia, American investors who have structured their investments in Russian sovereign bonds through foreign subsidiaries or other foreign entities may nevertheless be able to access international arbitration.

Investors may be able to make a number of claims against Russia arising out of a sovereign debt default. First, many Russian BITs contain provisions requiring Russia and the other state party to the treaty to accord fair and equitable treatment to investments of investors from the other state.

Fair and equitable treatment protects inter alia an investor's legitimate expectations, which may include the right to on-time payments of interest in the payment currency — i.e., U.S. dollars for the 2026 bonds and euro for the 2036 bonds.

Although the 2026 bonds contain alternative payment currency provisions that allow Russia to make payments in currencies other than the U.S. dollar, these are restricted to the euro, the pound sterling or Swiss francs only, and thus do not include the ruble.

This fact could be the basis for a claim that Russia's failure to make timely interest payments on the 2026 bonds in an acceptable currency violates investors' legitimate expectations and thus, the fair and equitable treatment provision in the relevant treaties.

By contrast, the 2036 bonds permit payments in similar alternative currencies — U.S. dollars, pound sterling and Swiss francs — but also contemplate payment in rubles "for reasons beyond [Russia's] control."

Whether sanctions imposed by the international community in response to Russia's invasion of Ukraine were within Russia's control will likely be a significant issue in fair and equitable treatment claims, but a strong argument could be made that sanctions were an obvious and foreseeable consequence of Russia's decision to invade Ukraine.

Second, many Russia BITs protect against expropriation, unless the measures are in the public interest and respect due process, are nondiscriminatory, and are accompanied by just compensation. In addition, investment treaty tribunals have required investors to demonstrate a substantial deprivation of the value of their investment in recognition of the high bar required for expropriation.

The strongest expropriation claims are therefore likely to arise out of nonpayment of principal rather than missed interest payments for the 2026 and 2036 bonds. Accordingly, investors in Russian sovereign debt due to mature in the near future should continue to monitor Russia's conduct and consider potential investment treaty claims against Russia, particularly if principal payments are missed.

Third, many Russian BITs guarantee free transfers of investment-related funds, although the text of the BITs — and therefore the specific protections available — may vary. For example, the Netherlands-Russia BIT requires Russia to "guarantee to investors of [the Netherlands] that payments due to them

related to the investment can be transferred" and that such transfers "will be carried out in freely convertible currency, without unfounded restrictions and delay." [4]

The Netherlands-Russia BIT specifically defines transfers to include payments of interest as well as funds in repayment of loans relating to an investment in Russia. [5]

Accordingly, Dutch investors may be able to argue that Russia failed to guarantee that interest payments due to Dutch investors on the 2026 and 2036 bonds can be transferred without undue restriction or delay in violation of the Netherlands-Russia BIT and to seek compensation from Russia.

Russia's failure to guarantee the transfer of future payments of principal and interest in the specified currency of its foreign currency bonds may give rise to similar breaches under other BITs, depending on the specific language of the treaty.

Investors that bring investment treaty claims against Russia may face a number of defenses by Russia. First, Russia may argue that it was willing and able to make sovereign debt payments but was prevented from doing so by independent third parties.

For example, Russia's Minister of Finance Anton Siluanov stated that Western countries have "artificially create[d] a man-made default." [6] Russia may argue that it is not the proximate cause of any harm, and/or actions by Western countries are intervening acts that interrupt the chain of causation, such that Russia is not liable for any harm and/or exempt from paying damages.

However, investors could respond that economic sanctions and/or policies directed at a state are the foreseeable result of conduct by that state, such that Russia remains liable and responsible for paying damages.

Second, Russia may argue that it offered to make payments to foreign bondholders in accordance with state-sanctioned legislation (or at the very least offered to mitigate investors' harm) and is not liable to investors under applicable investment treaties.

For example, on June 22, Russia passed a decree that granted the country the right inter alia to open up special accounts that would allow the transmission of sovereign debt payments in rubles, at an amount equivalent to the value of Russia's foreign currency obligations, calculated at the exchange rate applicable in Russia's foreign exchange market.

It appears that foreign bondholders need to provide certain documents to Russia and its instrumentalities in order to opt in to receive payment under the terms of this decree. The decree also purports to recognize such payments as properly discharging Russia's obligations under its foreign currency denominated bonds.

Russia's attempts to satisfy its sovereign debt obligations through payment mechanisms outside of the terms and conditions of its sovereign bonds are unlikely to be persuasive in international arbitration. It is well recognized that a state's domestic law is no defense to international obligations. [7]

However, investors that opt in to receive such payments — assuming doing so is not prohibited by applicable sanctions — may waive investment treaty claims and should carefully evaluate the benefits and drawbacks of utilizing the procedures described in the June 22 decree.

Third, Russia may argue that it is immune to arbitration outside of Russia because it refused to waive its rights to sovereign immunity in foreign jurisdictions, to submit to the jurisdiction of foreign courts or tribunals, and to designate an agent for service of process in connection with any actions or proceedings arising out of the 2026 and 2036 bonds — as well as Russia's other sovereign debt.

However, these disclaimers do not affect the express terms of existing Russian BITs, in which Russia consented to submit certain disputes to international arbitration in relation to investments made after the applicable BIT was executed, which may include the 2026 and 2036 bonds.

Fourth, Russia may contend that the threshold jurisdictional requirements for accessing international arbitration are not met, particularly for investors that purchased Russian sovereign bonds after the war in Ukraine and imposition of international sanctions.

With regard to those recent purchases, Russia may argue that the purchases were speculative, unreasonable and consistent with long-standing investment treaty jurisprudence, do not qualify for investment treaty protection.

These types of arguments are likely to raise novel issues in investment treaty jurisprudence because such arguments in past arbitration cases concerned investors who purchased sovereign debt at discounted prices in the hopes of collecting the full value from highly distressed issuers through arbitration.

Russia's default on sovereign debt presents a different issue, primarily because Russia has repeatedly affirmed its ability and willingness to pay even in the face of sanctions. Accordingly, investors may be able to argue that they reasonably expected to receive the face value of Russian sovereign bonds, such that their purchases of Russian sovereign debt were not speculative and merit investment treaty protection.

By contrast, Russia could reply that investors knew that Russia would only be able to pay in full in rubles through alternative payment procedures not in the bond terms and conditions, and accordingly such purchases are too speculative to receive investment treaty protection.

If investors in Russian sovereign debt prevail in claims against Russia, international arbitration offers important advantages in enforcement. Unlike domestic court judgments, arbitral awards are not subject to appeal.

They are also readily enforceable around the world under the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which is a multilateral treaty that requires its 169 contracting states — including Russia — to recognize and enforce arbitral awards rendered in other contracting states, subject to very limited exceptions.

While Russia has historically attempted to evade enforcement of arbitral awards, economic sanctions have frozen many billions of dollars in Russian assets held outside Russia. Investors therefore may have an invaluable opportunity to seek a license from the applicable sanctions authorities to allow enforcement against such assets.

Thus, international arbitration presents a unique opportunity for investors in Russian sovereign debt to bring claims directly against Russia and collect from the state.

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[1] "Russia's Latest Eurobond Coupons Are Stuck at Euroclear," Bloomberg News, June 7, 2022.

[2] See, e.g., *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, Aug. 4, 2011; *Ambiente Ufficio S.p.A. and others v. Argentine Republic*, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, Feb. 8, 2013; *Giovanni Alemanni and Others v. The Argentine Republic*, ICSID Case No. ARB/07/8, Decision on Jurisdiction and Admissibility, Feb. 8, 2013; *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*, ICSID Case No. ARB/13/8, Award, Apr. 9, 2015.

[3] Investment Policy Hub, *Russia Bilateral Investment Treaties*, available at <https://investmentpolicy.unctad.org/international-investment-agreements/countries/175/russian-federation>.

[4] *Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Union of Soviet Socialist Republics (1989)*, Article 4 (unofficial translation of the Russian original).

[5] *Id.*

[6] "Russia threatens legal action if forced into sovereign debt default," Reuters, April 11, 2022.

[7] *Vienna Convention on the Law of Treaties (1969)*, Art. 27 ("Internal law and observance of treaties. A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.").