



# SOVEREIGN DEBT CONTRACTS AND SOVEREIGN DEBT POLICY

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PEIF RESEARCH GROUP MEETING  
APRIL 1, 2017

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# *Overview*

- I. In the news: Russia v. Ukraine
- II. Contract as policy
- III. Old and new challenges



Neutral Citation Number: [2017] EWHC 655 (Comm)

Case No: FL-2016-000002

**IN THE HIGH COURT OF JUSTICE**  
**QUEEN'S BENCH DIVISION**  
**COMMERCIAL COURT**  
**FINANCIAL LIST**

Royal Courts of Justice, Rolls Building  
Fetter Lane, London, EC4A 1NL

Date: 29/03/2017

**Before:**

**MR JUSTICE BLAIR**

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**Between:**

**The Law Debenture Trust Corporation P.L.C**

**Claimant**

**- and -**

**Ukraine, represented by the Minister of Finance of**  
**Ukraine acting upon the instructions of the Cabinet**  
**of Ministers of Ukraine**

**Defendant**

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**Mark Howard QC and Oliver Jones (instructed by Norton Rose Fulbright LLP) for the**  
**Claimant**

**Bankim Thanki QC, Malcolm Shaw QC and Simon Atrill (instructed by Quinn Emanuel**  
**Urquhart & Sullivan, LLP) for the Defendant**

Hearing dates: 17-19 January 2017  
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# *I. Law Debenture Trust v. Ukraine (2017)*

272. It is not disputed that the structure of the transaction is in standard form. However, the background is extraordinary, and in the court's view, it is not credible to describe this as an "ordinary debt claim". That is not to say that lending by one state to another does not come sometimes (or even usually) with strings attached. But as it is put in Ukraine's evidence, Russia's policy can be seen as keeping it on a "tight leash", and that assertion is sufficient on a summary judgment application.

iv) However, it is at this point that the legal nature of the transaction becomes decisive. For the reasons just given, the general principle that a term is necessarily implied in a contract that neither party will prevent the other party from performing it is inapt where the subject matter of the contract is transferable financial instruments such as the Notes because transferees or potential transferees have to be able to ascertain the nature of the obligation they are acquiring (or considering acquiring) from within the four corners of the relevant contracts.

# *I. Law Debenture Trust v. Ukraine (2017)*

- “Troubling circumstances” of the issuance are not justiciable under English law
- Tradable character of the Notes precludes the court from implying a duty for Russia not to impede Ukraine’s ability to pay it back

# *I. Now What?*

- Will Ukraine pay?
  - Not any time soon
- Can Russia block payments to Ukraine's \$15 bn restructured bond holders?
  - *Pari passu* clause
- If Ukraine paid Russia more on the \$3 bn Notes, can restructured bond holders get more too?
  - Most Favored Creditor and Collective Action Clauses
- What about \$1 bn from the IMF (TBA Monday)?

# *I. Contracts Unusually Important in Sovereign Debt*

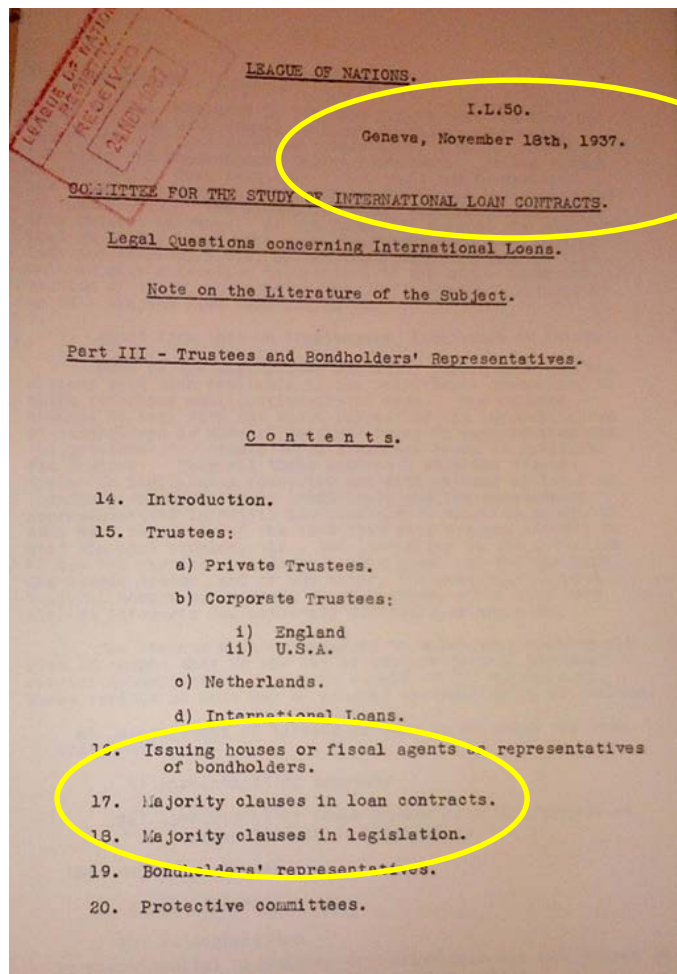
- No treaty bankruptcy
- Contracts are hard law
- History of successful (?) intervention
- Enforcement challenge

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## II. Contract as Policy



Academically appealing, practically near-impossible.

← 2 ↺ ❤️ ✉️



**Robin Wigglesworth** @RobinWigg 2h  
@ericlonners @Birdyword It took heavy arm-twisting from @EconomicsOne to get Mexico to introduce CACs, in reality a minor contractual tweak.

← 4 ↺ ❤️ 2 ✉️

❤️ Tony Fratto and Robin Wigglesworth like



**John B. Taylor**  
@EconomicsOne

@RobinWigg @ericlonners @Birdyword Yes! Taking ideas into practice is almost always hard, but really rewarding. So keep on trying.

7:35 PM · 30 Nov 16

Reply to John B. Taylor



Tweet



**Robin Wigglesworth** @RobinWigg 10h  
@frangildiaz1 @TonyFratto Who suggested it to Carstens though? Wasn't that @EconomicsOne? And in retrospect was SDRM that bad?

← 1 ↺ ❤️ ✉️



**Paco Gil Díaz** @frangildiaz1 10h  
@RobinWigg @TonyFratto @EconomicsOne I don't know, have to ask him. When first he proposed them I refused fearing a higher coupon

← 1 ↺ ❤️ ✉️

## *II. Three Waves of Contract Change*

2001-2003: Shift to Issue-by-Issue CACs in NY; ferment in London (response to Argentina) – EM and EU foreign-law bonds

- Need 15-25%+ of one issue to hold out

2010-2013: Shift to “Two-Limb” Euro-CACs in EU (response to Greece) – all new debt post 2013 (incl. domestic law)

- Need 50-55%+ of one issue to hold out

2012-2015: Shift to “Single-Limb” ICMA CACs and *Pari Passu* in NY and London (response to Greece and Argentina) – all foreign-law

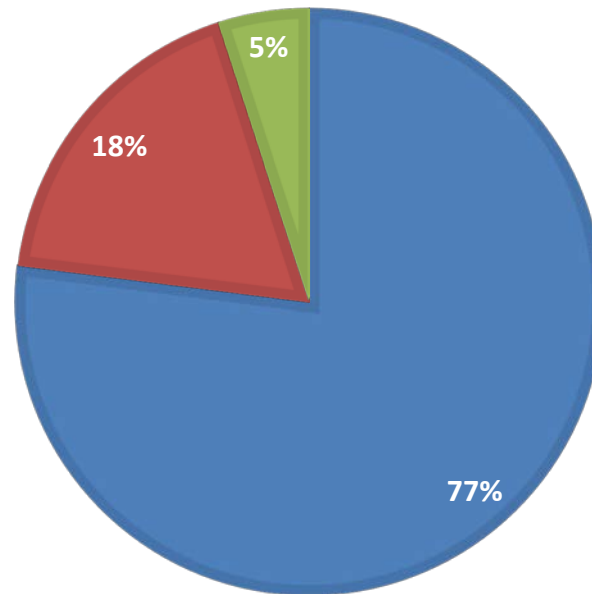
- No holdouts

## *II. Three Waves of Contract Change*

*Source: IMF (2016)*

**CAC ADOPTIONS IN FOREIGN-LAW BONDS, \$1.032 TRILLION  
(OCTOBER 2016)**

■ 1st & 2d Wave ■ 3rd Wave ■ No change



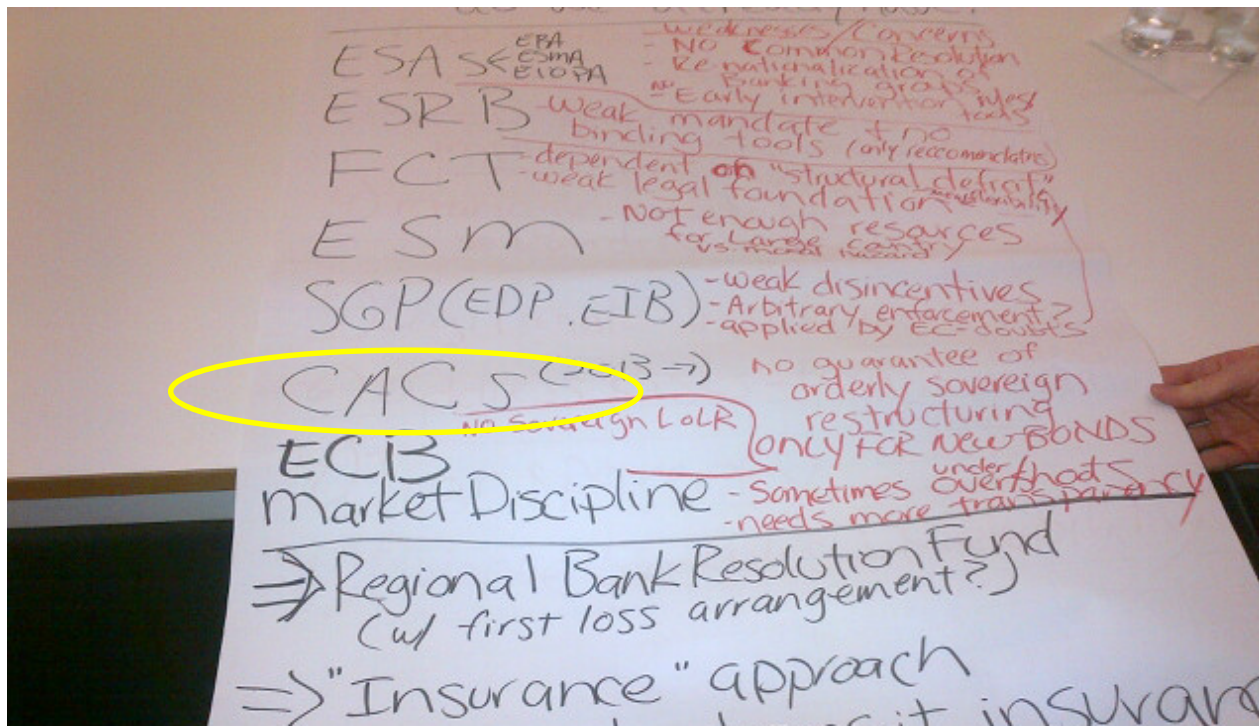
## *II. Is Contract Reform a Good Way to Reform Debt/Debt Restructuring Policy?*

- Private contracts are private
  - Official sector has no comparative advantage drafting
  - Limited information and accountability
- Standard-form contracts are hard to change
  - Adoption is voluntary
  - Stickiness
- When contracts change, they are rarely uniform
  - “Payment”
  - Fragmented interpretation and enforcement

## II. *Risk of Minor, Symbolic Change Displacing Substance*

[W]hether [issuers] include or exclude CACs meant not a hill of beans—which turned out to be the case. I thought it was entirely political.

Investment banker for a 2003 EM CAC issue (2005)



## *II. Can Contract Reform Backfire?*

- Issue-by-Issue CAC bonds can be more susceptible to free-riding

- Confusion:

*With the inclusion of collective action clauses, the type of 'holdout' litigation at issue here is not likely to reoccur.*

NML Capital Ltd. v. Republic of Argentina, 699 F.3d 246 (2d Cir. 2012)

- CACs in domestic law bonds may\* operate as a constraint on governments' ability to restructure

- Fear of signal leads to drowning all signal:

*They posed the question: ... would you add a seatbelt to your car? ... Would you buy a bond from a very strange guy, sitting in a building wearing a helmet?*

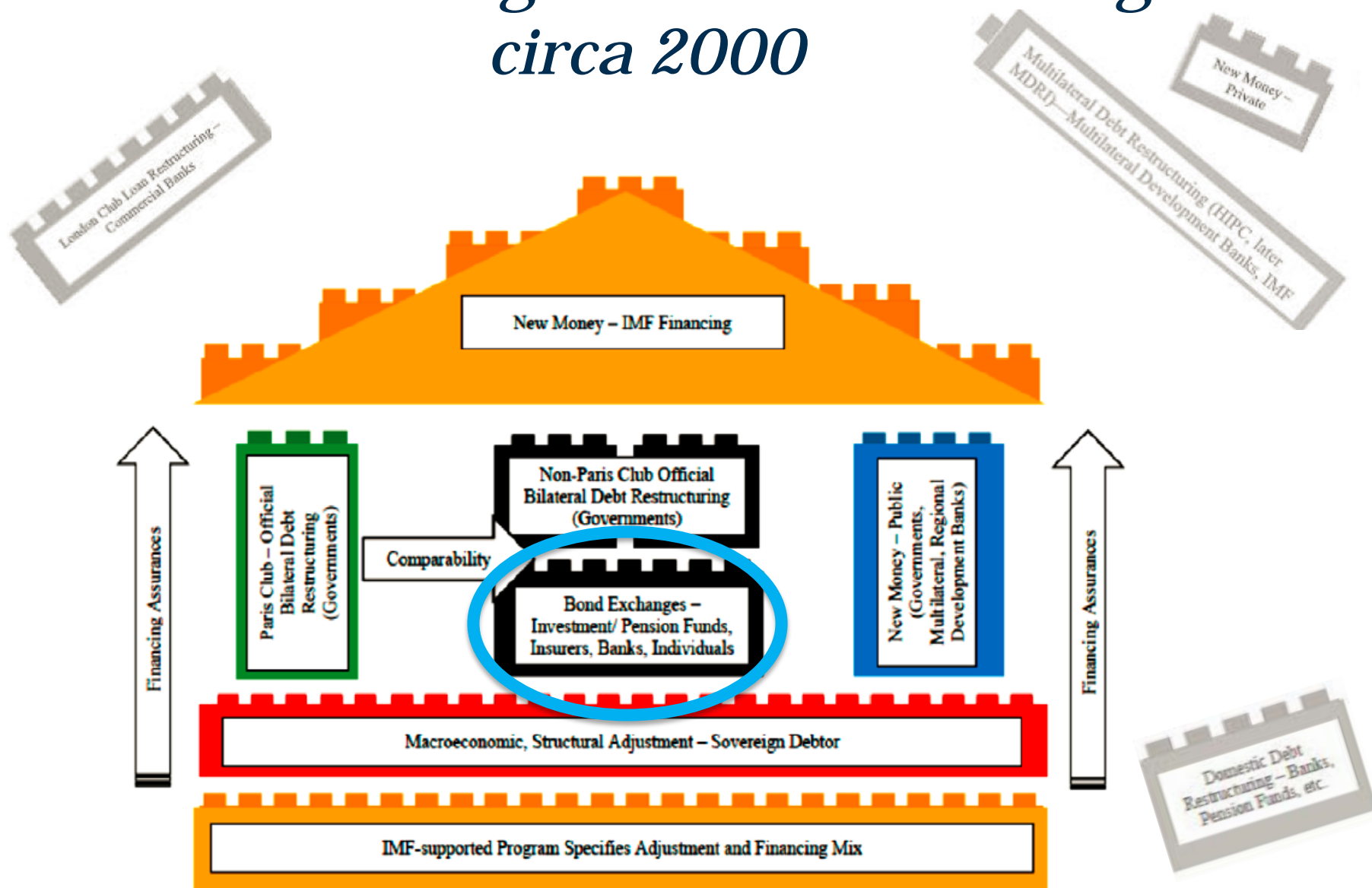
Small, high-income country debt manager, 2015

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# III. Sovereign Debt Restructuring circa 2000





### *III. Old Regime*

- Modules – incentives roughly matched remedies, relatively stable
- Sequencing
- Cross-conditionality
- IMF at the core

*“For 30 years sovereign debt restructurings  
have gotten done.”*

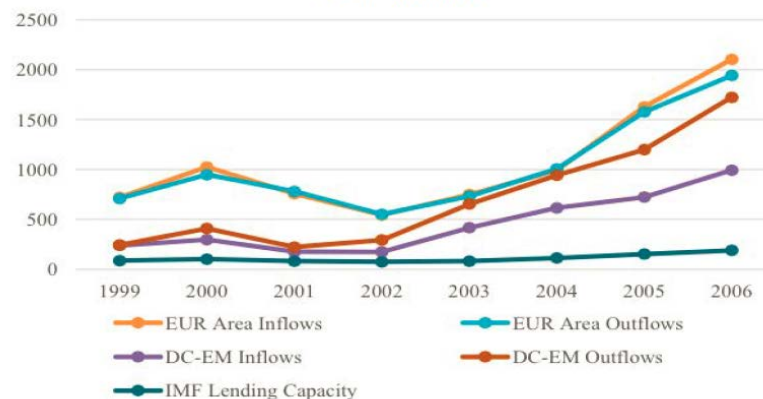
### III. New World

- Modules break down
  - Foreigners hold domestic debt
  - Governments hold private debt
  - New stakeholders
  - Hybrid forms of financing
- Sequencing, cross-conditionality weaken
  - New stakeholders
- IMF shrinks relative to potential needs
  - Implications of cofinancing

*Moreover, the ECB has stated in its written observations that, in the context of a restructuring subject to CACs, it will always vote against a full or partial waiver of its claims.*

Opinion of Advocate General Cruz Villalón (January 14, 2015)

Total Capital Inflows and Outflows, IMF Lending Capacity  
Euro Area, Developing Countries and Emerging Markets  
(USD billions)



Source: IMF <sup>93</sup>

# *Now What?*

- Contract reform can be a good thing (and worth improving), but ...
- It is no substitute for debt policy or regime design.
- It made some sense against the background of an informal institutional order, but ...
- It cannot be the main tool for addressing the new challenges of that order breaking down.



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