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Russia's Payment of Principal and Interest in Rubles of U.S. Dollar-Denominated Debt May Give Rise to Claims under International Investment Treaties

On April 11, 2022, the EMEA Credit Derivatives Determinations Committee (CDDC) determined that the state-owned Russian Railways is in default on a missed bond payment. Russian Railways tried to make the interest payment due March 14, 2022 but asserted that it was unable to do so, citing "legal and regulatory compliance obligations within the correspondent banking network."¹ The CDDC's decision that Russian Railways is in default raises questions as to whether Russia's efforts to pay its U.S. dollar-denominated sovereign debt in rubles would likewise trigger an event of default.

Last week, the U.S. Treasury blocked Russia from accessing its U.S. dollar reserves in U.S. banks. Russia's Ministry of Finance announced on April 6, 2022 that it had paid the country's English law governed, U.S. dollar-denominated debt obligations in rubles, including principal and interest payments due April 4, 2022. The Ministry of Finance also confirmed that the payment was made into an account at Russia's National Settlement Depository. These funds remain inaccessible to investors from the United States, European Union, and other nations that Russia has designated as "unfriendly" in response to economic sanctions.² There are strong reasons to believe that Russia's moves, upon the expiration of the relevant grace period, will constitute an event of default. This Client Alert considers the implications of a sovereign default by Russia on its dollar-denominated debt and the potential claims available to investors to seek redress directly from Russia through international arbitration.³

The Terms and Conditions of Russia's Sovereign Bonds with Principal and Coupon Payments Due April 4, 2022

In 2012, Russia issued sovereign bonds in an aggregate principal amount of \$2 billion, interest to be paid at 4.50% two times yearly, and a maturity



date of April 4, 2022 (“2022 Bonds”). Russia also issued sovereign bonds in an aggregate principal amount of \$3 billion, interest to be paid at 5.625% two times yearly, and a maturity date on April 4, 2042 (“2042 Bonds”). The terms and conditions (“Bond Terms and Conditions”) of the 2022 Bonds and 2042 Bonds specify that the “U.S. dollar is the sole currency of account and payment for all sums payable by the Russian Federation under or in connection with” the applicable series.

Non-payment of “any amount of principal or interest” of either series (i.e., the 2022 Bonds or the 2042 Bonds) for a period of 30 days after the due date constitutes an event of default for that series.⁴ Upon the occurrence of an event of default under either series, bondholders holding 25% or more of the aggregate outstanding principal for that series of bonds may declare those bonds immediately due and payable.⁵

Russia’s failure to pay the principal due on the 2022 Bonds and the interest due on the 2042 Bonds in U.S. dollars would be a breach of Russia’s obligations under the Bond Terms and Conditions, and if not remedied within the applicable grace period, will give rise to an event of default under the 2022 Bonds and the 2042 Bonds, respectively.

Investors in the 2022 Bonds and 2042 Bonds May Have Investment Treaty Claims Against Russia

Although Russia has not waived its right to sovereign immunity, has not consented to the jurisdiction of any court and has expressly stated as much in the offering circular for the 2022 Bonds and 2042 Bonds, this does not affect Russia’s existing consent to submit certain disputes to international arbitration in more than 60 investment treaties currently in force between Russia and other States. For the most part, these treaties are bilateral, meaning that they are signed between Russia and one other State – hence their name “Bilateral Investment Treaties” or “BITs.” These BITs protect investments made by foreign investors in Russia and, subject to certain conditions being fulfilled, allow investors from jurisdictions with BITs currently in force to bring claims and seek monetary damages and other relief directly against Russia. Indeed, BIT claims in connection with sovereign defaults and/or sovereign debt restructurings have been brought by investors in Greek and Argentine sovereign bonds in connection with Greece’s and Argentina’s respective sovereign debt crises.⁶ This Client Alert describes examples of potential claims that investors in the 2022 Bonds and 2042 Bonds (including secondary market purchasers) may bring against Russia arising out of a default.⁷

Fair and equitable treatment

Many BITs to which Russia is a party contain provisions requiring each State party to the treaty to “accord in its territory fair and equitable treatment to investments of investors of the other [treaty state].”⁸ Russia’s failure to make payment in U.S. dollars, which is expressly recognized in the Bond Terms and Conditions as the “sole currency of account and payment,” raises potential fair and equitable treatment claims. There are good reasons to believe that investors had a legitimate expectation that Russia would make payment in U.S. dollars promptly on April 4, 2022 and that Russia would remedy any failure to do so prior to the expiration of the applicable grace period. Absent a cure, investors may argue that Russia violated the fair and equitable treatment standard by breaching their legitimate expectations related to payments of principal and interest and therefore may be entitled to compensation.

Although the Bond Terms and Conditions for the 2022 Bonds and the 2042 Bonds contemplate the possibility that an investor may receive funds in currencies other than the U.S. dollar in connection with court proceedings (e.g., “whether as a result of, or the enforcement of, a judgement or order of a court of any jurisdiction or otherwise”), it is doubtful that this provision permits Russia to render payments of principal and interest in rubles. Moreover, the Bond Terms and Conditions make clear that Russia “shall indemnify such recipient against any loss” where the “U.S. dollar amount [received] is less than the U.S. dollar amount expressed to be due to the recipient under any Bond.” Accordingly, to the extent that the value of the ruble drops between the date on which Russia deposited in rubles the principal on the 2022 Bonds and the interest on the 2042 Bonds into the National Settlement Depository and the date



on which investors are able to access those funds, investors may assert breach of the fair and equitable treatment standard and claim compensation.⁹

Free transfer and repatriation of funds

Many BITs to which Russia is a party guarantee free transfers of investment-related funds, although the text of the BITs—and therefore the specific protections available—may vary. Currently, certain investors, including but not limited to U.S. and European investors, which Russia has designated as “unfriendly,” are blocked from accessing ruble principal and interest payments held in Russia’s National Settlement Depository. Accordingly, Russia’s actions may give rise to a breach of guarantees of free transfers of investment-related proceeds.

Impairment of investments by arbitrary or discriminatory measures

Many BITs to which Russia is a party protect against “impair[ing] by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal” of investments of investors of the other State party to the treaty.¹⁰ Russia’s decision to ring-fence in the National Settlement Depository ruble payments of principal on the 2022 Bonds and interest on the 2042 Bonds for investors from “unfriendly” jurisdictions, but not investors from other jurisdictions, is discriminatory. Moreover, notwithstanding that Russia has deposited rubles in the aggregate amount which it considers sufficient to discharge its current obligations under the 2022 Bonds and the 2042 Bonds, the value of the ruble may decline before investors designated as “unfriendly” may access those funds. Accordingly, Russia’s measures may give rise to a breach of non-impairment protections.

Treatment no less favorable than that accorded to Russian investors

Many BITs to which Russia is a party guarantee that investors will not be treated less favorably by Russia than domestic investors (known as national treatment protection) or investors from any third State (known as Most Favored Nation protection). The fact that Russia has blocked payments to investors from jurisdictions it has designated as “unfriendly,” but not Russian investors in U.S. dollar-denominated debt or investors from “friendly” jurisdictions, is textbook nationality-based discrimination prohibited under many BITs.

In sum, Russia’s conduct gives rise to numerous potential investment-treaty breaches and could entitle investors to claims for monetary damages to compensate for the loss or harm to their investments. Any claim would need to be assessed on a case-by-case basis depending on the nationality of the investor and exposure to Russian sovereign debt.

Russia’s Likely Defenses Against Investor-State Claims

Russia could bring several defenses against investors in any investor-State arbitration. To offer a few examples:

First, Russia may argue that threshold jurisdictional requirements needed to access international arbitration are not met because sovereign debt does not qualify as a “protected” investment under BITs. However, in landmark investment treaty cases against Argentina, including *Abaclat* (which involved approximately 60,000 claimants) and *Ambiente Ufficio*, the tribunals found that interests in sovereign debt were entitled to protection under the Argentina-Italy BIT. By contrast, the tribunal in *Poštová* found that interests in sovereign debt were not protected investments under the specific terms of the Slovakia-Greece BIT. Accordingly, the strength of Russia’s defense in any potential claim must be assessed by reference to the applicable BIT, particularly the definition of “investment” and whether on a fair interpretation it includes the 2022 Bonds and/or the 2042 Bonds. These arbitral tribunals’ decisions indicate that the precise language of each BIT is critical, along with the factual circumstances surrounding the acquisition of the bonds.



Second, Russia may argue that payment in rubles, as well as payment into the National Settlement Depository, is fully consistent with Russian law, particularly the Decree of 5 March 2022,¹¹ which provides that obligations to make payment in U.S. dollars, including to foreign holders of Russian sovereign debt, will be considered duly performed if paid in rubles. However, Russia is not permitted through government-issued decrees to unilaterally rewrite the Bond Terms and Conditions, which expressly state that the currency of account and payment in respect of the 2022 Bonds and 2042 Bonds is the U.S. dollar. The 2022 Bonds and the 2042 Bonds are governed by English law and set forth specific mechanisms to amend their terms (including payment terms), which do not permit the State's unilateral amendment. Moreover, under a black-letter principle of international law, States may not invoke their own domestic laws as a justification to violate their international obligations. Therefore, Russia's 5 March 2022 Decree would not serve as a defense against an international law claim for violation of a BIT.

Third, Russia may argue that it tried to discharge its U.S. dollar-denominated sovereign debt obligations but was prevented from doing so by third parties. For example, Russia's Minister of Finance Anton Siluanov stated that "Western countries" have "artificially create[d] a man-made default."¹² Russia may argue that it is therefore not the proximate cause of any harm, and/or actions by Western countries (as well as clearinghouses) are intervening acts that interrupt the chain of causation. Russia may argue that, as a result, it 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.

Fourth, Russia may assert that payment in rubles into a special account at the National Settlement Depository was reasonable in view of sanctions and policies that severely restricted its access to U.S. dollars and compromised its ability to render payment through U.S. banks. However, it appears that Russia has dollar-denominated reserves outside of U.S. banks but chose not to draw on them and therefore its decision to render payment in rubles was unreasonable. Russia could of course reply that it needed access to its other U.S. dollar reserves for other compelling reasons, such as national security.

Investors Could Also Bring Claims in the English Courts

International arbitration offers certain advantages over English litigation. Enforcement of an award is far more straightforward than an English judgment. In addition, arbitrators appointed in these kinds of disputes have greater expertise in the types of public international law issues that arise in matters against sovereigns. However, investors (depending on the special factual circumstances regarding their acquisition of the 2022 Bonds and/or the 2042 Bonds) could nonetheless consider bringing claims in the English Courts as an alternative. Although Russia will likely challenge the jurisdiction of the English courts, these challenges are likely to fail. The English courts will assume jurisdiction in a variety of circumstances, including where the relevant instrument is governed by English law or aspects of the underlying transactions have taken place in England, as here. Investors therefore may be able to bring claims against Russia under English law. Subject again to analysis of each case, there could be some advantages under English law with respect to establishing breach and avoiding potential jurisdictional issues that may arise in an international arbitration under a BIT.

Enforcement of an Arbitral Award

As described in our Client Alert, "Russia's Recent Actions Against Foreign Investors Will Give Rise to Claims Under International Investment Treaties,"¹³ an arbitral award may be enforced under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the "New York Convention"), which is a multilateral treaty that requires its 169 Contracting States (which include Russia) to recognize and enforce arbitration awards rendered in



other Contracting States, subject to very limited exceptions. Accordingly, the New York Convention permits investors to enforce arbitral awards in numerous other countries.

Although enforcement of an award (or judgment) will pose significant challenges, including because Russia has historically sought to shield its assets, international sanctions regimes have frozen many billions of dollars in Russian assets held outside Russia. To the extent that investors can identify frozen assets belonging to Russian state-owned entities that are recognized to be the alter ego of the Russian state, investors may seek a license from the applicable sanctions authorities to enforce arbitral awards against such assets.

Conclusions for Investors

Significant issues will arise for investors in Russia's sovereign debt denominated in U.S. dollars, including but not limited to the 2022 Bonds and the 2042 Bonds. Similar issues may also arise in the future for investors in Russia's sovereign debt denominated in euros. We recommend that investors:

- understand whether, and if so, to what extent, their investments in Russia are protected by international investment treaties, and the steps that investors need to take to ensure their investments continue to be protected;
- closely monitor the rapidly evolving developments in Russia, including Russia's non-payment of any foreign-denominated debt;
- analyze any requests by Russia to modify the terms and conditions of any foreign-denominated debt issued and whether voting in favor of such modifications adversely affects potential claims against Russia;
- evaluate participation in any debt buybacks and/or market sales of Russian sovereign debt and to what extent such actions may waive potential claims against Russia; and
- assess the relative benefit of an international arbitration under a BIT and a claim under English law in the English courts.



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¹ Karin Strohecker and Jorgelina Do Rosario, "Credit Committee Asked Bout Russia Gov't Bonds After Railways Ruling," Reuters, April 11, 2022.

² See Ministry of Finance, Press Release, "The Ministry of Finance of Russia transferred funds for the payment of coupon income and the redemption of Eurobonds to the National Settlement Depository," April 6, 2022.

³ Any claims available to investors in the 2022 Bonds and 2042 Bonds could apply to investors in Russian sovereign debt under any other debt instrument, to the extent an event of default occurs under that debt instrument in circumstances similar to that described here in relation to the 2022 Bonds and/or the 2042 Bonds.

⁴ The Bond Terms and Conditions for each series provide that Russia's "default[] in performance or observance of or compliance with any of its other obligations or undertakings in respect of the [2022 and 2042 Bonds]," after the expiration of a 60-day grace period, is also an event of default.

⁵ Moreover, the terms of certain other Russian foreign-denominated sovereign debt instruments contain cross-acceleration events of default similar to those set out in the Bond Terms and Conditions, which provide that Russia's failure to "make the final payment of principal" in excess of \$75 million on any Public External Indebtedness (which would, in the context of other debt instruments, be expected to include the 2022 Bonds) upon the expiration of any applicable grace period, constitutes an event of default. In the context of the Bonds Terms and Conditions, Public External Indebtedness includes, but is not limited to, bonds issued by Russia, denominated in currencies other than the ruble, and "not originally incurred or assumed under an agreement or instrument made with or issued to creditors substantially all of whom were residents of the Russian Federation or entities having their head office or principal place of business within the territory of the Russian Federation." Accordingly, the occurrence of a non-payment event of default at maturity of any Russian debt instrument (including the 2022 Bonds) could potentially cause an event of default to occur under other foreign-denominated Russian sovereign debt. Thus, investors in other foreign-denominated Russian sovereign debt may also have claims against Russia, should it be unable to meet its obligations as and when they fall due and which may be accelerated at the option of the requisite investors.

⁶ See, e.g., *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*, ICSID Case No. ARB 13/8, Award (2015); *Giovanni Alemanni and Others v. The Argentine Republic*, ICSID Case No. ARB/07/8, Decision on Jurisdiction and Admissibility (2014); *aclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (2011); *Ambiente Ufficio S.p.A. and others v. Argentine Republic*, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility (2013).

⁷ This Client Alert is based upon a review of the publicly available offering circular and Bond Terms and Conditions for the 2022 Bonds and 2042 Bonds. A detailed analysis of individual investors' claims would require a full analysis of all of the transaction documents.

⁸ See, e.g., Singapore-Russia BIT, Article 4(1); see also Netherlands-Russia BIT, Article 3(1); UK-Russia BIT, Article 2(2); UAE-Russia BIT, Article 3(1).

⁹ Many BITs to which Russia is a party also protect against expropriation, which may be available as another potential BIT claim.

¹⁰ See, e.g., Netherlands-Russia BIT, Article 3(1); UK-Russia BIT, Article 2(2).

¹¹ Decree No. 95 "On the Temporary Procedure for the Performance of Obligations to Certain Foreign Creditors," March 5, 2022.

¹² "Russian threatens legal action if forced into sovereign debt default," Reuters, April 11, 2022.

¹³ See [Russia's Recent Actions Against Foreign Investors Will Give Rise to Claims Under International Investment Treaties](#).