

P.R.I.M.E. Finance

Panel of Recognized International Market Experts in Finance

Emerging Themes in Financial Law



Sovereign Immunity: unequal players on a level playing field

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THE DOGMA OF THE LEVEL PLAYING FIELD

When entities otherwise entitled to immunity access the capital markets, they should be treated in the same way as the other players.

- No preferred creditor status: their claims should rank equal to all other creditors.
- Burden sharing: they should share in the burden when creditors are forced to take a haircut.
- No immunity: they should either waive immunity or be denied immunity.

However, what about the features of these entities that make them fundamentally different to other market participants?



TWO KEY CASES IN 2019

In 2019, two cases in the domestic courts illustrate that the mantra of equal treatment is unable to mask the reality that certain entities are different, which limits the extent to which they can be subjected to market rules.

- United States: *Jam v International Finance Corporation*
- United Kingdom: *The Law Debenture Trust Corporation plc v Ukraine*

The US case concerned the question whether the immunity of an international organisation should be restricted when its activities are deemed commercial/private.

The UK case suggests that, even when immunity is waived, submission to a domestic jurisdiction still may not yield satisfactory results.



JAM v IFC: LIMITS OF ANALOGY WITH STATES

THE INTERNATIONAL FINANCE CORPORATION

- The IFC's foundational instrument is a treaty, *i.e.*, *International Finance Corporation Articles of Agreement* (as amended through June 27, 2012).
- The IFC is an international financial institution that offers investment, advisory, and asset-management services to encourage private-sector development in less developed countries.
- It is a specialised agency within the meaning of the UN Charter.
- IFC's shareholders are sovereign States and its share capital is paid-in capital.
- The IFC leverages its capital to deliver financing for businesses in developing countries.



JAM v IFC: LIMITS OF ANALOGY WITH STATES (cont'd)

The immunity of the IFC is set out in three main documents:

- IFC Articles of Agreement: limited amenability to domestic jurisdiction in respect of its borrowing activities in the capital markets.
- UN Convention on the Privileges and Immunities of the Specialized Agencies: absolute immunity for all activities (contractual or non-contractual) unless waived.
- International Organisations Immunity Act: in the United States, absolute immunity for all activities (contractual or non-contractual) unless waived (until *Jam v IFC* in 2019).

In general terms, the IFC shares these characteristics with all global and regional multilateral financial institutions, except development funds.



JAM v IFC: LIMITS OF ANALOGY WITH STATES (cont'd)

- Indian farmers, fishermen and a small village brought a claim in the United States against the IFC for environmental harms suffered when the IFC financed the development of a coal-fired power plant in India.
- During the proceedings in the United States, the courts were faced with the question of whether the IFC enjoyed absolute immunity from suit under the International Organizations Immunities Act.
- Reversing the decision of the Court of Appeals for the District of Columbia, the Supreme Court of the United States decided that international organisations enjoy the same restrictive immunity from suit as that enjoyed by foreign governments under the Foreign Sovereign Immunities Act.



JAM v IFC: LIMITS OF ANALOGY WITH STATES (cont'd)

In reaching this conclusion, the Supreme Court held that:

- The IOIA is to be interpreted dynamically.
- The “*IOLA should ... be understood to link the law of international organization immunity to the law of foreign sovereign immunity, so that the one develops in tandem with the other*”.
- “*The privileges and immunities accorded by the IOLA are only default rules. If the work of a given international organization would be impaired by restrictive immunity, the organization’s charter can always specify a different level of immunity*”.
- There is no “*good reason to think that restrictive immunity would expose international development banks to excessive liability*”, since the activities performed by international organisations are not necessarily commercial and, even if they are, they do not necessarily have a sufficient nexus to the United States.



JAM v IFC: LIMITS OF ANALOGY WITH STATES (cont'd)

- This decision fails to appreciate the differences between States and international organisations. Justice Breyer (diss.) rightly explained:

[u]nlike foreign governments, international organizations are not sovereign entities engaged in a host of different activities. ... Rather, many organizations ... have specific missions that often require them to engage in what U.S. law may well consider to be commercial activities.

- The public/commercial dichotomy applicable to States cannot be applied to international organisations.
- This is particularly so when the *raison d'être* of certain international organisations, such as the IFC, is the performance of commercial functions such as extending finance to the private sector.



LAW DEBENTURE TRUST v UKRAINE: LIMITS OF PROPER LAW

A (NOT SO) NORMAL EUROBOND ISSUE – UK Supreme Court heard the following case in December 2019

- In 2013, Ukraine was on the verge of signing an Association Agreement with the European Union.
- Ukraine delayed signing the Association Agreement. Russia convinced the Ukraine administration into accepting Russian financial support instead.
- The financial support was structured as standard Eurobond notes issued by the State of Ukraine with a nominal value of USD 3bn. The sole subscriber of the notes was the Russian Federation.
- The transaction documentation was otherwise as usual for Eurobonds: the notes were constituted by a trust deed governed by English law with the Law Debenture Trust Corporation plc appointed as trustee.
- The notes were listed on the Irish stock exchange and fully tradeable instruments, although Russia has retained the notes since their issue.



LAW DEBENTURE TRUST V UKRAINE: LIMITS OF PROPER LAW (cont'd)

- In 2014, Russia invaded and annexed Crimea, impeding Ukraine's ability to meet its obligations under the notes (in particular, due to adverse effects on tax revenues).
- The principal amount of the notes fell due for payment on 21 December 2015. Ukraine refused to make payment and continues to do so.
- Following Ukraine's default, the Trustee (acting on the direction of the Russian Federation) brought proceedings against Ukraine in the English courts.



LAW DEBENTURE TRUST V UKRAINE: LIMITS OF PROPER LAW (cont'd)

Ukraine's defence was threefold:

1. Capacity and authority: The notes are void because, as a matter of Ukrainian law, Ukraine lacked legal capacity to issue the notes due to restrictions in its Constitution and Budget laws. Further, the ministers/officials who purported to act on its behalf in agreeing the issue of the notes lacked the authority to do so.
2. Breach of implied terms: Russia, by invading the Crimea, was in breach of implied terms, including, not to demand repayment if it (a) deliberately interfered with Ukraine's ability to comply with its obligations, or (b) breached its obligations to Ukraine under public international law.
3. Duress: The issue of notes was procured by wrongful and illegitimate threats and pressure, so as to vitiate the consent of Ukraine and to constitute duress as a matter of English law.



LAW DEBENTURE TRUST V UKRAINE: LIMITS OF PROPER LAW (cont'd)

The elephant in the room:

- In considering whether Ukraine can run a defence of ‘duress’ at trial, it is necessary to assess the conduct of Russia.
- Even though English law is the proper law, in essence, the dispute is a dispute between sovereign States.
- Does a choice of law and forum divorce the relationship between the two States from the underlying legal order governing their relationship, *i.e.*, public international law?
- No, if you ask an international tribunal: *The Loan Agreement between Italy and Costa Rica (Dispute Arising under a Financing Agreement)* (Award) PCA (1998) XXV RIAA 21.



LAW DEBENTURE TRUST V UKRAINE: LIMITS OF PROPER LAW (cont'd)

Lessons:

- The waiver of immunity and submission to domestic law is not a panacea.
- Whichever solution the Supreme Court of the UK opts for, it is likely that the underlying dispute will not be resolved.



Thank you



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