Financial Markets Law Committee ("FMLC")

Sovereign Debt Scoping Forum

Date: Tuesday 6 March 2018

Time: 8.30am to 10.15am

Location: Allen & Overy LLP, Bishops Square, London E1 6AD.

In Attendance:

Yannis Manuelides (Chair)	Allen & Overy LLP
Carter Brod	Morgan Lewis & Bockius LLP
Lachlan Burn	Linklaters LLP
Francis Fitzherbert-Brockholes	White & Case LLP
Leland Goss	ICMA
Jim Ho	Cleary Gottlieb Steen & Hamilton LLP
Andrew Shutter	Cleary Gottlieb Steen & Hamilton LLP
Harriet Territt	Jones Day LLP
Venessa Parekh	FMLC
Thomas Willett	FMLC

Guest Speakers:

Daniel Bayfield QC	3-4 South Square
Jeff King	University College London

Regrets:

Ian Clark	White & Case LLP
Robert Gray	
Michael Godden	Norton Rose Fulbright LLP
Duncan Kellaway	Freshfields Bruckhaus Deringer LLP
Robin Knowles CBE	
John McGrath	Sidley Austin LLP
Tolek Petch	Slaughter and May
Deborah Zandstra	Clifford Chance LLP

Minutes:

1. Introduction.

1.1. Yannis Manuelides opened the meeting and delivered a brief introduction.

2. Administration: a short presentation on the FMLC Radar Function – Revisited (Venessa Parekh)[1]

2.1. Venessa Parekh outlined the remit of the FMLC and its radar function, defined as the manner in which the FMLC identifies appropriate issues to analyse. The function can be broken down into three initiatives: (i) scoping forums; (ii) the relationship management programme; and (iii) radar meetings. She explained that the radar programme guarantees that the FMLC addresses those issues that are of most concern to stakeholders in the financial markets, ensuring that the FMLC's work is current and has impact.[2]

3. *Bakhshiyeva v Sberbank of Russia & Ors*, [2018] EWHC 59 (Ch): Implications for government agency debt (Daniel Bayfield QC)

3.1. Daniel Bayfield provided an overview of the arguments and judgment in *Bakhshiyeva v Sberbank of Russia & Ors* and its implications for government agency debt. In his introduction, Mr Bayfield highlighted that this was a significant case in deciding whether the rule in *Gibbs v Societe Industrielle des Metaux* (1890) 25 QBD 399 ("**the rule in Gibbs**") remains good law in the U.K. in the context of the Cross Border Insolvency Regulations ("**CBIR**"), which implement the Model Law on cross-border insolvency proceedings (the "**Model Law**") adopted by the United Nations Commission on International Trade Law ("**UNCITRAL**") in 2007. In the context of this common law principle and in relation to *Sberbank*, two questions of importance arise:

i. whether a U.K. court has the jurisdiction to impose a moratorium that extends beyond the term of the foreign restructuring; and

ii. whether a U.K. court might prevent English law governed creditors from enforcing English law governed debts?

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[1] Please see Appendix I below.

[2] If you would like to learn more about the FMLC radar programme, or become involved in one of the three initiatives, please contact Debbie Steen at secretarial@fmlc.org.

3.2. Mr Bayfield continued by outlining the facts of the case. The International Bank of Azerbaijan ("**IBA**"), an open joint-stock company, had fallen into financial difficulties and proposed a $3.3 billion restructuring of its debts in Azerbaijan. While a majority of creditors approved the plan, the Respondents, Sberbank—the sole lender under $20 million term facility agreement—and Franklin Templeton—the beneficial owners through Citibank as trustee of $500 million Notes—did not vote in favour of the plan. In June 2017, a Recognition Order in the U.K. was obtained by the IBA's Foreign Representative, recognising the Azeri Restructuring Proceedings as foreign main proceedings under the CBIR. A wide-ranging moratorium preventing creditors from commencing or continuing any action against IBA was imposed, and was binding on all creditors whether or not they voted for the plan. The Foreign Representative applied on behalf of the IBA for a permanent stay on creditors' claims in England under an English law governed contract contrary to the terms of the foreign insolvency proceeding. Sberbank and Franklin Templeton opposed the extension.

3.3. Mr Bayfield explained that the Respondents relied on the rule in *Gibbs,* which provides that the discharge of an English law governed debt under the insolvency laws of a jurisdiction outside of England and Wales is not a valid discharge of such debt as a matter of English law. *Gibbs*, however, was considered in contention with the principle of "modified universalism" which stipulates that a court has a common law power to recognise and grant assistance to foreign insolvency proceedings so far as it properly can. Ultimately, the High Court confirmed that *Gibbs* remained good law, noting that the Model Law was concerned only with procedural matters while any perpetual stay would have significant substantive impact. The IBA was not entitled to a permanent moratorium against creditor action in England and Wales. Mr Bayfield concluded by informing the Forum that the Court of Appeal would be considering this issue in October.

3.4. When the floor was opened to discussion, one Forum member observed that the IBA's application to continue the moratorium might have succeeded under Chapter 15 of the U.S. Bankruptcy Code, which usually recognises the conditional discharge of New York governed debt under foreign restructuring plans. Mr Bayfield agreed that the Azeri plan works in Azerbaijan and the U.S. under Chapter 15, but not in the U.K. He also noted that the Court had focused simply on the *Gibbs* principle and not considered the restructuring proceedings or their fairness at all.

3.5. One participant asked if the role of *Gibbs* remained relevant even in the context of the CBIR. Investors which engaged with opportunities in countries with unfamiliar and

unenforceable legal systems often did so mindful that English law would protect English law-governed debt. Mr Bayfield observed in response that despite the availability of recognition of foreign insolvency proceedings under Chapter 15 of the U.S. Bankruptcy Code, a sizable amount of debt in foreign countries is governed by New York law. In a situation such as this, creditors might challenge under Chapter 15 on policy grounds; Chapter 15 recognition has not reduced the demand for New York law-governed foreign debt. Another participant mused that both frameworks had interesting implications for the sovereign debt market and perhaps an international treaty would be needed to achieve uniformity.

3.6. Forum members agreed to return to this topic at a future meeting, perhaps after the appeal.

4. Odious debt and its legal implications (Jeff King)[3]

4.1. Professor King delivered a presentation on odious debt and its legal implications, with a focus on the recent developments in Venezuela. Professor King's remarks drew on his own research on the concept of odious debt in international law.[4]

4.2. Professor King began by providing an overview of recent analysis in the media of whether the odious debt doctrine could be applied in the case of Venezuela, where a future government could argue that the country's debts were not duly authorised by the National Assembly.[5] Professor King highlighted the difficulty in assessing whether a debt is odious or just unsavoury; the doctrine he had worked on, he hoped, offers a distinction.

4.3. Professor King explained that the odious debt doctrine has been met generally with scepticism from commercial lawyers and the World Bank. In international law, such analysts think there is no precedent of an odious debt defence succeeding and analysts worry that the concept undermines *pacta sunt servanda* ("agreements must be kept").

4.4. Next, Professor King offered Alexander Nahum Sack's initial hypothesis of odious debt, published in 1927, as the starting point. Since Sack, the concept of odious debt has been studied widely by international law scholars. For the most part it has come to be

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[3] Please see Appendix II below.

[4] For more information, see: King J, *The Doctrine of Odious Debt in International Law: A Restatement*, (2016), Cambridge: Cambridge University Press.

[5] See, for example: Wigglesworth R, "Venezuela crisis raises talk of 'Odious Debt' doctrine", *Financial Times*, (2017), available at: https://www.ft.com/content/fa6850cc-96c3-11e7-b83c-9588e51488a0.

understood as government debt which is undertaken without the approval of citizens and/or is used for purposes which do not benefit the country's populace.

4.5. Turning to his own definition, Professor King explained that he has identified four variants of odious debt: (i) war debts; (ii) illegal occupation debts; (iii) subjugation debts; and (iv) corruption debts. Concentrating on subjugation debt, Professor King emphasised that these are loans used for "unlawful purpose"—i.e., contrary to public policy and used to commit serious or grave breaches of *jus cogens* norms, human rights and/or humanitarian law. As most sovereign debt is issued under English and New York law, Professor King explained that, according to the case-law of both systems, contracts and loans made to facilitate such core violations of international law could be held unenforceable. There exists, however, a doctrinal debate in the assessment of "illegality", wherein it is unclear whether a party's *participation* or mere *knowledge* of the unlawful purpose is required to sustain an illegality claim in New York and U.K. law. For particularly egregious crimes, many authorities claim that mere knowledge alone is sufficient.

4.6. Professor King then returned to the context of Venezuela. He explained that, even before the U.S. applied sanctions in 2017 freezing President Nicolás Maduro's assets under U.S. jurisdiction and preventing U.S. citizens from doing business with him, Goldman Sachs were considerably criticised for paying $865 million in May 2017 for PDVSA bonds. If an odious debt claim is made, Professor King continued, it would depend on the definition of subjugation debt. Any identification of Venezuelan debt as odious would depend on the purpose of the loan, in which case the so-called "Hunger Bonds" and any other refinancing of the loan with cash pay-outs to the Venezuelan government or to PDVSA which would help sustain the Maduro regime would become relevant. Professor King concluded that there could be a legal basis for a successor government in Venezuela to invoke the odious debt doctrine, in proceedings in U.K. or U.S. courts, in respect of any new loans made since August 2017.

4.7. Forum members discussed the definition of "corruption debts". A participant asked why a new doctrine of odious debt would be required when existing laws of fraud or default might serve the purpose just as well. Professor King clarified that such an argument could easily be mounted without using the term "odious debt". That said, in countries where governments might follow all domestic laws in securing loans which were then used decidedly not to citizens' benefit, the concept would prove useful. He acknowledged that there would, in practice, be a high threshold of proof to establish that

an actual debt is for the purpose of facilitating serious breaches of jus cogens, human rights or humanitarian law norms.

4.8. Another question was raised about the transferability of wilful blindness and the implications of an odious debt defence for participants in the secondary market. Professor King said that there was no law applying the doctrine to secondary markets but in his own research he has argued that, especially given the calibre of legal advice available to institutional investors, the doctrine should apply. A short discussion ensued on whether the advent of real-time trading complicated this.

4.9. The nexus between financing and violation of human rights law was considered by Forum members. An attendee highlighted the tightrope to be navigated when invalidating debt obligations, where courts are keen not to let off a successor government that isn't necessarily working to benefit its citizens while punishing innocent populations. Members queried if this was the best way to tackle human rights issues. Professor King noted that that where two parties engage in an illegal transaction, the defendant always has the upper hand. From a policy perspective, there is no reason to be more worried about giving debt relief to these dodgy sovereigns than with saddling the people of those countries with a debt burden they shouldn't legally have. Forum members agreed to monitor the development of the doctrine especially as the crisis in Venezuela progresses.

5. Other developments: plenary discussion (Yannis Manuelides)

5.1. Yannis Manuelides brought the Jubilee Debt Campaign's efforts to make "secret" loans unenforceable to Forum members' attention. He explained that the Campaign aims to change U.K. law to ensure that debts governed by English law are required to be transparent. Mr Manuelides observed that these efforts were likely in reaction to the debt crisis in Mozambique where the Attorney General has announced legal action against government officials who contracted "secret" loans from the London branches of Credit Suisse and VTB. $2 billion of loans were issued in 2013 but were not publicised until 2016.

5.2. Mr Manuelides also briefly mentioned the publication of a book on bonds linked to gross domestic product ("**GDP**").

6. Any other business.

6.1. A Forum member drew attention to a Dutch proposal to make Euro-area sovereign debt subject to the same/similar requirements for bail-in and loss absorbing capacity as

applicable to large banks. Forum members noted this with interest and agreed that this topic should be included on the agenda for the Q2 Forum meeting.

6.2. An attendee mentioned that the Russia/Ukraine Eurobond litigation had been heard by the Court of Appeal but judgment had been withheld. Forum members agreed that an update should be provided at the next Forum meeting.

The FMLC Radar Function: *revisited*

Venessa Parekh, FMLC Research Manager

FMLC Remit

"The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed."

FMLC Founding Documents, September 2002

FMLC Mission

- According to the remit, the FMLC has a tripartite mission:
  - to identify relevant issues (the **radar** function);
  - to consider such issues (the **research** function); and
  - to address such issues (the **public education** function).
- The **radar function** relies on the FMLC's **scoping forums** and other horizon-scanning, advisory bodies. It also relies on a **relationship management programme** which the FMLC Secretariat maintains with Patrons and Stakeholders.
- The **research function** is addressed by the FMLC Secretariat and by highly-focused working groups who work to draft papers and correspondence on behalf of the FMLC.
- The **public education function** is furthered when the FMLC publishes these letters and papers. It is also addressed by the regular programme of events organised by the FMLC Secretariat, including: roundtables, seminars and conferences. These feature high-profile guest speakers.

Breaking down the radar function

The FMLC's radar function is (broadly) broken down into three initiatives:

1. **Scoping forums**
2. **Relationship management programme;** and
3. **Radar meetings**

Scoping Forums

"Scoping forums serve as an avenue for the FMLC to engage with focus groups on legal issues affecting specific segments of the financial markets.

The forums serve as spaces for discussion of broader issues of legal uncertainty, and members formulate and propose to the FMLC issues considered by them to cause substantive legal uncertainty to their industry."

FMLC Brochure, January 2017

Scoping forums in practice

- A scoping forum establishes a **pool of expertise** available to the FMLC. That pool of expertise can guide the FMLC in **establishing priorities**, **allocating resources** and **recommending specific issue to the FMLC for analysis**.
- Scoping forum members can make non-binding suggestions as to the manner of the FMLC's engagement and nominate experts for working groups.
- They often include presentations from industry experts, individuals with first-hand experience of legal uncertainty and those working at the cutting edge of their respective fields (presenters are often all three at once).
- **Scoping forums discuss all manner of topics, issues and solutions within their chosen sector.**
- Not every issue discussed will go on to become an issue adopted by the FMLC. Scoping forums are horizon-scanning bodies and places to share and compare knowledge. They are about **learning and discovery** as much as they are about **evaluating specific issues for further consideration.**
- Information about the FMLC's scoping forums—as well as the agenda and minutes of all 2017 meetings—can be found on our website at: http://www.fmlc.org/scoping-forums.html

Relationship management

- Another key aspect of the radar function, the FMLC's **relationship management programme**, ensures regular communication and information exchange between the FMLC Secretariat and Patrons, Members or other stakeholders.
- Relationship management calls provide a valuable opportunity for participants to highlight issues—both present and future—for the FMLC to investigate, providing the FMLC with up-to-date and market-relevant information. They also allow the FMLC Secretariat to update Patrons and stakeholders on the Committee's recent work.
- FMLC Patrons have calls monthly. We try to organise calls with a predetermined list of stakeholders when time permits.
- Monthly relationship management calls normally last around 15 minutes. If you're a Patron who'd like to participate in your firms' monthly call (as an alternate perhaps), or if you'd like to receive a stakeholder call, let us know!

Radar meetings

- FMLC Chief Executive Joanna Perkins regularly meets with financial markets participants to discuss issues of legal complexity.
- These meetings are an excellent opportunity for the exchange of information. Participants can:
  - raise issues of concern or interest in relation to legal complexity, and
  - learn about the FMLC's recent work and insights, get updates on forthcoming publications or—in the case of new contacts—learn more generally about the work and remit of the FMLC.
- Please speak to a member of the Secretariat if you are interested in arranging a meeting with your firm or organisation.

Information exchange

- The Radar programme guarantees that the FMLC addresses those issues that are of most concern to stakeholders in the financial markets, across the public and private sector.
- It also helps to ensure that the FMLC only addresses in depth issues that are material and may have an appreciable impact on the international wholesale financial markets.
- Together, these three Radar initiatives ensure our work is current and has impact.

Summary and Conclusion

To sum up…

- The FMLC is tasked with identifying, considering and addressing **legal uncertainty**…
- …which is sometimes better thought of as "legal risk".
- The **radar function** is the manner in which the FMLC identifies appropriate issues to analyse.
- The radar function is fulfilled through **scoping forums, relationship management calls,** and **radar meetings.**
- At this time, the FMLC Secretariat would be grateful for help with **assessing legal risks, identifying priorities** and **selecting issues for further work**.