

University of Virginia School of Law

Public Law and Legal Theory Research Paper Series 2023-40
Law and Economics Research Paper Series 2023-10

May 2023



Contractual Howlers: A Russian Bond Case Study

By

Robert E. Scott
Columbia University - Law School

Stephen J. Choi
New York University School of Law

Mitu Gulati
University of Virginia School of Law

Abstract 4438641

A complete index of University of Virginia School of Law research papers is available at:
Law and Economics: <http://www.ssrn.com/link/U-Virginia-LEC.html>
Public Law and Legal Theory: <http://www.ssrn.com/link/U-Virginia-PUB.html>

CONTRACTUAL HOWLERS: A RUSSIAN BOND CASE STUDY[†]

Robert E. Scott,^{*} Stephen J. Choi,^{**} and Mitu Gulati^{***}

Abstract

Both theorists and courts commonly assume that high-dollar financial contracts between sophisticated parties are free of linguistic errors: sophisticated parties, the thinking goes, will carefully express their shared intentions and eliminate any troublesome gaps and glitches. Consistent with this assumption, most courts interpret the language of commercial contracts literally according to the plain or ordinary meaning of the words in the agreement. An examination of contracts governing Russian bonds outstanding in 2022, however, reveals a large number of troublesome contractual gaps and glitches. We refer to these linguistic irregularities

[†] We owe a special thanks to comments at a presentation we did for the Financial Markets Law Committee Meeting in September 2022. The comments, which were from a set of experts in the field, were on a ‘not for attribution’ basis so we do not thank those lawyers by name. Thanks also to Lee Buchheit, Albert Yoon, Anthony Niblett, Yannis Manuelides and Mark Weidemaier for their general comments.

^{*} Faculty of Law, Columbia University, New York, NY, United States.

^{**} Faculty of Law, New York University, United States.

^{***} Faculty of Law, University of Virginia, Charlottesville, United States.

as “howlers” to highlight the significant litigation risks they create. In this paper we use interviews with market participants to assess the causes of the contractual howlers we observe in the Russian bonds. The presence of howlers undermines the core assumption that justifies the literal interpretive approach used by courts for contracts between sophisticated parties.

I Introduction

Contract theory and legal doctrine typically posit that financial contracts among sophisticated parties, if not fully state contingent, are close to being complete.^[1] There will likely be only a few contingencies that are so remote that the parties could not reasonably have foreseen them. Courts in jurisdictions that are favoured by commercial actors, such as New

^[1] See Elisabeth de Fontenay, ‘Complete Contracts in Finance’ [2020] Wis L Rev 533 (‘[j]udges tend to believe that sophisticated parties should write lengthy agreements that explicitly provide for the parties’ conduct under every contingency, because, in their view, such “complete” contracts come closer to expressing the parties’ entire bargain’ at 535). An implication of this assumption is for courts to take a strict textualist approach to contract interpretation – that is, to assume that the literal text is what the parties wanted and to not look deeper into context for possible nuance. See also Uri Benoliel, ‘The Interpretation of Commercial Contracts’ (2017) 69:2 Ala L Rev 469 at 472–80 (noting the lack of empirical evidence on what commercial parties actually prefer and providing some examples).

York,^[2] will only seek to fill the gaps caused by the failure to anticipate these contingencies if it is clear, *ex post*, (a) that the contingency was too remote to anticipate and (b) the judicial solution is what the parties would have negotiated had they thought of the issue.^[3] The inference is that the failure to allocate the risks of reasonably foreseeable contingencies is most likely intentional and the court will typically let the risk fall on the party who was disadvantaged by fate.

The implication of this assumption of completeness is that if there is an explicit provision in the contract dealing with a contingency there is no hypothetical bargain to be constructed: Once there is a provision on point, the question becomes one of interpretation rather than gap filling. Moreover, courts in financial matters involving sophisticated parties tend to be hyper-literal.^[4] They will not investigate whether alternative plausible meanings make more sense in the

^[2] See Theodore Eisenberg & Geoffrey Miller, 'The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts' (2009) 30:4 Cardozo L Rev 1475 (suggesting that parties prefer a more textualist approach).

^[3] This is the 'hypothetical bargain' approach to gap filling and implicates doctrines such as impossibility, impracticability, frustration, good faith, and fiduciary duties. See David Charny, 'Hypothetical Bargains: The Normative Structure of Contract Interpretation' (1991) 89:7 Mich L Rev 1815; Mariana Pargendler, 'Modes of Gap Filling: Good Faith and Fiduciary Duties Reconsidered' (2008) 82 Tul L Rev 1315 at 1316, 1318; Melvin A Eisenberg, 'Impossibility, Impracticability and Frustration' (2009) 1:1 Journal of Legal Analysis 207.

^[4] See Royce de R Barondes, 'Vestigial Literalism in the Interpretation of Corporate Financing Instruments' (2014) 15 Transactions: Tennessee Journal of Business Law 239 ('a number of factors ... result in courts relying to a lesser extent on the evident purposes of contractual

context of the particular transaction.⁵ In short, sophisticated parties know what they say and say what they mean.⁶ Words are intended and are not the product of errors, glitches, or goofs.

This is not to say that contract law does not recognize that there can be anomalies in drafting on occasion. There are doctrines that address problematic drafting, but they are narrow in scope. If a provision is vague, where the language lends itself to multiple meanings, courts are permitted to look beyond the language of the contract for evidence of market understandings or for evidence about the drafting and negotiation process for the contract. Courts in textualist jurisdictions, however, are rarely willing to find explicit provisions among commercial and sophisticated parties sufficiently vague to search for meaning in relevant context evidence: if a dictionary meaning exists textualist courts will uphold the plain language of the contract.

provisions in interpreting corporate financing instruments ... one consequence is tedious literalism – hyperliteralism – may reign in interpreting corporate financing instruments’ at 288).

⁵ Stephen J Lubben, ‘Protecting Ma and Pa: Bond Workouts and the Trust Indenture Act in the 21st Century’ (2022) 44:1 Cardozo L Rev 82 (‘[c]ourts have been extremely reluctant to do anything other than a highly formalistic ‘plain meaning’ analysis in corporate finance cases’ at 136); Diane Lourdes Dick, ‘Confronting the Certainty Imperative in Corporate Finance Jurisprudence’ (2011) Utah L Rev 1461 (‘the prevailing judicial decision-making approach in corporate finance finds its roots in what this Article calls the “Certainty Imperative,” ... which, in the realm of finance and lending, is best preserved when courts exercise considerable restraint, narrowly tailoring opinions to strict construction and passive enforcement of contracts’ at 1466).

⁶ There are other reasons why judges might prefer such doctrines, including that they often reduce the amount of work that an otherwise busy judge needs to do.

"Scrivener's error" is another doctrine that addresses linguistic errors. But here courts are reluctant to reform the language of the contract unless the error is readily verifiable --- such as the price of an asset that is misstated by several zeroes.⁷

The conclusion one draws from contract doctrine, therefore, is clear: sophisticated financial contracts are presumptively complete and error-free. But how well does this assumption about the absence of contractual glitches or 'howlers' (to use a term that market participants suggested to us) hold with real world contracts? How free from howlers are high value contracts between the most sophisticated financial transactors? Are there linguistic irregularities that, if one understood the context, would howl at the reader that they present a landmine that could blow up in the future? Our starting assumption – based on our review of the relevant contract doctrine– is that there should be, on average, zero howlers in the typical high-dollar financial contract. Glitches might show up here or there, but market-disciplining forces – the lawyers who do the drafting charge high fees and compete for business – should ensure that problems that pose risks to any of the parties will be corrected immediately. To the extent that there are ambiguities in the contract that one side or the other might exploit, they would be difficult to detect, buried in obscure boilerplate language.⁸ Yet, our findings from the market for

⁷ See Glenn A West, 'On the Nature of Being Mistaken in Contract' (3 May 2016), online: *Global Private Equity Watch* <privateequity.weil.com/features/nature-mistaken-contract/> [perma.cc/9DG2-M5JQ] (discussing how reluctant courts are to find scrivener's errors in contracts among sophisticated financial parties).

⁸ See Robert E Scott, Stephen J Choi & Mitu Gulati, 'Contractual Arbitrage' in Eric Brousseau, Jean-Michel Glachant & Jérôme Sgard, eds, *The Oxford Handbook of Institutions of*

international sovereign bonds and the contracts governing such bonds, suggest otherwise.

Contractual howlers not only exist in sophisticated commercial contracts, but they also often exist in plain sight.

International Economic Governance and Market Regulation (New York: Oxford University Press, 2019) (describing these lawyers and their firms elsewhere at ‘contractual arbitrageurs’). Bob Rasmussen and Mike Simkovic, writing about a different industry than us, describe the dynamic:

[A] party on the losing-end of a transaction combs over the documents to find creative solutions to capture value. Such parties do not seek mere ambiguities that exist either through design or oversight. Rather, they look for “holes” in the contract. They scour the pages of complex contracts to devise unanticipated transactions that were neither contemplated nor intended by the parties to be a strategic option, but nevertheless comport with the dictates of the documents. They end up with results that all agree are at odds with the expectations the parties had when they signed the contract, but that adhere to the strict dictates of the contract. That there are holes in sophisticated contracts in this setting is not surprising. Lending contracts today routinely exceed pages. However, competitive pressure limits the amount of time lawyers can spend at the drafting stage worrying about seemingly outlandish hypotheticals. The result is that even the most expensive law firms cannot preclude a clever player from later devising a transaction that was unforeseen by the parties when the contract was made.

Robert Rasmussen & Michael Simkovic, ‘Bounties for Errors: Market Testing Contracts’ (2020)

1: 10 Harvard Business L Rev 117, 120.

To provide context, we come to this exercise from a prior project where we documented the presence of one contractual howler that was found in literally every single international sovereign bond issued over the past thirty years – that is, in trillions of dollars and euros worth of bond issuances.⁹ This howler – the *pari passu* clause – was an obvious landmine waiting to blow up. No one knew quite what the clause meant, but it was in every international sovereign bond. And the lack of understanding of what this vague term was supposed to mean put both the debtor and the majority of creditors at risk of having their assets vulnerable to claims by litigation specialists in distressed debt. The puzzle was that every senior lawyer in the market seemed to recognize that the *pari passu* clause was a howler. Yet, even after litigation specialists successfully sued sovereigns in 2001 using an aberrant interpretation of the *pari passu* clause, it took close to a decade and a half for the market to clarify the clause's meaning. Given this long litigation history, we asked ourselves and others asked as well: is the *pari passu* clause idiosyncratic or are there more howlers out there?

In a prior article, drawing on suggestions from veterans of the sovereign debt industry, we identified and described seventeen separate contractual howlers that are occasionally found in international sovereign bonds.¹⁰ Here, we extend the analysis in our earlier article by focusing

⁹ See Stephen J Choi, Robert E Scott & Mitu Gulati, ‘The Black Hole Problem in Commercial Boilerplate’ (2017) 67:1 Duke LJ 1 [Choi, Scott & Gulati, ‘Black Hole Problem’]; Mitu Gulati & Robert E Scott, *The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design* (Chicago: University of Chicago Press, 2013).

¹⁰ See Robert E Scott, Stephen J Choi & Mitu Gulati, ‘Contractual Landmines’ (2022) Virginia Public Law and Legal Theory Research Working Paper No 2022/56, online: *Social Science*

on the phenomenon of howlers in one sovereign issuer: the Russian Federation. At the time of writing of this Article, Russia, because of its invasion of Ukraine, is a pariah in much of the world, and many of its assets in the West have been frozen. As a result, Russia is at risk of defaulting on its foreign currency-denominated sovereign debt. Reading the Russian contracts within this context – a pariah debtor seeking to avoid default, on the one hand, and desperate creditors seeking to obtain a recovery, on the other – has highlighted howlers specific to the Russian contracts with high salience to both Russia and its creditors. In the following subparts, we describe seven howlers in the Russian contracts. With each of these howlers, it is possible that the formulation of the clause is a feature—purposefully put in place to benefit Russia -- rather than a bug -- the result of a drafting mistake or the overzealous cut and paste of contractual language from a different context that does not apply in the Russian situation. We cannot disprove either position. In earlier work, we report on interviews with thirty of the leading lawyers in this market concerning the howlers that we had found.^[1] These lawyers did not dispute the landmine quality of the howlers that we had identified, although they did vary in their views of the source of these irregularities. Some imagined drafting errors by inexperienced or inattentive lawyers, others suggested misaligned incentives, and yet others suggested that they

Research Network

<papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID4202556_code48063.pdf?abstractid=4178649&mirid=1> [perma.cc/RB79-NMJW] [Scott, Choi & Gulati, ‘Contractual Landmines’].

^[1] Ibid.

were exercises in rational delegation of difficult *ex ante* contracting matters to *ex post* negotiations.^[12]

II *The Howlers*

A CURRENCY INDEMNIFICATION

As of this writing, in January 2023, Russia has in fact defaulted on several of its foreign currency debt obligations because of US and European sanctions. Russia claims that it is not in default: it is unable to make the dollar or euro payments because of the sanctions and is entitled to make its payments in rubles. Some investors dismiss this notion.^[13] To be sure, some bonds contain an ‘alternate payments clause’ (our next howler) issued in the post-2014 period: as to these, Russia is arguably entitled to make payments in rubles if, for reasons beyond its control, it is unable to pay in the primary currency specified in the bond. But the bonds that came due in April 2022 do not contain that alternate payment currency clause. Thus, one might conclude that the payment of debt obligations in rubles, when the contracts governing these obligations require foreign currency, constitutes a default on the part of Russia.

^[12] Ibid.

^[13] Alan Rappeport, ‘A Russian Default Is Looming: A Bitter Fight Is Likely to Follow,’ *New York Times* (16 April 2022), online: <https://www.nytimes.com/2022/04/16/business/russia-debt-default.html>

But maybe not. There is a clause in the dollar bonds that have come due in 2022 titled ‘currency indemnity.’ The first sentence of this clause reads: ‘The U.S. dollar is the sole currency of account and payment for all sums payable by the Russian Federation ... in connection with the Bonds, including damages.’^[14] But the clause goes on to provide:

‘Any amount received ... in a currency other than the U.S. dollar ... by any Bondholder in respect of any sum ... due to it from the Russian Federation shall only constitute a discharge to the Russian Federation to the extent of the U.S. dollar amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery.’^[15]

This sentence appears to provide that payment in a different currency (for example, rubles) can constitute a ‘discharge’ so long as the recipient can use those rubles to buy a sufficient number of dollars. On its face the statement seems to mean that Russia, contrary to what some investors think, can discharge its obligations by paying in rubles.

If we are correct about the meaning of the currency indemnity clause then the following mischief becomes possible. Russia could make payments in rubles into an account in Russia, immediately convert the rubles to dollars, and then claim that the dollars are frozen in place under capital controls. Pay enough in rubles and, according to the strict terms of the contract, this

^[14] Ministry of Finance of the Russian Federation, ‘Prospectus’ (20 March 2018) at 54, online:

Ministry of Finance Russia <minfin.gov.ru/common/upload/library/2018/12/main/Russia-2029_Russia-2047tap_Prospectus_final.pdf> [perma.cc/PJ68-LKMC] [Ministry of Finance of the Russian Federation, ‘Prospectus’].

^[15] *Ibid* at 54–5.

would be a discharge. Russia could argue that those dollars would be frozen until its foreign assets in the West were unfrozen. One might ask: does the bond not require payments to be made in New York? It does. But the currency indemnity clause describes what happens if the holder ‘recovers or receives’ a payment in another currency, presumably in another place. And it says that the US dollar payment is ‘discharged’ if the holder receives a sufficient amount of that other currency to buy dollars in the amount originally due on the date the other currency is received or recovered. And all of that will have happened.

Would a court buy this argument? It probably depends on where the court is located – London, New York, or Moscow (another howler in the Russian debt contracts is that the contracts do not specify jurisdiction).^[16] The point is that the literal language of the currency indemnity clause allows for the foregoing interpretation. Indeed, as of this writing, in January 2023, Russia seems to be paying all its bondholders, regardless of the currency of denomination, in rubles, and investors are not yelling bloody murder, let alone rushing to litigate.

B UNABLE TO PAY IN US DOLLARS

A clause in a number of recent Russian dollar and euro currency bonds – written in anticipation of the possibility of sanctions from the United States or the European Union – allows payments to be made in a currency other than in Euros and US dollars under certain

^[16] Mark Weidemaier & Mitu Gulati, ‘Russia’s Perplexing Sovereign Bonds,’ *Just Money* (20 April 2022), online: <justmoney.org/mark-weidemaier-and-mitu-gulati-russias-perplexing-sovereign-bonds/> [perma.cc/LU4M-XCQP] [Weidemaier & Gulati, ‘Russia’s Perplexing Sovereign Bonds’].

conditions.^[17] Russia's 2019 bond issuances in US dollars and Euros states, for example, that the Russian Federation may, under conditions 'beyond its control,' make payments in an 'alternative payment currency.'^[18] 'Alternative payment currency' in the US dollar issuance is defined as

'Euros, Pound sterling or Swiss francs or, if for reasons *beyond its control* the Russian Federation is *unable to make* payments of principal or interest (in whole or in part) in respect of the Bonds in any of these currencies, Russian rubles.'^[19]

What is not defined is what the reasons are 'beyond the control' of the Russian Federation that cause it to be 'unable to pay.' What about 'unable to pay' because President Vladimir Putin forbids it—could such an order from President Putin qualify as matters beyond the control of the Russian Federation? It is hard to imagine that this is the meaning that creditors believed they were agreeing to. But the contract language is sufficiently ambiguous to allow that interpretation. More seriously, given the ambiguities in the contract language, Russia could plausibly argue that it is unable to pay because of Western sanctions (matters beyond its control).

A creditor might respond that a court in New York or London, where the creditor expects to be bringing their lawsuit, would not support Russia offering such a sympathetic reading of the ambiguous contract language. After all, the Western sanctions were caused by the Russian

^[17] See e.g. Jonathan Wheatley, 'Russia Bond Sales Allow Payments in Alternative Currencies' *Financial Times* (17 March 2018), online: <https://www.ft.com/content/69da000c-2915-11e8-b27e-cc62a39d57a0>

^[18] Ministry of Finance of the Russian Federation, 'Prospectus,' supra note 16 at 15 [emphasis added].

^[19] Ibid at 64 [emphasis added].

invasion of Ukraine, and the invasion definitely was under Russia's control. If a court saw the causal story in this way, it would not allow payment in rubles. The point, for our purposes, is that this is a howler for the unwary investor. And, again, as noted above, investors who are currently being paid in rubles are not rushing to sue Russia for breach.

C AUTONOMY OF DECISION MAKING

A key question in every sovereign restructuring, where a vote of the creditors is required prior to any crucial decision, is who gets to vote?^[20] Frequently, the bonds will contain a disenfranchisement provision providing that securities controlled ‘directly or indirectly’ by the issuer may not vote. On occasion though, as with the Russian dollar bond issuance of 2018, the bonds will contain a more detailed ‘autonomy of decision making’ provision that, if carefully parsed, offers the sovereign issuer leeway to manipulate the vote. The Russian disenfranchisement clause begins:

‘For the purposes of ... determining the right to attend and vote at any meeting of Bondholders. ... Bonds shall be disregarded ... if they are held by [an] entity that is controlled directly or indirectly by the Russian Federation ... in cases where the holder of the Bond does not have autonomy of decision.’^[21]

^[20] These voting mechanisms are referred to as ‘collective action clauses’ because they enable collective action via a voting mechanism. See Mark Weidemaier & Mitu Gulati, ‘A People’s History of Collective Action Clauses’ (2014) 54:1 Va J Intl L 1 (discussing the history of collective action clauses).

^[21] Ministry of Finance of the Russian Federation, ‘Prospectus,’ supra note 16 at 54.

This statement suggests that bonds held by an institution controlled by the Russian Federation can have their votes counted so long as the holder of the bonds retains ‘autonomy of decision.’

So, what is ‘autonomy of decision’? The contract answers that in the next sentence:

‘[T]he holder of a Bond has autonomy of decision if, *under applicable law, rules or regulations* ... (1) the holder may not... take instruction from the Issuer ... on how to vote on a proposed modification; or (2) the holder, in determining how to vote ... is required to act in accordance with an objective prudential standard ... or (3) the holder owes a fiduciary or similar duty to vote on a proposed modification.’²²

On its face, this provision invites the Russian government to pass its own ‘law, rules or regulations’ that decree that some institution (that it controls) has autonomy of decision making and such a decree would definitively allow the institution to qualify for the autonomy of decision clause despite Russia’s actual control over the institution. This invocation of “applicable law” might make sense in a corporate context. But in a context where the sovereign is both the debtor and the law maker, it does not make sense. Yet, that is what we have.

D WHO GETS AGGREGATED?

Starting roughly in 2014, modern international sovereign bonds began including provisions allowing for restructurings to occur via an aggregated vote of the bondholders across different types of security. These are often referred to as ‘enhanced’ collection action clauses (CACs) because the prior generations of collective action clauses did not allow for restructurings to occur unless a certain vote threshold was satisfied in each individual series of bonds. The rationale for these aggregation provisions (enhanced CACs) was avowedly to ameliorate the

²² Ibid at 51 [emphasis added].

risks posed by holdouts.^[23] The natural question then, for a country that has issued a variety of debts, is which of those debts can be aggregated? The enhanced CACs answer that question with the following:

“Debt Securities Capable of Aggregation” means those debt securities which include ... [the provisions described in “Modifications and Amendments; Meetings of Holders” and “Aggregation Agent; Aggregation Procedures”] or provisions substantially in these terms which provide for the debt securities which include such provisions to be capable of being aggregated for voting purposes with other series of debt securities.’^[24]

The foregoing says that all of the bondholders who purchased bonds that had enhanced CACs allowing aggregation can be aggregated. We find such a provision in several of the Russian bonds after 2014. On its face, this makes sense.

But imagine a scenario where a country has both a large stock of local debt (governed by local law) with no CACs or other meaningful legal terms and a large stock of foreign debt (governed by foreign law) that does have these aggregation provisions. Now also imagine that the holders of the local debt are more amenable to the interests of the government if for no other reason than that their debt is governed by local law and thus subject to any rules the local legislature imposes on those debts.^[25] Assume a situation where a number of the foreign

^[23] See Lee C Buchheit & Mitu Gulati, ‘The Argentine Collective Action Clause Controversy’ (2020) 15:4 Capital Markets Law Journal 464 (providing background on these clauses).

^[24] Ministry of Finance of the Russian Federation, ‘Prospectus,’ supra note 16 at 73.

^[25] Much of this debt is also typically held by local financial institutions who, because of fear of local regulators, will be pliable. Russia’s 2018 dollar bonds and Sri Lanka’s 2019 dollar bonds

bondholders are unwilling to agree to the severe haircut that the sovereign is requesting and they have enough votes to block a use of the CACs. The government in response can secure additional bondholders to vote in favour of the haircut by inserting aggregation provisions similar to those in the foreign bonds into the local bonds via legislation. Now these local bonds are all entitled to vote in the same fashion as the foreign bonds. Assuming the local bonds are subject to government influence (and that there many of them with corresponding votes), the foreign bonds suddenly lose their blocking position and become vulnerable to the whims of the sovereign debtor.

E REOPENINGS

A conversation with an industry insider, to whom we described the preceding glitch in the aggregation provisions, responded by pointing to a forerunner of this clause – the ‘reopenings’ provision.^[26] He thought this particular howler had long since been identified and repaired in sovereign bonds. But we found it in the Russian bonds. The clause, formally titled the ‘further issues’ provision, reads as follows:

The Russian Federation shall be at liberty from time to time, without the consent of the holders of the Bonds, to create and issue further bonds ranking equally in all respects (or in all respects save for payments made prior to the issuance of such further bonds and, if

have these provisions. See Mark Weidemaier & Mitu Gulati, ‘Episode 70,’ *Clauses & Controversies* (18 April 2022), online: <podcasts.apple.com/us/podcast/ep-70-ft-mitu-mark/id1528208049?i=1000557930029> [perma.cc/Q79F-DYWF].

^[26] Ministry of Finance of the Russian Federation, ‘Prospectus,’ *supra* note 16 at 15.

applicable, the date and amount of the first payment on such further bonds) *so that the same shall be consolidated and form a single series with the Bonds.*²⁷

In other words, the issuer can issue new bonds of an existing series of a particular bond at its whim and place them with sympathetic holders. These sympathetic holders – call them Oligarch Co. – can then vote in favour of whatever deal the issuer wants. Indeed, even before that, the new bondholders can make it difficult for existing investors to accelerate the debt and, if a subset of investors manages to accelerate, they can with sufficient votes reverse the acceleration. Under a plain reading of the clause, there is no constraint on the debtor issuing these new bonds and associating them with whatever prior series of bonds it wishes. There are some tax consequences for holders in the United States who are subject to federal taxes, but presumably Oligarch Co. holds its assets in Russia.²⁸ Faced with a desperate debtor, this would be a howler for investors.

F MEETINGS AND ADJOURNED MEETINGS

Some sovereign bonds, as part of their CACs, allow for votes to be taken either via written resolutions of the bondholders or at meetings at particular locations. It may seem strange that creditors who are dispersed around the globe would want the option of going to a particular

²⁷ Ibid at 54 [emphasis added].

²⁸ Some bond issues, such as Uruguay in 2003, identified this risk and revised the reopenings clause to fix it. Not Russia's bonds, however. See Lee C Buchheit & Jeremiah Pam, 'Uruguay's Innovations' (2004) 19 J International Banking Law and Regulation 28 at 30 (reporting that Uruguay, in its post-restructuring bonds, had to covenant that it would not 'issue new securities (or reopen any existing series of bonds) in order to place them in the hands of investors expected to vote in support of a proposed modification').

location to cast their collective votes. (We speculate that the meeting option might be an antiquated concept from the days when bondholders were all in the same location and could be expected to readily attend a meeting.) Several features of these meeting provisions have the potential of providing an opportunistic sovereign a significant advantage. Initially, meeting provisions typically allow for the relevant vote to be taken by a much smaller number of bondholders than a written vote – specifically, the required percentage of bondholders is typically applied to those present at the meeting so long as the specified quorum is satisfied. Assuming a typical quorum of 50 percent, this means that the 75 percent vote requirement in order to change payment terms can be reduced to as little as 37.5 percent.

Moreover, bonds with meeting provisions typically will also have a provision for adjourned meetings. And at the adjourned meetings, the quorum requirement is often as little as 25 percent, which means, assuming a requirement of 75 percent in the CAC, it would take a vote of as little of 18.75 percent to change the payment terms of the bond.^[29] The foregoing is enough of a howler, but some bonds give the issuer even more of an advantage with additional features such as allowing the issuer to specify the location of the meeting or allowing the issuer, in the case of a first meeting where the quorum is not met, to call the adjourned meeting immediately, with no need for any lapse in time or notice to the holders.

^[29] See e.g. Ministry of Finance of the Russian Federation, ‘Prospectus,’ supra note 16. See also Michael Bradley & Mitu Gulati, ‘Collective Action Clauses for the Eurozone’ (2014) 18:6 Review of Finance 2045.

Russia's 2018 dollar bonds not only contain such a meeting provision but also provide that the Russian Federation, as the issuer, gets to decide where the meeting is to be held. The provision governing the convening of meetings states:

*'The Issuer may convene a meeting of the Bondholders at any time in respect of the Bonds. ... The Issuer will determine the time and place of the meeting and will notify the Bondholders of the time, place and purpose of the meeting not less than 21 and not more than 45 days before the meeting.'*³⁰

Writing in January 2023, with Russia enmeshed in war with Ukraine and under sanctions from much of the Western world, it is easy to imagine that Western bondholders might be reluctant to appear if the meeting is specified, for example, to be held in the basement of the Kremlin. Or if the bondholders do appear, they might worry that voting the wrong way while physically in Moscow could result in negative consequences.

G EVENT OF DEFAULT WITHOUT IMPLICATIONS

Every international sovereign bond specifies events of default – that is, a set of events that, if they occur, serve as an early warning signal to the creditors that a default may be imminent. If one or more of these events occur and are not cured within a specified time (usually thirty days), creditors are generally entitled to ask that all their future payments be accelerated. But, on rare occasion, events of default are listed in a bond contract where there is no implication attached to the occurrence of these events. Russia's 2018 international bond issuance is one such example, where a number of its events of default are described without triggering any

³⁰ Ministry of Finance of the Russian Federation, 'Prospectus,' supra note 16 at 42 [emphasis added].

implications except the last one listed – the *pari passu* promise.³¹ The fact that a violation of the *pari passu* clause is in one of the events of default is itself puzzling.³² But to have implications attached to only this event of default is even more bizarre.

The events of default listed in addition to the promise that the bonds will be *pari passu* include the event that the sovereign stops payment on the debt and the event that some of the sovereign's other debt is accelerated. Given the importance of such events to creditors, it is hard to see how the failure to attach any consequences to the occurrence of the event of default is anything but a goof. The fact that we find this strange structure only in the 2018 Russian bond supports our conjecture. After all, there is no reason to specify events of default if there are no implications once they triggered. It might be that there is a rational explanation: perhaps Russia was only willing to allow for the acceleration of its debt once it actually violated one of its covenants. Maybe Russia was especially clever in drafting this particular bond. But, if so, why only in this one bond? In any case, accelerating the 2018 Russian bond is going to be much more difficult to accomplish.

III *How Idiosyncratic are the Russian Howlers?*

³¹ Ibid at 38.

³² See Choi, Gulati & Scott, 'Black Hole Problem,' supra note 11 (for discussion of the *pari passu* clause).

We framed our inquiry by asking whether the assumption that contracts between sophisticated commercial parties are complete and error-free is supported in practice. Given our examples of Russian howlers, the obvious next question is how prevalent are these howlers in the standard bond contract outside of Russia. Are the Russian howlers idiosyncratic? The answer is both yes and no. On the one hand, as we explain below, the average sovereign bond has multiple howlers (roughly nine). The Russian bonds are at one end of the spectrum in that they have roughly sixteen howlers, including the seven we discuss in this article and nine more identified in earlier work.³³ Exploring why the Russian bonds have more howlers than others, with most of them favouring the sovereign side, can shed light on the dynamics of how howlers appear in other bonds as well.

But before getting to the specifics of the Russian case, there is the matter of the average sovereign bond. In our earlier article on this subject, we reported on different howlers found in international sovereign bonds.³⁴ These were howlers that we identified by asking legal experts in the sovereign markets whether they knew of provisions such as the *pari passu* clause that had the potential to unexpectedly blow up either in litigation or in restructuring negotiations. Having identified the seventeen howlers, we then turned to the offering circulars, prospectuses, and prospectus supplements for each sovereign bond issuance. For a random sample of a hundred sovereign bonds issued between 2020 and 2022, 100 per cent of the bonds had at least one of the

³³ See Scott, Choi & Gulati, ‘Contractual Landmines,’ supra note 1; Weidemaier & Gulati, ‘Russia’s Perplexing Sovereign Bonds,’ supra note 18.

³⁴ Scott, Choi & Gulati, ‘Contractual Landmines,’ supra note 1.

seventeen howlers. Most had multiple howlers and on average a bond had nine howlers.³⁵ To get traction on why we were finding so many glitches in these contracts between sophisticated commercial parties, we did a series of in-depth interviews with the leading practitioners in the field. From those interviews, we distilled three explanations:

- Rational design: This explanation posits that there are contingencies for which parties are unable or unwilling to allocate risks in a fully specified complete contract *ex ante* but are willing to delegate discretion to a court via a vague standard to allocate the risks *ex post* when the court is likely to have additional information available to shed light on how the vague provision should be interpreted.
- Satisficing/Haste. The story in this explanation is that because bond issues have to be done quickly, whenever a market window appears, there is little time to craft

³⁵ We also find that the majority of the howlers – roughly 70–80 per cent – advantage the sovereign debtor. Only 20–30 per cent advantage the creditor who might seek to litigate. And, of those that advantage the creditor, the source is almost always from a set of clauses – *pari passu*, negative pledge, International Monetary Fund eligibility – that, from their start of the modern market in the 1990s, have had an uncertain purpose but have somehow stayed part of the standard document despite their lack of obvious value. The advantages on the sovereign side, by contrast, mostly come from clauses that, while having a real purpose, have had some glitchy language added along the way.

new provisions. Yes, flaws in drafting result, but reputational constraints ensure that the parties do not exploit the gaps in contracts.³⁶

- Agency. Bond issuances in this market are characterized by a two-sided agency problem. On the seller side, the government officials who represent the populace of the country have short time horizons, which means that they usually care about raising capital rather than paying it back. On the purchaser side, the actual purchasers, the investors, do not even appear until the bonds have been issued, and the underwriters, who represent the investors, primarily care about getting the deals done rather than crafting the perfect contract term.

The problem with what we gathered from the interviews with the experts was not the lack of a theory but too many theories, all of which can explain some of our howlers, but not one of which explains all of them. And that is not even approaching the more complicated questions of why some of these howlers persist over time and get repeated, whereas others are only short lived. To illustrate the multiplicity of explanations (lack of attention to detail given the speed of deals, sleep deprived associates drafting at 2:00 a.m., sneaky drafters on the issuer side), here is what one of our sovereign debt gurus said:

Why is this happening? [that is, why so many howlers]. These bond agreements are so differently agreed to than anything else. ISDA [International Swaps and Derivatives Association] documents or trade treaties are negotiated over for months. In these bonds, the creditors never even get a look. Creditors – including the biggest asset managers – get a call that bonds are being issued and they have to decide whether they want them, independent of the terms (that are assumed to be

³⁶ See Robert K Rasmussen & Michael Simkovic, ‘Bounties for Errors: Market Testing Contracts’ (2020) 1: 10 Harvard Business Law Review 117 at 120.

standard). They don't negotiate for months. They look at the credit rating and spread and say ... I'll take a half a billion. Only when [the bond] gets into trouble, they see all this stuff ... the landmines.

Part of the problem is that there is no negotiation [involving actual creditors]. Underwriters are supposed to look out for the ultimate investors, but they are looking from the debtor perspective ... and they depend on big boys at PIMCO and Blackrock to look at the documents. JP Morgan will look at subscription agreement, but not the indenture. Maybe [a distressed debt investor] like Hans Humes looks at the documents, but those investors don't enter the market until there is distress. And, once again, there is so little time – no time for negotiation of contract terms. One buys and the docs follow.

Part of it is associates drafting at 2:00 a.m. in the morning. Errors occur. Inadvertence is probably 80 per cent. And then there is stealth. Some of the words are try-ons ... weasel words ... that maybe help the issuer ... and then there are deviations ... that should jump out ... and would, if anyone were to read.

The Russian case, because of the crisis context, is one that market experts and the press have given more attention than normal. Because of the salience of Russia in the market, we expected that market participants would focus particularly on the question of default and the origins of the contractual howlers. We returned to ask a subset of the industry gurus we had tapped for our prior project specifically about the Russian howlers. Our respondents provided a more focused answer on the origins of howlers. The Russian howlers in the most recently issued Russian bonds, and, particularly, the alternate payment currency clause allowing payments in rubles for dollar- and euro-denominated bonds, was likely the product of an exacerbated agency

problem. A clue was that the primary investment bank in the transactions was VTB, a bank owned by the Russian state.³⁷ One respondent provided the following explanation:

We have always assumed that the underwriter and the underwriter's legal counsel in a sovereign bond issue will be quietly looking out for the interests of the investors in the instrument. The theory is that any material feature of the bond documentation that is 'out of market' (departs from standard practice) would need to be prominently disclosed to investors at the peril of the underwriter being accused of having colluded in a material misstatement or omission in the disclosure.

But that assumption broke down in the case of Russia's post-2014 bonds. Why? Because the Russian Federation, in the wake of Western sanctions imposed after the Crimean incursion, was no longer able to easily hire western bankers. So, Russia had to go in house and hire Russian state-owned banks to be the underwriters. And those Russian state-owned banks in turn hired and gave instructions to the law firms advising the underwriters. In other words, everyone involved in the transaction was effectively working for Russia. Investors and their concerns were nowhere in the picture. Some of these clauses are the product of that dynamic.

We do not take the foregoing to mean that the agency problem explanation is the primary story explaining the Russian howlers. Rather, it is that, when agency problems are exacerbated, we will see more howlers of a particular type.

³⁷ See Michael Bradley et al, 'A Silver Lining to Russia's Sanctions Busting Clause' (2022) 108 Va L Rev Online 326, online: *Virginia Law Review* <www.virginialawreview.org/articles/a-silver-lining-to-russias-sanctions-busting-clause/> [perma.cc/ZR37-FY6Y].

IV Conclusion

We identify numerous howlers that affect the contracts governing Russian bonds. We use these howlers to illustrate how financial contracts among highly sophisticated commercial parties can be full of traps for the unwary. Identifying these possible howlers and talking to a small set of market participants about them, however, is but a start to understanding whether this is a broader phenomenon. The presence of such howlers calls into question assumptions by courts as to the meaning of language in contracts between sophisticated parties and thus how courts approach the interpretation of such contracts.