

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

FL-2016-000002

BETWEEN:

THE LAW DEBENTURE TRUST CORPORATION PLC

Claimant

and

**UKRAINE, REPRESENTED BY THE MINISTER OF FINANCE OF UKRAINE
ACTING UPON THE INSTRUCTIONS OF THE CABINET OF MINISTERS OF
UKRAINE**

Defendant

DEFENCE

1. Except where otherwise indicated, references to paragraph numbers in this Defence are to paragraph numbers in the Particulars of Claim. Abbreviations used in the Particulars of Claim are adopted in this Defence for convenience only and do not constitute admissions. Allegations which Ukraine is unable to admit or deny are the subject of non-admissions in this Defence.

Summary

2. This claim is explicitly brought for the benefit of and upon the instruction of the Russian Federation (Particulars of Claim, paragraphs 12 and 20). The claim forms part of a broader strategy of unlawful and illegitimate economic, political and military aggression by the Russian Federation against Ukraine and its people aimed at frustrating the will of the Ukrainian people to participate in the process of European integration. As part of that strategy, the Russian Federation applied massive, unlawful

and illegitimate economic and political pressure to Ukraine in 2013 to deter the administration led by Viktor Yanukovych from signing an Association Agreement with the European Union, and to accept Russian financial support instead. The Trust Deed and Agency Agreement that are the subject of this action were the fruit of that pressure. When Mr. Yanukovych was removed from power following popular protests sparked by his administration's decision, procured by the Russian Federation, not to proceed with the Association Agreement, the Russian Federation responded with a campaign of unlawful aggression that has included the illegal invasion and occupation of sovereign Ukrainian territory, namely the Crimean peninsula, and military and other interference and unlawful use of force in eastern Ukraine. These Russian actions have killed thousands of Ukrainian citizens, injured tens of thousands, displaced millions, inflicted severe damage to Ukraine's economy and infrastructure and resulted in Russian seizure of Ukrainian state assets, which damage is measured in many billions of dollars.

3. The entry into the purported transaction which the Russian Federation seeks to enforce through this claim was, in fact, void since Ukraine lacked the relevant capacity to do so. This matter is addressed at paragraphs 34 to 38 and 47 to 70 below.
4. So far as (contrary to the foregoing) the contractual arrangements have any effect, they were procured by duress and Ukraine's purported consent to them was vitiated by unlawful and illegitimate threats and pressure exerted by the Russian Federation, including illegal trade restrictive measures and threats to Ukraine's territorial integrity and independence. The circumstances and consequences of this conduct are addressed at paragraphs 17 to 24 and 71 to 73 below.
5. The Russian Federation's subsequent illegal invasion and unlawful occupation of the Crimean peninsula and intervention in the eastern regions of Ukrainian territory, summarized at paragraphs 74 to 84 below, had the effect of depriving Ukraine of the entire purported economic benefit of the transaction which the Russian Federation now seeks to enforce through its instruction of the Trustee in these proceedings. The legal significance of this conduct is addressed at paragraphs 85 to 92 below.

6. The Court should dismiss the claim, or decline to grant the Russian Federation the relief it seeks through the Trustee, or stay the claim unless and until the Russian Federation complies with its obligations under public international law. These matters are addressed at paragraphs 93 to 94 below.

The context for the Russian Federation's Attempts to Frustrate Ukraine's Entry into an Association Agreement with the European Union

7. Ukraine's policy since soon after its independence from the USSR in December 1991 has been to draw closer to and ultimately seek membership of the European Union. For example:

- 7.1. In a decision of 2 July 1993, "On the Key Directions of the Foreign Policy," the Verkhovna Rada (the Ukrainian Parliament) stated that "*the priority of Ukrainian foreign policy is Ukrainian membership in the European Communities.*"

- 7.2. In 1994, Ukraine concluded a Partnership and Cooperation Agreement with the European Community, the preamble to which "[r]ecogniz[ed] and support[ed] the wish of Ukraine to establish close cooperation with European institutions."

- 7.3. In 2007, negotiations began on what was to become a new Association Agreement between Ukraine and the European Union, including participation in a Deep and Comprehensive Free Trade Area ("DCFTA") at its core.

8. In response, the Russian Federation sought to deter Ukraine from the path of European integration and to encourage it instead to join the Eurasian Customs Union ("ECU") formed among Russia, Kazakhstan and Belarus in 2010. For example:

- 8.1. In April 2011, Vladimir Putin (then Prime Minister) warned that the Russian Federation "*will have to introduce protective measures*" if Ukraine's participation in the DCFTA led to detrimental effects on Russia.

- 8.2. At a press conference on 18 May 2011, then President Medvedev stated that "*if Ukraine ... chooses the European vector, it would be hard for Ukraine to find any common grounds with the ... Customs Union.*" He added that "[a]ll shall

understand that, including my Ukrainian friends and colleagues, -- You cannot 'sit on two chairs,' you have to make a choice."

9. Notwithstanding these Russian threats, negotiations between Ukraine and the European Union continued and significant progress was made by the two sides towards the conclusion of an Association Agreement:

- 9.1. On 30 March 2012, the chief negotiators of the EU and Ukraine initialled the text of the political part of the Association Agreement, which also included integral provisions for the economic part (initialled subsequently), namely the establishment of the DCFTA. This event was the culmination of five years of discussions and evidenced the successful conclusion of negotiations of the Association Agreement, ahead of its formal conclusion.

- 9.2. On 19 July 2012, the chief negotiators from both sides initialled the DCFTA, the economic part of the Association Agreement. Representatives of both the EU and Ukraine expressed their common commitment to undertake the further technical steps required to prepare for the conclusion of the Association Agreement.

- 9.3. On 10 December 2012, the EU Foreign Affairs Council reaffirmed *"its commitment to the signing of the already initialled Association Agreement... possibly by the time of the Eastern Partnership Summit in Vilnius in November 2013"*.

- 9.4. On 13 February 2013, the Cabinet of Ministers of Ukraine ("**the CMU**") approved a Plan on Priority Measures for the Integration of Ukraine into the European Union.

- 9.5. On 22 February 2013, a resolution was approved by 315 of the 349 registered members of the Verkhovna Rada stating that *"within its powers"* the Parliament would ensure that the 10 December 2012 EU Foreign Affairs Council *"recommendations"* would be implemented.

- 9.6. On 25 February 2013, at the Sixteenth EU-Ukraine Summit, the President of Ukraine, Viktor Yanukovich, the President of the European Council, Herman Van Rompuy, and the President of the European Commission, Jose Manuel

Durao Barroso, reaffirmed their commitment to concluding the Association Agreement, with a view to doing so at the Vilnius Summit scheduled for 28 November 2013.

The context for the issue of Eurobonds to the Russian Federation in December 2013

Ukraine's borrowing needs during 2013 and history of borrowings

10. The poor state of Ukraine's public finances at this time left it particularly vulnerable to Russian economic pressure. During 2012 and 2013, Ukraine was reliant on external borrowing in order to fund its public finances. For example, during 2012 the Ukrainian State budget deficit was UAH 53.4 billion (approximately USD 6.7 billion,¹ and 3.8% of GDP). Further, the Law of Ukraine "On State Budget of Ukraine for 2013" No. 5515-VI dated 6 December 2012 ("**the 2013 Budget Law**"), as originally passed, imposed a limit for the Ukrainian State budget deficit in 2013 of UAH 50.532 billion (approximately USD 6.3 billion²), and permitted borrowings for the general fund of the State budget in that year of up to UAH 135.530 billion (approximately USD 17 billion).
11. In the period up to the end of 2012, Ukraine had borrowed some of the funds that it required from the International Monetary Fund ("**IMF**"), pursuant to its 2010 Standby Arrangement facility, but that facility was terminated as of 27 December 2012.
12. During 2012 and until April 2013, Ukraine had been able to raise a significant proportion of the external borrowing that it required through the international capital markets. In particular, Ukraine issued the following Eurobonds over that period:

¹ At the official exchange rate of UAH 7.9898 per USD set by the National Bank of Ukraine ("**the NBU**") as of 1 January 2012. Throughout this Defence, the Defendant refers to the NBU official exchange rate at the relevant time. The official exchange rate was UAH 7.993 per USD at all material times, save where otherwise stated.

² At the official exchange rate of UAH 7.993 per USD set by the NBU.

| Date | Sum borrowed | Interest rate payable | Maturity period (maturity date) |
|-------------------|---------------------|------------------------------|--|
| 24 July 2012 | USD 2 billion | 9.25% | 5 years (July 2017) |
| 26 September 2012 | USD 600 million | 9.25% | 5 years (July 2017) |
| 28 November 2012 | USD 1.25 billion | 7.80% | 10 years (November 2022) |
| 11 February 2013 | USD 1 billion | 7.80% | 10 years (November 2022) |
| 17 April 2013 | USD 1.25 billion | 7.50% | 10 years (April 2023) |

13. Each of the issues of Eurobonds above was oversubscribed, and in some cases very substantially so (for example, the Eurobonds issued in July 2012 were three times oversubscribed and the Eurobonds issued in April 2013 were 2.3 times oversubscribed). Some of the key factors that determined the existence and extent of Ukraine's ability to borrow funds on the capital markets on economically viable terms at this time were:
- 13.1. The state of Ukraine's relationship with Russia, in light of the fact that Russia accounted for approximately a quarter of Ukraine's export market at this time;
 - 13.2. The market perception that, after several years of negotiations and reforms, Ukraine was preparing to enter into an Association Agreement with the European Union during the course of 2013. That market perception was in accordance with the progress that Ukraine had been making towards entry into of that Association Agreement.
 - 13.3. Ukraine's entry into the Association Agreement with the EU would be viewed favourably by the international capital markets, and would thereby improve Ukraine's ability to access international capital markets in order to satisfy its borrowing requirements.

14. After issuing the Eurobonds in April 2013 (“**the April 2013 Eurobonds**”), Ukraine intended to issue further Eurobonds in the international capital markets later in 2013, and on 1 July 2013 the First Deputy Prime Minister of Ukraine announced that it might do so later in 2013 once it became possible for Ukraine to borrow on more favourable terms.
15. Ukraine’s intention and announcement (given all prevailing circumstances and expectations at the time) reflected the fact that it would be able to borrow on more favourable terms once Ukraine had entered into, or at least was on the verge of entering into, the Association Agreement later in 2013. As stated above, that was scheduled to take place at the Vilnius Summit on 28 November 2013.
16. If Ukraine had entered into the Association Agreement, this would have facilitated (and during 2013 was widely known to be likely to facilitate) Ukraine in borrowing further funds from both international capital markets and also supranational institutions, including the European Bank for Reconstruction and Development and the IMF, on economically attractive terms.

Russian actions during 2013

17. In June 2013, the Verkhovna Rada published the text of the draft Association Agreement on its website. As particularised further below, following the publication of the text the Russian Federation took a number of steps to threaten and put pressure on Ukraine with the aim of preventing it from entering into the Association Agreement. Those steps included the imposition by the Russian Federation of unlawful trade restrictive measures on Ukraine, and the making of threats by the Russian Federation to impose further trade restrictive measures on Ukraine, as well as threats regarding the security of Ukraine’s status as a sovereign state, including its territorial integrity, in the event that Ukraine entered into the Association Agreement. The Russian Federation also sought to use its influence and lobbying power with European governments and institutions in order to place obstacles in the path to the entry into by the EU of the Association Agreement with Ukraine.
18. The Russian Federation imposed trade restrictive measures and applied pressure to Ukraine including (without limitation) the following:

- 18.1. On or around 29 July 2013, immediately after President Putin had met with President Yanukovych, the Russian Federal Service for Surveillance on Consumer Rights Protection and Human Wellbeing (Rospotrebnadzor) imposed a ban on the import of confectionery products of a major Ukrainian chocolate manufacturer that had substantial annual exports to Russia (in 2012 worth around £350 million). The ban was purportedly justified on the basis that the confectionery was unsafe, but later the justification supposedly relied on was a purported breach of Russian labelling requirements. Kazakhstan, Kyrgyzstan and Moldova – which all imported the same products – did not impose any similar ban or restrictive measures on those products.
- 18.2. During July 2013, the Russian Customs Service added about 40 Ukrainian companies to a list of “high-risk” producers. This classification meant that the companies were suspected of providing unsatisfactory information to the Russian Customs Service in the past and so its exports had to be scrutinised meticulously before being permitted to cross the border. The practical effect of this was to block the exports of these goods from Ukraine to the Russian Federation.
- 18.3. On 14 August 2013, the Russian Customs Service extended the purported “high risk” categorisation to all Ukrainian producers. The practical effect of this was to create a *de facto* trade ban on all Ukrainian exports to Russia.
- 18.4. Although the *de facto* trade ban was lifted around a week later, Russia continued thereafter to apply “additional control procedures” to Ukrainian exports to Russia, severely inhibiting their passage. Further, in an interview given on 21 August 2013, Mr Sergei Glazyev, an Advisor to the President of the Russian Federation with responsibilities for the development of Eurasian integration, publicly stated that this *de facto* trade ban could be imposed on Ukraine on a permanent basis in the event that Ukraine entered into the Association Agreement with the EU (Mr Glazyev said *"if Ukraine signs the Association Agreement with the EU, the administration regime that has been temporarily introduced on the Russia- Ukraine border in order to verify the conformity of imported Ukrainian goods to the currently effective goods origin rules and the accuracy of declared customs value, may apply on a permanent basis."*)

- 18.5. In October 2013, the Lithuanian Foreign Minister, Linas Linkevičius, indicated that Russia had threatened to suspend gas supply to Ukraine should Ukraine proceed to sign the Association Agreement.
- 18.6. In November 2013, Russia introduced new customs procedures. On 4 November 2013, Russian customs officials stated publicly that at least 300 trucks exporting goods from Ukraine were lined up at the border.
- 18.7. On 26 November 2013, President Yanukovich reportedly told his Lithuanian counterpart by phone that President Putin had threatened to procure Russian banks to bankrupt factories in eastern Ukraine if Ukraine signed the Association Agreement.
19. Each of the above actions were illegitimate and/or unlawful in that:
 - 19.1. The restrictions on trade with Ukraine at paragraph 18 were spurious and not applied for bona fide reasons and/or applied for an ulterior purpose, with the intention of applying pressure to Ukraine. In support of this position, Ukraine will rely on the facts that:
 - 19.1.1. Each of the trade restrictive measures were imposed in the few months before the Vilnius Summit, and coincided with the application of pressure by the Russian Federation on Ukraine not to sign the Association Agreement, including the threats at paragraph 20 below;
 - 19.1.2. Mr Sergei Glazyev publicly stated on 21 August 2013 that the imposition of checks on Ukrainian exports to Russia was in response to the possibility that Ukraine would sign the Association Agreement;
 - 19.1.3. On 17 December 2013, when the parties announced that Ukraine would be borrowing funds from the Russian Federation, the Russian Federation also agreed to terminate a number of these trade restrictive measures, to be effective within a matter of months. (However, following the fall of the administration of President Yanukovich, and as pleaded further below, Russia subsequently reintroduced various trade restrictive measures and took other economic action against Ukraine.)

- 19.2. The measures at paragraphs 18.1 to 18.4 and 18.6 above were each breaches of:
- 19.2.1. Articles I:1, III:4, VIII:3, X:3(a), XI:1, XIII:1 and/or XXIII of the General Agreement on Tariffs and Trade 1994.
- 19.2.2. In the case of the trade restrictive measures at paragraph 18.1, Articles 2, 5, 7 and/or 8 of the Agreement on the Application of Sanitary and Phytosanitary Measures;
- 19.2.3. The 2011 Free Trade Agreement between Member States of the Commonwealth of the Independent States;
- 19.3. Each of the measures at paragraph 18 were also breaches of:
- 19.3.1. The 1997 Agreement on Friendship, Cooperation and Partnership between Ukraine and the Russian Federation;
- 19.3.2. The Budapest Memorandum on Security Assurances 1994.
20. Representatives of the Russian Federation made threats of further action in the event that Ukraine entered into the Association Agreement. For example:
- 20.1. On 18 August 2013, at a time when Russia had imposed the *de facto* trade ban on Ukrainian exports pleaded at paragraph 18.3 above, Mr Glazyev stated: "*We are preparing to toughen customs administration in case Ukraine takes this suicidal step and signs the association agreement with the EU*".
- 20.2. On 21 August 2013, Mr Glazyev said that Russia could annul the CIS Free Trade Area Agreement (to which Ukraine had acceded in 2011) and cancel joint projects in a number of industries if Ukraine signed the Association Agreement with the EU.
- 20.3. On 22 August 2013, President Putin suggested that if Ukraine concluded the Association Agreement with the EU "*the member states of the [Eurasian] Customs Union will have to consider protective measures [against imports from Ukraine]*".

- 20.4. On 23 August 2013, Deputy Prime Minister Dmitri Rogozin announced the possibility that Russia would cease to co-operate with Ukraine in the production of the An-124 Ruslan transport aircraft.
- 20.5. On 9 September 2013, Russian Prime Minister Dmitry Medvedev warned that Ukraine would be barred from entry into the Eurasian Customs Union if it entered into the Association Agreement: *"I don't want there to be any illusions ... Practically, for our Ukrainian partners, entry into the Customs Union will be closed"*.
- 20.6. On 19 September 2013, President Putin warned Ukraine that Russia would retaliate with protectionist measures if Ukraine entered into the Association Agreement: *"We would somehow have to stand by our market, introduce protectionist measures. We are saying this openly in advance"*.
- 20.7. Speaking at a conference in the city of Yalta, Crimea, on 22 September 2013, Mr Glazyev:
- 20.7.1. Threatened that the tariffs and trade checks that Russia would impose if Ukraine entered into the Association Agreement could cost Ukraine billions of dollars and result in a default in its obligations to creditors. *"Who will pay for Ukraine's default, which will become inevitable?"* Mr Glazyev asked. *"One has to be ready to pay for that."* Saying that a default would cost Ukraine *"25 or even 35 billion euros"*, he asked: *"Would Europe take responsibility for that?"*
- 20.7.2. Asserted spuriously that by signing the Association Agreement with the EU, the Ukrainian government would violate the 1997 Agreement on Friendship, Cooperation and Partnership between Ukraine and the Russian Federation. He threatened that if Ukraine signed the Association Agreement, Russia could no longer guarantee Ukraine's status as a State and could possibly intervene if pro-Russian regions of the country appealed directly to Moscow.

- 20.8. On 23 September 2013, Mr Glazyev threatened that Russia would support a partitioning of Ukraine if it signed the Association Agreement in two months' time. Mr Glazyev stated that Ukraine's Russian-speaking minority might break up the country in protest at such a decision, and stated wrongly that Russia would be legally entitled to support them.
- 20.9. On 1 November 2013, Mr Glazyev again stated spuriously that if Ukraine signed the Association Agreement, that would be a breach of the 1997 Agreement on Friendship, Cooperation and Partnership between Ukraine and the Russian Federation, and that if the Association Agreement were signed "*we will have to start over [discussion of] all matters from the very beginning, including the issues of borders [between Ukraine and the Russian Federation]*".
21. Each of the above actions was illegitimate and/or unlawful in that:
- 21.1. The Russian Federation's public statements in offering to support the partitioning of Ukraine were:
- 21.1.1. A threat of the use of force, directly or indirectly, contrary to customary international law which rule has the status of *jus cogens* and/or Article 2(4) of the UN Charter.
- 21.1.2. A breach of the Russian Federation's duty under customary international law to refrain from intervention in the internal affairs of a sovereign State, namely Ukraine, which duty has the status of *jus cogens*.
- 21.2. The Russian Federation's public statements in threatening further trade restrictive measures were each threats of action that, if taken, would have been illegitimate and/or unlawful, and in breach of:
- 21.2.1. Articles I:1, III:4, X:3(a), XI:1, XIII:1 and/or XXIII of the General Agreement on Tariffs and Trade 1994;
- 21.2.2. The 2011 Free Trade Agreement between Member States of the Commonwealth of the Independent States;

21.2.3. The 1997 Agreement on Friendship, Cooperation and Partnership between Ukraine and the Russian Federation;

21.2.4. The Budapest Memorandum on Security Assurances 1994.

The effect of Russian action during 2013 on Ukraine

- 22. These actions had a significant impact on Ukraine's economy. For example:
 - 22.1. During 2013, Ukrainian exports to Russia were around 15% lower than during 2012 (although in sectors specifically affected by Russian trade restrictive measures, exports fell by around a third).
 - 22.2. Overall trade between Ukraine and Russia during 2013 reduced by around 15% as well (as against 2012).
- 23. The matters referred to above significantly and adversely affected Ukraine's ability to access international capital markets in the period from summer 2013 onwards. In particular:
 - 23.1. Credit Default Swap bid prices for Ukrainian debt increased substantially throughout the period from June 2013 to October 2013;
 - 23.2. Ukrainian sovereign bond yields also increased substantially throughout this period;
 - 23.3. By around September 2013, Ukraine was unable to access international capital markets on terms that were economically viable.
- 24. Also, by around autumn 2013, Ukraine:
 - 24.1. Had the credit rating on each of its existing Eurobonds downgraded by each of three major credit rating agencies (Fitch, Moody's and Standard & Poor) between 20 September 2013 and 8 November 2013;
 - 24.2. Had borrowed several billion US dollars on domestic markets through short-term domestic government bonds that were repayable in 2014-2015. In practice, Ukraine was unable to raise any significant further funds from borrowing on the domestic market.

- 24.3. Was due to repay sums totalling around USD 1.6 billion to the IMF by the end of November 2013;
- 24.4. In December 2013, would either have had to repay or roll over (at the discretion of VTB Capital PLC (“**VTB**”) and Sberbank of Russia (“**Sberbank**”)) at an increased interest rate (9.5%) a total of USD 750 million in borrowings from VTB and Sberbank. Both of these banks were majority-owned by the Russian Federation.

The decision to borrow funds from the Russian Federation

- 25. It was clear that if Ukraine signed the Association Agreement Ukraine would face a grave threat to its national security and territorial integrity and that its economy would be intentionally and severely (if not irreparably) damaged by Russian action. That was clear from the actions taken, and threats made, by the Russian Federation, and in light of the seriously deteriorating ability of Ukraine to borrow the funds that it required from the international capital markets that was itself in substantial part a result of those actions and threats. If Ukraine signed the Association Agreement, the likely consequences of Russian actions were such that Ukraine would be unable to meet its future debt repayment obligations, unable to refinance them on economically viable terms, and/or unable to borrow any further funds sufficient to offset the consequences of the Russian actions and threatened actions.
- 26. As a consequence of the foregoing, during meetings in October 2013 and November 2013 between President Putin on behalf of the Russian Federation and President Yanukovich on behalf of Ukraine, the Russian Federation and Ukraine agreed that:
 - 26.1. Ukraine would not sign the Association Agreement;
 - 26.2. The Russian Federation would take steps to remove the restrictions on trade with Ukraine that it had imposed during 2013;
 - 26.3. The Russian Federation would lend Ukraine up to USD 15 billion;
 - 26.4. The Russian gas company, Gazprom, would sell Ukraine’s national gas company, Naftogaz, natural gas at a discounted rate.

27. In the circumstances summarised at paragraphs 10 and 17 to 25 above, Ukraine had no practical choice but to accept these terms, and only did so as a result of the duress applied to it by the Russian Federation summarised in those paragraphs.
28. Thereafter, and pursuant to the agreement pleaded at paragraph 26 above:
- 28.1. On 21 November 2013 the CMU passed Order No. 905-p suspending the process of preparation to enter into the Association Agreement “[w]ith the purpose of taking measures to ensure the national security of Ukraine, examining in more detail and elaborating a complex of measures that need to be taken to restore the lost production volumes and lines of trade and economic relations with the Russian Federation and other member states of the Commonwealth of Independent States ...”.
- 28.2. Also on 21 November 2013, the Verkhovna Rada rejected some of the key pieces of legislation designed to meet the remaining preconditions of the European Union for Ukraine to sign the Association Agreement.
- 28.3. On 28 November 2013, the Vilnius Summit took place and the Association Agreement was not signed there as had been envisaged.
29. As a result of these steps, Ukraine’s ability to access international capital markets became even more limited, indeed those markets became effectively closed to Ukraine. For example, Ukrainian sovereign bond yields increased throughout November 2013, and reached 14% during the first two weeks of December 2013.

The process of entering into the contractual documents

30. Pursuant to the agreement pleaded at paragraph 26 above, on 12 December 2013 the Ukrainian Minister of Finance, Mr Yuriy Kolobov, and the Head of the External Borrowing Department of the Ukrainian Ministry of Finance, Ms Galina Pakhachuk, visited Moscow to negotiate the final terms of the borrowing that Ukraine would undertake from the Russian Federation. They met there with the Minister of Finance of the Russian Federation, Mr Anton Siluanov and Deputy Ministers of Finance Sergei Storchak and Alexei Moiseev, ministerial aide Timur Maksimov, Director of the Department of International Financial Relations of the Ministry of Finance, Andrei

Bokaryev and Deputy Director for Public Debt and Public Financial Assets, Petr Kazakevich.

31. As a result of those discussions, and in light also of the terms which were insisted on (through Minister Siluanov) by President Putin of Russia, the parties reached an arrangement under which:

31.1. As a first tranche, Ukraine would borrow around USD 3 billion from the Russian Federation. Initially, the Ukrainian delegates sought financing in the sum of around USD 1.6 billion, as this was, and was understood to be, the maximum sum that Ukraine was permitted to borrow by the 2013 Budget Law in force at that time (and taking into account the existing level of external borrowing at the time), as pleaded further below. However, at the insistence of the Russian Federation (which arose from the precondition at paragraph 31.3 below for the benefit of the Russian Federation), this amount was increased to USD 3 billion.

31.2. The borrowing would take place through the issuing of Eurobonds. Amongst other reasons, a bilateral direct loan agreement between Ukraine and the Russian Federation would take much longer to implement, whereas the relevant documents in respect of a contemplated issue of Eurobonds had been substantially prepared (albeit for a different purpose, namely a capital markets offering) and could be adapted. Ukraine agreed to send a copy of the draft Eurobond Offering Circular to the Russian Federation for consideration.

31.3. It would be a precondition of any lending by the Russian Federation to Ukraine that around USD 1.6 billion out of the USD 3 billion would be used to permit or enable Naftogaz to make payment of a like sum forthwith to Gazprom, the Russian gas company, in respect of alleged debts of Naftogaz to Gazprom for gas supplies to Ukraine. Likewise, if the Russian Federation were to lend further funds – up to USD 15 billion – then USD 5 billion of that total lending would be required to be used to permit or enable Naftogaz to make payment of a like sum to Gazprom. Minister Kolobov explained at the meeting on 12 December 2013 that he had no authority to agree to such an arrangement, but nevertheless it was made clear by the Russian delegates that this was an essential

precondition, whether the money to pay Gazprom came directly out of the loan monies to be advanced by Russia or indirectly through some other mechanism.

31.4. The remainder of the terms would be the subject of further negotiation between Ukraine and the Russian Federation.

32. The said Offering Circular identified, amongst other matters, the following “*Risk Factors*” that could “*individually or in the aggregate [with other Risk Factors] have a material adverse effect on Ukraine’s capacity to repay principal and make payments of interest on the Notes*” (with emphasis added):

“Ukraine’s economy depends heavily on its trade flows with Russia and certain other CIS countries and any major change in relations with Russia could have adverse effects on the economy, including as a result of the prices charged by Gazprom for natural gas supplied to Ukraine.

Ukraine’s economy depends heavily on its trade flows with Russia and other Commonwealth of Independent States (the “CIS”) countries, largely because Ukraine imports a large proportion of its energy requirements, especially from Russia (or from countries that transport energy related exports through Russia). In addition, a large share of Ukraine’s services receipts comprise transit charges for oil, gas and ammonia from Russia, which are delivered to the EU via Ukraine. Furthermore, in 2012, approximately 26.0 per cent. of all Ukrainian exports of goods went to Russia (although this decreased to 23.7 per cent. for the nine months ended 30 September 2013).

Ukraine therefore considers its relations with Russia to be of strategic importance. Until recently, relations between Ukraine and Russia were strained to a certain extent due to factors including:

- *disagreements over the prices and methods of payment for gas delivered to, and transported through, Ukraine by the Russian gas supplier Gazprom;*
- *issues relating to the delineation of the Russia-Ukraine maritime border;*
- *issues relating to the temporary stationing of the Russian Black Sea Fleet (Chernomorskyi Flot) in the territory of Ukraine; and*
- *a Russian ban on imports of meat and milk products from Ukraine and anti-dumping investigations conducted by Russian authorities in relation to certain Ukrainian goods*

...

If bilateral trade relations were to deteriorate or if Russia were to stop transiting a large portion of its oil and gas through Ukraine or if Russia halted supplies of natural gas to Ukraine, Ukraine’s balance of payments and foreign currency reserves could be materially and adversely affected.

Recently, pressure was placed on Russia-Ukraine bilateral relations arising out of the prospect of Ukraine signing the Association Agreement with the EU, including the threat of restrictive trade measures by Russia. For the nine months ended 30 September 2013, exports of Ukrainian goods to Russia decreased by 13.4 per cent. as compared to the corresponding period in 2012. As at the date of this Prospectus, discussions are ongoing between Russia and Ukraine in relation to restoring industrial cooperation and trade and economic relations between the two countries, following the decision of Ukraine to defer the signing of the Association Agreement with the EU. The work on the preparation of a "road map" for continuing negotiations between Ukraine and the EU remains in progress. If for any reason the announced economic and financial support is not forthcoming from Russia and Ukraine in the future signs the Association Agreement with the EU, this could impact trade and other aspects of Ukraine's bilateral relations with Russia and could lead to the imposition of trade and other punitive measures by Russia. These factors, in turn, could have a material adverse effect on the Ukrainian economy.

Russia has, recently and in the past, threatened to cut off the supply of oil and gas to Ukraine in order to apply pressure on Ukraine to settle outstanding gas debts and maintain the low transit fees for Russian oil and gas through Ukrainian pipelines to European consumers. In line with its threats, Gazprom substantially decreased natural gas supplies to Ukraine in early January 2009, due to a failure to agree terms regarding the supply of natural gas.

...

Reduced revenue from Naftogaz, or any further adverse changes in Ukraine's relations with Russia, or an increased need for support, could put pressure on the State Budget and have a material adverse effect on Ukraine's ability to perform its obligations under the Notes."

33. On 17 December 2013, President Putin and President Yanukovych announced:
- 33.1. The intention of Russia to subscribe for up to USD 15 billion of Ukrainian sovereign debt before the end of 2014, including an initial tranche of USD 3 billion that is the subject matter of these proceedings, which sovereign debt would be in the form of Eurobonds and other instruments having a maturity of two years and an affixed interest rate of five per cent per annum; and
 - 33.2. A substantial reduction in the price of gas to be supplied by Gazprom to Naftogaz. It was agreed that the price of gas would not exceed USD 268.50 per 1,000 cubic metres, compared to the then-prevailing price of around USD 400 per 1,000 cubic metres.

34. On 18 December 2013, the CMU adopted Decree No. 904 (**“the CMU Decree”**) that resolved:
- 34.1. To effectuate external state borrowings through the issuance of notes (referred to therein as **“the notes”**);
- 34.2. To confirm the Terms and Conditions of the issuance of the notes attached thereto. The CMU Decree attached an outline of certain terms of the notes, which provided at point 7 that *“the placement of the notes shall be as determined in the issue prospectus”* but which did not include:
- 34.2.1. Reference to any covenant entitling the Russian Federation call an Event of Default and to procure the Trustee to demand early repayment of the full principal and interest outstanding under the notes in the following circumstances:
- (a) violation of a requirement that the total of Ukrainian State debt and State guaranteed debt must not exceed an amount equal to 60 per cent of the annual nominal gross domestic product of Ukraine (whether this was permitted by then-prevailing Ukrainian law or not) (**“the GDP Ratio Clause”**);
 - (b) default by Ukraine in repayment of any Relevant Indebtedness exceeding USD 25 million. Since Relevant Indebtedness was in due course defined as including (amongst other matters) any indebtedness to any noteholder, and the Russian Federation was entitled to sell the notes to any third person without notice to Ukraine, in practice this Clause required Ukraine not to default on any indebtedness exceeding USD 25 million to any person (**“the Cross-Default Clause”**);
- 34.2.2. The Clause prohibiting Ukraine from claiming or exercising any right of set off in respect of the payment obligations under the notes (**“the No Set Off Clause”**);

- 34.3. For the Ministry of Finance to issue the notes pursuant to the Terms and Conditions approved by the CMU Decree.
35. However, as at the date of the CMU Decree:
- 35.1. The final terms of the Trust Deed and the Terms and Conditions of the notes had not been agreed;
- 35.2. There was no agreement in respect of the Conditions summarised at paragraphs 34.2.1 to 34.2.2 above, which conditions were onerous and unusual in Eurobonds generally and/or certainly in Eurobonds being purchased by a sovereign wealth fund and/or being issued by a sovereign state;
- 35.3. The CMU did not have access to and had not been provided with the draft Terms and Conditions of the notes;
- 35.4. The CMU did not have access to and had not been provided with the Expert Opinion required under the Rules of Procedure of the Cabinet of Ministers of Ukraine, as pleaded further below.
36. Thereafter, Ukraine purported to enter into the Trust Deed and Agency Agreement both dated 24 December 2013.
37. On 17 December 2013, a draft Amendment Law to the 2013 Budget Law had been registered with the Verkhovna Rada that proposed to increase the permitted level of external State borrowing for the general fund during 2013 by a sum of UAH 4,575,426,000 (equivalent to an increase of around USD 0.6 billion).
38. However, the said Amendment Law:
- 38.1. Was not passed by the Verkhovna Rada until 19 December 2013, was only signed by President Yanukovich on 27 December 2013 and by its own terms was not effective until the day after its publication. The Amendment Law was published on 28 December 2013, and accordingly took effect on 29 December 2013. It did not have retrospective effect as a matter of Ukrainian law.

- 38.2. In any event, did not increase the permitted level of external State borrowing for the general fund sufficiently to accommodate a further USD 3 billion in borrowing.

The Trust Deed and Agency Agreement

39. Paragraphs 1 to 8 are admitted, without prejudice to Ukraine's case as set out below that the Trust Deed and Agency Agreement are void and of no effect.
40. Paragraphs 9 and 10 are admitted.
41. Further:
- 41.1. As was public knowledge from the joint statement made by President Putin and President Yanukovich on 17 December 2013, and as was recorded in the terms of the Prospectus at page 4, and as the Trustee was aware:
- 41.1.1. The purpose of the arrangements to be entered into pursuant to which Ukraine would issue USD 3 billion of Eurobonds was for the Russian Federation to provide "economic support" to Ukraine as part of a larger USD 15 billion package.
- 41.1.2. To that end, the Russian Federation was to be the sole subscriber for and Noteholder of the USD 3 billion Eurobonds.
- 41.2. As pleaded at paragraph 4, Clause 5 of the Trust Deed provides that the Conditions shall be binding on Ukraine and the Noteholders (i.e. the Russian Federation);
- 41.3. Clause 25.2 of the Trust Deed provides that Ukraine irrevocably agreed that the Courts of England shall have exclusive jurisdiction to settle any disputes as therein defined, which agreement was for the exclusive benefit of the Trustee and each of the Noteholders (i.e. the Russian Federation);
- 41.4. Clause 8 of the Trust Deed and Condition 13 of the Terms and Conditions of the Notes provides that the Noteholders (i.e. the Russian Federation) themselves may proceed directly against Ukraine in certain circumstances;

- 41.5. Clause 3.6 of the Trust Deed provides that in certain circumstances, including a failure to pay principal in respect of any Note at maturity, a Noteholder may require the Issuer to issue the Noteholder with Definitive Original Notes in place of the relevant Original Global Note.
42. The effect of the matters pleaded at paragraphs 41.1 to 41.5 above is that:
- 42.1. The Russian Federation is able to enforce the obligations of Ukraine through the Trustee or directly. In support of the foregoing, Ukraine will also rely on the fact that solicitors acting for the Ministry of Finance of the Russian Federation sent a letter dated 2 February 2016 in anticipation of the present proceedings, apparently on the basis that the Russian Federation considered itself entitled and intended to seek to enforce Ukraine's purported obligations directly.
- 42.2. The Russian Federation's rights, and Ukraine's obligations, are not affected by the mechanism by which the Russian Federation takes enforcement action.
- 42.3. It was an implied term of the Trust Deed, necessary to give effect to the obvious shared intention of the parties (including the Russian Federation as Noteholder) and/or business efficacy that the Trustee would not be able to enforce, and the Russian Federation would not instruct the Trustee to enforce and the Trustee would not accept any instruction to enforce, any purported obligation of Ukraine if the Russian Federation could not itself enforce any such purported obligation of Ukraine or would not itself be able to enforce any such obligation if it were owed directly to the Russian Federation (whether by reason of duress applied by the Russian Federation or otherwise).
43. Paragraph 11 is noted. Ukraine will rely on the Trust Deed, Conditions and Agency Agreement at trial for their full terms, meaning and effect.

The Notes

44. Paragraph 12 is admitted, save that it is denied that the issuing of the Notes was valid or effective for the reasons pleaded in this Defence.

45. Paragraph 13 is admitted, save that it is denied that Ukraine was obliged to make such payments or that they were due and owing. In particular:
- 45.1. It is denied that Ukraine owed any contractual obligation to make those payments for the reasons pleaded in this Defence.
- 45.2. Further or alternatively, those payments were made in the circumstances at paragraphs 74 to 84 below, and hence are voidable and/or otherwise ineffective.
46. Paragraph 14 is denied for the reasons pleaded below.

Lack of capacity

47. The transaction that the Russian Federation seeks to enforce in the present proceeding is void because as a matter of Ukrainian law, Ukraine, acting through the CMU, had no capacity to enter into it.
48. As a matter of Ukrainian law:
- 48.1. Article 19 (2) of the Constitution of Ukraine dated 28 June 1996, as amended ("**the Constitution**") stipulates that *"Agencies of State power and agencies of local self-government and the officials thereof be obliged to operate only on the basis of and within the limits of powers and by the means which have been provided for by the Constitution and the laws of Ukraine."*
- 48.2. Article 170 of the Civil Code of Ukraine (the "**Civil Code**") provides that the *"The State shall acquire and effectuate civil rights and duties through agencies of State power within the limits of their competence established by law"*.
- 48.3. Pursuant to Article 19(2) of the Constitution, and as consolidated and elaborated by Article 2(3) of the 2005 Code on Administrative Proceedings of Ukraine, decisions adopted and/or performed by agencies of State power and officials must satisfy various legal criteria, including that they must:
- 48.3.1. Be adopted on the basis of and within the limits of powers and by a means provided by the Constitution and laws of Ukraine;

48.3.2. Be substantiated, that is, taking into account all circumstances having significance for the adoption of the decision (or performance of the action);

48.3.3. Be adopted sensibly, that is, pursuant to a procedure that accords with common sense and that reaches an outcome that accords with common sense.

49. By Article 85 of the Constitution, the Verkhovna Rada was responsible for, amongst other matters, approving the State Budget of Ukraine and introducing any necessary changes therein.
50. By Article 39 of the Ukrainian Budget Code dated 8 July 2010 (“**the Ukrainian Budget Code**”) and Article 159(6) of the Law of Ukraine “On the Reglament of the Verkhovna Rada of Ukraine” dated 10 February 2010, the Verkhovna Rada was required to approve the State Budget for the forthcoming calendar year by 1 December of the previous calendar year by a Law on the State Budget of Ukraine (“**the Budget Law**” for each year).
51. By Articles 16(1) and 40 of the Ukrainian Budget Code, the Budget Law for any given year must specify limits on (amongst other matters) the financing of the annual Budget by reference to certain coded categories. Accordingly, the Budget Law for each year, including the 2013 Budget Law, specified limits as to the amount of monies that could be borrowed by Ukraine by way of external borrowings (i.e. borrowings from foreign creditors, including foreign States) for the general fund of the State budget.
52. By Article 116(6) of the Constitution, the CMU was responsible for (amongst other matters) ensuring the implementation of the Budget Law passed by the Verkhovna Rada.
53. By Article 3(2) of the Law of Ukraine on the Cabinet of Ministers of Ukraine dated 7 October 2010 (“**the CMU Law**”): “*The Cabinet of Ministers of Ukraine shall effectuate executive power on the basis of, within the limits of, and by the means provided by the Constitution and laws of Ukraine.*”

54. By Article 4 of the CMU Law:

“(1) The Cabinet of Ministers of Ukraine shall be guided in its activity by the Constitution of Ukraine, this Law, other laws of Ukraine and also by acts of the President of Ukraine;

(2) The organisation, powers, and procedure of activity of the Cabinet of Ministers of Ukraine shall be determined by the Constitution of Ukraine and by this and other laws of Ukraine.”

55. The effect of the provisions pleaded at paragraphs 48 to 54 above is that, for relevant purposes, during 2013 Ukraine, acting through the Cabinet of Ministers of Ukraine, only had capacity to enter into external borrowings for the general fund of the State budget:

55.1. Within the limits specified by the 2013 Budget Law;

55.2. Insofar as it complied with the legal criteria pleaded at paragraph 48.3 above.

Lack of capacity: Budget Law limits

56. As at 18 December 2013 when the CMU Decree was adopted and/or 24 December 2013 when Ukraine purported to enter into the Trust Deed and Agency Agreement:

56.1. The 2013 Budget Law provided that the limit on external borrowings for the general fund of the State budget during 2013 was UAH 36,540,000,000 (around USD 4.6 billion);

56.2. Ukraine had already accumulated external borrowings for the general fund of the State budget during 2013 of UAH 23,979,000,000 (USD 3 billion);

56.3. Accordingly, the CMU had no capacity to approve or permit further external borrowings during 2013 that exceeded UAH 12,561,000,000 (around USD 1.6 billion).

57. Further, if (contrary to Ukraine’s primary case) the capacity of Ukraine, acting through the CMU, is to be ascertained as at 31 December 2013, the Amendment Law only increased the permitted external borrowings for the general fund of the State budget by UAH 4,575,426,000 (equivalent to an increase of around USD 0.6 billion).

58. Accordingly, whether as at 18, 24 or 31 December 2013:

58.1. As a matter of Ukrainian law, Ukraine, acting through the CMU, had no capacity to enter into, or to permit the Minister of Finance to enter into, the Trust Deed or Agency Agreement, or to issue the Eurobonds or otherwise to borrow USD 3 billion;

58.2. In the premises, as a matter of English law (being the law governing the Trust Deed and the Terms and Conditions of the Notes), the Trust Deed and Agency Agreement, and the Eurobonds issued thereunder, are void and of no effect.

Lack of capacity: Breach of Constitutional criteria

59. Point 55 of the Rules of Procedure of the Cabinet of Ministers of Ukraine (“**the CMU Procedural Rules**”) required:

“After processing by the Secretariat of the Cabinet of Ministers, the draft act of the Cabinet of Ministers shall be placed on the agenda of the next meeting of the Cabinet of Ministers. In addition to the materials submitted by the principal draftsman, the draft act shall also be accompanied by an Expert Opinion of the Secretariat of the Cabinet of Ministers, which shall be obligatory for consideration at the session of the Cabinet of Ministers.”

60. Point 52(3) of the CMU Procedural Rules prescribes the nature and contents of the said Expert Opinion. This included that the Secretariat should:

*“(1) verify the draft act for conformity to the Constitution and laws of Ukraine, acts of the President of Ukraine, international treaties of Ukraine in force, the Program of Activity of the Cabinet of Ministers, State special-purpose programs, programs of the President of Ukraine, as well as coordination with acts of the Cabinet of Ministers and conformity with requirements established by the present Reglament;
(2) study the sufficiency of financial and economic calculations;
(3) verify the completeness of coordination with interested agencies;
(4) evaluate the effectiveness of the means chosen for normative-legal regulation of the problem, whether the socio-economic and other indicators of the results of the realization of the act are realistic ...”*

61. In breach of the CMU Procedural Rules:
- 61.1. The Secretariat of the CMU only received the draft of the CMU Decree and supporting documents on 19 December 2013 (i.e. the day after the CMU Decree was passed);
- 61.2. The said Expert Opinion was only issued on 19 December 2013 (i.e. the day after the CMU Decree was passed) and was not before the CMU when it passed the CMU Decree.
62. In the premises, the adoption of the CMU Decree was not substantiated nor adopted sensibly, in breach of the legal criteria at paragraph 48.3 above, and was thereby in breach of Article 19(2) of the Constitution, and Article 2(3) of the 2005 Code on Administrative Proceedings of Ukraine.
63. Accordingly:
- 63.1. As a matter of Ukrainian law, Ukraine, acting through the CMU, had no capacity to enter into, or to permit the Minister of Finance to enter into, the Trust Deed or Agency Agreement, or to issue the Eurobonds or otherwise to borrow USD 3 billion;
- 63.2. In the premises, as a matter of English law (being the law governing the Trust Deed and the Terms and Conditions of the Notes), the Trust Deed and Agency Agreement, and the Eurobonds purportedly issued thereunder, are void and of no effect.

Lack of capacity: Breaches of non-delegation principle and principle of legal certainty; the scope of the CMU Decree

64. Article 16(1) of the Budget Code provided that:
- “The Cabinet of Ministers shall determine the conditions for the effectuation of the State borrowing, including the type, currency, term and interest rate of the State borrowing.”*
65. By an Instruction to Carry Out External State Borrowings in 2013 dated 16 January 2013 (**“the January 2013 Instruction”**), the CMU permitted Minister of Finance Kolobov to effectuate (but not determine the conditions of) external state borrowings

but only (a) within the limits provided for by the 2013 Budget Law and (b) on the terms stipulated by the CMU.

66. However, the purported effect of point 7 of the Annex to the CMU Decree pleaded at paragraph 34.2 above was to delegate the non-delegable right to formulate the conditions of the bond issue to another person, other than the CMU. That was:

66.1. In breach of Article 16(1) of the Budget Code;

66.2. Beyond the Minister of Finance's power to effectuate (but not determine the conditions of) the State borrowing.

67. Further or alternatively, point 7 of the Annex was in breach of the principle of legal certainty under Ukrainian law.

68. Accordingly:

68.1. As a matter of Ukrainian law, Ukraine, acting through the CMU, had no capacity to enter into, or to permit the Minister of Finance to enter into, the Trust Deed or Agency Agreement, or to issue the Eurobonds or otherwise to borrow USD 3 billion on the terms thereof;

68.2. In the premises, as a matter of English law (being the law governing the Trust Deed and the Terms and Conditions of the Notes), the Trust Deed and Agency Agreement, and the Eurobonds issued thereunder, are void and of no effect.

69. Further or alternatively, as pleaded at paragraphs 34 and 35 above:

69.1. The CMU did not approve draft Terms and Conditions of proposed Notes that included the GDP Ratio Clause or the Cross-Default Clause or the No Set Off Clause;

69.2. On its proper construction, the CMU Decree did not permit the Minister of Finance to:

69.2.1. Enter into any agreement or issue Eurobonds that exceeded the limits on external State borrowings contained in the 2013 Budget Law;

69.2.2. Enter into any agreement or issue Eurobonds that contained additional essential terms not envisaged by the CMU Decree, including the GDP Ratio Clause or the Cross-Default Clause or the No Set Off Clause. These were unusually onerous terms and/or (in the case of the GDP Ratio Clause and the Cross-Default Clause) terms that materially conflicted with the maturity date of 20 December 2015 provided for under the CMU Decree, in that there was a material risk that there would be a breach of the GDP Ratio Clause and/or the Cross-Default Clause and thereby entitle the noteholder or the trustee to accelerate the maturity date.

70. Accordingly:

70.1. As a matter of Ukrainian law, Ukraine, acting through the CMU, had no capacity to enter into, or to permit the Minister of Finance to enter into, the Trust Deed or Agency Agreement, or to issue the Eurobonds or otherwise to borrow USD 3 billion.

70.2. Further or alternatively, the Minister of Finance had no authority to enter into the Trust Deed or Agency Agreement on behalf of Ukraine, or to issue the Eurobonds pursuant thereto.

70.3. As a matter of English law (being the law governing the Trust Deed and the Terms and Conditions of the Notes), the Trust Deed and Agency Agreement, and the Eurobonds issued thereunder, are void and of no effect.

Duress

71. Further or alternatively, in light of the matters pleaded at paragraphs 10 and 17 to 25 above, and in particular the wrongful and illegitimate acts and threats of the Russian Federation, at the time of entering into the Trust Deed and Agency Agreement and issuing the Eurobonds:

71.1. Through a series of unjustified trade restrictive measures and threats against Ukraine's territorial integrity, the Russian Federation had placed considerable political, economic and financial pressure on Ukraine from July 2013 onwards, thereby demonstrating its will and ability to harm the Ukrainian economy if

Ukraine did not accede to Russia's pressure that it suspend signature of the EU Association Agreement and accept Russian financial support instead.

- 71.2. Ukraine had urgent need of substantial further sums to meet its budgetary obligations, including meeting salaries to state employees and social payments, including pensions, to its citizens;
 - 71.3. Ukraine effectively had no access to the international capital markets;
 - 71.4. Ukraine had no effective ability to raise funds from the EU or the IMF or any other supranational institution;
 - 71.5. Further, Ukraine was not able to raise sufficient funds in the domestic market in order to meet its needs;
 - 71.6. In those circumstances, Ukraine had no realistic choice other than to borrow from the Russian Federation, through the postulated Eurobond structure, and to accept the onerous and unfavourable terms including the GDP Ratio Clause and the Cross-Default Clause and the No Set Off Clause insisted on by the Russian Federation. Ukraine sought to resist the imposition of those terms by the Russian Federation, but the Russian Federation rejected such attempts out of hand.
72. The wrongful and illegitimate acts and threats of the Russian Federation pleaded at paragraphs 17 to 25 above constitute duress and Ukraine entered into the Trust Deed and Agency Agreement and issued the Eurobonds as a result of the duress applied to Ukraine.
73. The Trust Deed and Agency Agreement (and the issue of the Eurobonds thereunder) was voidable as a result, and has been avoided by the CMU passing a moratorium suspending payments in respect of the Notes dated 18 December 2015, alternatively is hereby avoided, and in particular:
- 73.1. The Trustee is unable to enforce its purported rights under the Trust Deed on the instructions of and for the sole benefit of the Russian Federation in circumstances where the Russian Federation applied duress to Ukraine and would not itself be permitted to enforce any purported obligation of Ukraine, or

would not itself be able to enforce any such obligation if it were owed by Ukraine directly to the Russian Federation;

73.2. Further or alternatively, and as pleaded at paragraph 42.3 above, it was an implied term of the Trust Deed that the Trustee would not be able to enforce its purported rights under the Trust Deed on the instructions of and for the sole benefit of the Russian Federation in circumstances where the Russian Federation applied duress to Ukraine and would not itself be permitted to enforce any purported obligation of Ukraine, or would not itself be able to enforce any such obligation if it were owed directly to the Russian Federation;

73.3. In any event, and insofar as it is necessary for Ukraine so to allege, the wrongful and illegitimate acts and threats of the Russian Federation pleaded at paragraphs 17 to 25 were public knowledge and/or reflected in the Prospectus for the Eurobonds and/or matters of which the Trustee was either aware or had constructive notice.

Continuing duress: Russian interference in Crimea and eastern Ukraine

74. The decision made by the CMU on 21 November 2013 to suspend Ukraine's signing of the Association Agreement resulted in mass protests in the Ukrainian capital, Kyiv. Following President Yanukovich's decision not to sign the Association Agreement at the Vilnius Summit on 28 November 2013, these protests grew significantly in size. Protests became larger in scale in the coming months. Following the killings of scores of civilians on 18 and 20 February 2014, President Yanukovich was reported to have fled Kyiv on 21 February 2014 and was ultimately relieved of his duties by a constitutional majority of the Verkhovna Rada on the grounds that he had withdrawn in an unconstitutional manner from performing his duties under the Constitution. Oleksandr Turchynov, temporarily exercising the duties of President in Yanukovich's place, announced in a televised address on 23 February, 2014, that his government would return Ukraine to the path of European integration.

75. Following these developments, the Russian Federation applied intensified duress to Ukraine, involving economic and political pressure and military aggression, including as pleaded at paragraphs 78 to 84 below.

76. As pleaded at paragraph 31 above, at the meeting between representatives of Ukraine and the Russian Federation on 12 December 2013, representatives of the Russian Federation insisted that it would be a precondition of any lending to Ukraine that around USD 1.6 billion of or deriving from the first tranche USD 3 billion of lending would be used to put Naftogaz in a position to pay a like sum to Gazprom in respect of alleged debts of Naftogaz to Gazprom for gas supplies to Ukraine.
77. In accordance with this precondition, Naftogaz duly paid to Gazprom USD 2.145 billion by way of various payments made during the first quarter of 2014. Those funds were paid partly from the USD currency reserves of the NBU, which had in turn been derived from the funds loaned to Ukraine by the Russian Federation through the Eurobonds. On 14 February 2014, Ukraine had provided further capital to Naftogaz in the sum of around UAH 11.1 billion (equivalent to around USD 1.3 billion³), which permitted Naftogaz to make the aforesaid payment to Gazprom.
78. In February 2014, the Russian Federation cancelled its future commitment to lend up to a further USD 12 billion which had been a fundamental part of the overall agreement reached between President Putin and President Yanukovych on the basis of which the Eurobonds had been issued.
79. On or around 2 April 2014, following the unlawful occupation of Crimea pleaded at paragraphs 82 to 84 below, the Russian Federation purported to terminate the Agreement dated 21 April 2010 between Ukraine and the Russian Federation Regarding the Issues of Stationing of the Russian Federation Black Sea Fleet in the Territory of Ukraine (the "**Kharkiv Accord**"). Pursuant to the Kharkiv Accord, stationing of the Russian Black Sea fleet in Crimea was extended from 2017 until the year 2042 in exchange for a discount on the price of gas, given in the form of the abolition of gas export duty for Ukraine. In diplomatic correspondence, Ukraine made clear that it considered that the Kharkiv Accord remained in effect. As a matter of public international law, the Russian Federation's purported unilateral termination of the Accord was therefore ineffective. The Russian Federation nonetheless reinstated gas export duty, substantially increasing the price of gas. The Russian Federation purported to justify the termination of the Kharkiv Accord by reference to the fact that it had

³ At the official exchange rate of UAH 8.6309 per USD set by the NBU.

annexed Crimea (which matter is addressed below). That action was itself unlawful and ineffective, as was the purported termination of the Kharkiv Accord.

80. During spring 2014, the Russian Federation procured Gazprom to cease to continue its discounted pricing of natural gas for Ukraine under the agreement dated 17 December 2013, and increased the price to around USD 400 per 1,000 cubic metres (excluding the export duty of around USD 100 per 1,000 cubic metres that the Russian Federation was imposing as pleaded above). The effect of the decision to cease to continue the discounted pricing of natural gas and the decision to reinstate export duty increased the price of gas by approximately 80%, to a level unaffordable to Ukraine in the medium to long term, as it was intended by the Russian Federation to be. In June 2014, Gazprom ceased to provide gas supplies to Ukraine.
81. During 2014 and 2015, the Russian Federation commenced various trade restrictive measures on imports from and trade with Ukraine, each of which was spurious and not applied for bona fide reasons and/or applied for an ulterior purpose, with the intention of applying pressure to Ukraine, and was illegitimate and/or unlawful for the reasons pleaded at paragraphs 19 and 21 above. For example:
 - 81.1. Since July 2014, Russia has banned the import of certain Ukrainian milk and dairy products, and all juice products including baby food.
 - 81.2. Since July 2014, Russia has suspended the import of railway rolling stock, railroad switches, other railroad equipment, and parts thereof from Ukraine.
 - 81.3. Since August 2014, Russia has banned imports of alcoholic beverages (beer, beer-containing beverages and distilled spirits) from Ukraine.
 - 81.4. Since September 2014, Russia has banned the import of all Ukrainian confectionery products.
 - 81.5. Since October 2014, Russia has banned the import of Ukrainian cheese products (and, since November 2014, cheese-like products) and certain wood chipboards.
 - 81.6. During the first half of 2015, Russia banned the import of Ukrainian food salt, detergents, cleaning agents, wallpapers and similar wall coverings.

82. More significantly, the Russian Federation took steps to interfere in, and ultimately proceeded unlawfully to occupy, the Crimean Peninsula:
- 82.1. Russian military activity in connection with the invasion of Crimea began on 20 February 2014. A significant troop transfer of special forces to Crimea began on 26 February 2014. On 28 February 2014, the Ukrainian Presidential Representative in Crimea reported an unprecedented military operation and 13 landings of Russian paratroopers in Crimea. On 27 February 2014, at 4:25 am, 50 heavily-armed men, with equipment only available to the newly-created Russian Special Operations Forces, seized the Crimean Parliament and raised the Russian flag over the building.
 - 82.2. The President of the Russian Federation, Vladimir Putin, stated (in an interview in March 2015) that he raised the issue of “re-incorporating” Crimea within the Russian Federation with the four most senior representatives of the Russian security services in February 2014.
 - 82.3. On 1 March 2014, the Russian Parliament approved President Putin’s request to use force in Ukraine. By the end of 5 March 2014, various units of the Russian armed forces had joined the 810th Marines Brigade which was stationed in Crimea.
 - 82.4. A purported referendum on Crimea’s status was held on 16 March 2014, while the Crimean Peninsula was effectively under Russian military control.
 - 82.5. Immediately following the referendum, the Russian Federation purported to recognise the independence of Crimea and proceeded purportedly to annex it as a subject of the Russian Federation.
 - 82.6. Once in effective control of Crimea, the Russian authorities and their local proxies engaged in a discriminatory campaign of unlawful expropriation targeting Ukrainian state and privately owned assets.
 - 82.7. The steps taken by the Russian Federation in Crimea constitute clear violations of customary public international law and/or Article 2(4) of the United Nations Charter. Further, on 24 March 2014, by a vote of 100 in favour to 11 against (with 58 abstentions), the General Assembly of the United Nations called on all

States, international organizations and specialized agencies not to recognise any alteration of the status of the Autonomous Republic of Crimea and the city of Sevastopol on the basis of the 16 March referendum “*and to refrain from any action or dealing that might be interpreted as recognizing any such altered status.*”.

83. In addition to unlawfully occupying the Crimean Peninsula, the Russian Federation also fuelled and supported separatist elements in, interfered militarily in and succeeded in destabilising and causing huge destruction across eastern Ukraine:

83.1. In April 2014, large cities in eastern Ukraine saw a wave of what appeared to be well organised and coordinated protests by crowds of pro-Russian demonstrators. In the cities of Donetsk, Lugansk and Kharkiv, the protestors seized the main governmental buildings and proclaimed “People’s Republics”.

83.2. In July 2014, in response to a ramping up of the military operation against pro-Russian insurgents in eastern Ukraine by the Ukrainian government, the Russian Federation increased its military support for the self-proclaimed Donetsk and Lugansk People’s Republics in the form of supplying weapons, hardware, training and soldiers. A Buk missile system provided by the Russian Federation was used from separatist-controlled territory to shoot down a Malaysian Airlines civil flight, resulting in the deaths of 298 civilians and aircrew.

83.3. By mid-August 2014, the Russian Federation, in addition to continuing covertly to supply weapons and training, resorted to more direct action in assisting the insurgents, including use of regular Russian troops. For example, Ukraine’s forces in and around Ilovaisk were attacked by 4 battalions of tactical groups of the Russian armed forces (about 2,000 soldiers) that had been secretly deployed from across the border.

83.4. Russia’s support for the separatists has resulted in huge damage to eastern Ukraine, in terms of large scale loss of life, relocation of persons and destruction and damage to property and infrastructure, in effect crippling large parts of that

area, which forms the industrial heartland of Ukraine, and reducing its economic output dramatically.

- 83.5. The well-known involvement of the Russian Federation in destabilising eastern Ukraine is a clear violation of customary public international law and/or Article 2(4) of the UN Charter.
- 84. As a result of Russian military action in and unlawful occupation of Crimea, its military action in eastern Ukraine and the economic measures adopted in 2014 and thereafter by the Russian Federation towards Ukraine:
 - 84.1. More than 9,000 people have lost their lives and 21,000 people have been injured in the conflict.
 - 84.2. More than 1.7 million Ukrainian citizens have been displaced within Ukraine, and in addition around 1.4 million Ukrainian citizens have fled to other countries.
 - 84.3. Ukraine has sustained billions of dollars of damage to its infrastructure, and lost industrial capacity and production.
 - 84.4. The Russian Federation has expropriated assets from Ukrainian state-owned entities and private persons worth billions of dollars without paying any compensation.
 - 84.5. Bilateral trade between Russia and Ukraine reduced by some 39% in 2014 (as against 2013) from USD 44 billion to USD 27 billion, followed by a further 41% fall in 2015.
 - 84.6. Ukraine has lost control of Crimea and large portions of eastern Ukraine, and hence significant sources of productive economic capacity and its ability to collect tax and other revenue from these areas.
 - 84.7. Such action has been the predominant cause of a severe and ongoing recession in Ukraine. According to the IMF, Ukraine's real GDP fell 6.8% in 2014 (the fall accelerated to 14.4% in the fourth quarter) and a further 11% in 2015. Industrial output shrank by 10.1% in 2014.

84.8. The USD : UAH rate moved from 1 : 8.24 on 1 January 2014 to 1 : 15.84 on January 2015, a 48% depreciation.

Implied term not to (1) deprive Ukraine of the economic benefit of the Russian loan and/or (2) demand repayment if (a) repayment would be impossible or impracticable for Ukraine and/or (b) Russia had deliberately interfered with or hindered Ukraine's ability to repay

85. Alternatively to the foregoing, if the Trust Deed and Agency Agreement are binding and enforceable as against Ukraine, and in light of the matters pleaded at paragraphs 41 and 42 above, it was an implied term of the Trust Deed, necessary to give effect to the obvious shared intention of the parties (including the Russian Federation as Noteholder) and/or business efficacy that Ukraine would be excused performance of its obligations (including obligations to make any repayment under the Eurobonds) and/or the Russian Federation would not insist on repayment, or procure the Trustee to insist on such repayment if:

85.1. Either the Trustee or the Russian Federation (as Noteholder) deliberately and/or unlawfully deprived Ukraine of the economic benefit of the loan received by Ukraine through the issue of the Eurobonds and/or frustrated the economic purpose of the loan;

85.2. Either the Trustee or the Russian Federation (as Noteholder) deliberately and/or unlawfully acted in such a way as to make it impossible or impracticable for Ukraine to comply with its obligations under the Trust Deed (including the Conditions), or deliberately and/or unlawfully and/or unreasonably interfered with or took steps to prevent, hinder or delay its ability to do so.

86. By its actions pleaded at paragraphs 78 to 84 above, the Russian Federation has (amongst other things):

86.1. Severely disrupted the economy of Ukraine, directly and indirectly in the manner pleaded at paragraph 84 above;

86.2. Required Ukraine substantially to increase public spending on Ukrainian defence and security, from approximately UAH 45 billion during 2013 (around USD 5.6 billion) to approximately UAH 64 billion during 2014 (around USD 8

billion), UAH 96 billion in 2015 (around USD 6 billion) and UAH 115 billion in 2016 (around USD 4.8 billion);⁴

- 86.3. Required Ukraine to increase expenditure to cater for the needs of large numbers of internally displaced persons.
- 87. The effect of this action has been to:
 - 87.1. Continue to prevent Ukraine from accessing international capital markets;
 - 87.2. Require Ukraine to enter into an Extended Fund Facility with the IMF in March 2015 to borrow some USD 17.5 billion from the IMF and a further USD 7.2 billion pursuant to assorted bilateral and multilateral arrangements.
- 88. As a condition of borrowing the required funds from the IMF:
 - 88.1. Ukraine had to implement a “debt operation” under which Ukraine would restructure its borrowings such that some USD 15.3 billion due in repayments to creditors in the period up to 31 December 2018 (**“the IMF Program Period”**) would not be required to be paid during the IMF Program Period, either by deferring or reducing those repayments.
 - 88.2. In order to implement this debt operation, on 12 November 2015 Ukraine issued further Eurobonds (maturing on dates no earlier than 2019 and in each case outside the IMF Program Period) (**“the 2015 Eurobonds”**) to its creditors in exchange for their existing debt, on terms that, in summary, represented a discount of up to 20% on the sums due under the existing obligations. This was achieved by issuing to existing creditors new Notes in a principal amount of USD 800 for every USD 1000 in existing debt and a further notional value of USD 200 in GDP-linked Securities.
 - 88.3. By Condition 14 of the 2015 Eurobonds, Ukraine is prohibited from making any payment to its other (alleged) creditors unless it offers similar terms to the holders of the 2015 Eurobonds. The effect of this is to prevent Ukraine from making payment to the holders of the Notes that are the subject of these

⁴ All figures are as at 1 January for the relevant calendar years pleaded. Exchange rates used: 1 USD = 7.993 UAH as at 1 January 2013; 1 USD = 7.993 UAH as at 1 January 2014; 1 USD = 15.76 UAH as at 1 January 2015; 1 USD = 24.00 UAH as at 1 January 2016. Source: NBU official exchange rate.

proceedings or the Trustee in accordance with the alleged contractual terms relied on by the Trustee in these proceedings. Condition 14 was included in the 2015 Eurobonds to encourage the highest possible participation by all of Ukraine's bondholders in the debt operation so as to enable Ukraine to meet the financing targets set out in the IMF Extended Fund Facility. All bondholders other than the Russian Federation participated in, or by virtue of supermajority voting were bound by, the debt operation, so it is only payments to the holders of the Notes that are the subject of these proceedings (i.e. the Russian Federation) that would be subject to the effect of Condition 14 of the 2015 Eurobonds.

- 88.4. Without prejudice to Ukraine's case that it has no contractual entitlement to be repaid, the Russian Federation has refused to participate in this debt operation.
- 89. In the premises, and without prejudice to Ukraine's case that it is under no contractual obligation to make such repayment, if Ukraine were to repay the Russian Federation and/or the Trustee the sums claimed:
 - 89.1. That would be a breach of Condition 14 of the 2015 Eurobonds and constitute an Event of Default thereunder, entitling the holders of the 2015 Eurobonds to declare that the 2015 Eurobonds are immediately due and payable at their outstanding principal amount plus accrued but unpaid interest;
 - 89.2. Such outstanding principal plus accrued but unpaid interest as at 23 May 2016 was approximately USD 13.3 billion;
 - 89.3. If Ukraine were required to make such payments:
 - 89.3.1. The fact that these payments fell due in the IMF Program Period would mean that the IMF would decline to lend further tranches under the Extended Fund Facility; and
 - 89.3.2. Ukraine would be unable to make the accelerated payments to the holders of the 2015 Eurobonds.

90. Accordingly:
- 90.1. It would be impossible or impracticable for Ukraine to repay the Russian Federation and/or the Trustee.
- 90.2. If Ukraine were to repay the Russian Federation and/or the Trustee, then that would deprive Ukraine of the economic benefit of the loan represented by the Eurobonds that is the subject of these proceedings.
91. Further, the Russian action pleaded at paragraphs 78 to 84 above deliberately and/or unlawfully and/or unreasonably interfered with or involved steps to prevent, hinder or delay Ukraine's ability to repay the loan in accordance with its terms.
92. In the premises:
- 92.1. Ukraine has no obligation to repay the sums borrowed by Ukraine;
- 92.2. The Russian Federation and/or the Trustee has no right to request, demand or require Ukraine to do so.

Implied term not to (1) enforce the Russian loan and/or (2) demand repayment if the Russian Federation is in breach of its obligations towards Ukraine under public international law

93. In the further alternative, and in light of the matters at paragraphs 41 and 42 above, if the Trust Deed and Agency Agreement are binding and enforceable as against Ukraine, it was an implied term of the Trust Deed, necessary to give effect to the obvious shared intention of the parties (including the Russian Federation as Noteholder) and/or business efficacy that Ukraine would be excused performance of its obligations (including obligations to make any repayment under the Eurobonds) and/or the Russian Federation would not insist on repayment, or procure the Trustee to insist on such repayment if:
- 93.1. The Russian Federation was in breach of its obligations towards Ukraine under public international law not to use force against Ukraine and/or not to intervene internally in the affairs of Ukraine; and/or

- 93.2. The Russian Federation was in breach of its obligations towards Ukraine as pleaded at paragraph 93.1 above, and this had been a significant cause of loss to Ukraine and/or had deprived Ukraine of the economic benefit of the loan represented by the Eurobonds.

Countermeasures and discretion

94. Further or alternatively, in the circumstances pleaded at paragraphs 93.1 and 93.2 above:
- 94.1. Ukraine is entitled to decline to make the payment demanded by or for the benefit of the Russian Federation, and thereby breach the 1997 Agreement on Friendship, Cooperation and Partnership between Ukraine and the Russian Federation, in circumstances where that is an appropriate and proportionate countermeasure under public international law for the purpose of inducing the Russian Federation to comply with its obligations under public international law.
- 94.2. In any event, as a matter of the Court's discretion the Court should decline to grant the discretionary relief sought by the Trustee unless and until Russia ceases to act in breach of public international law in its relations with Ukraine.

Non-payment

95. As to paragraph 15:
- 95.1. Paragraph 73 above is repeated.
- 95.2. Save that it is denied that Ukraine was obliged to make the alleged or any payments in respect of the Notes, paragraph 15 is admitted.
96. Save that it is admitted that Ukraine has not made any payments of principal or interest since 20 June 2015, paragraphs 16 to 19 are denied for the reasons pleaded above.

97. Paragraph 20 is not within Ukraine's knowledge and is not admitted.
98. Save that the validity and effectiveness of the purported notice is denied, paragraph 21 is admitted.
99. Paragraphs 22 and 23 are denied for the reasons pleaded above. Further, paragraph 22(c) is wholly unparticularised as to the "*various other costs*" allegedly incurred or the basis on which the Trustee and Ministry of Finance of the Russian Federation claim that they are entitled to recover them.
100. Paragraph 24 is noted.
101. Save as expressly admitted or not admitted above, each and every allegation in the Particulars of Claim is denied.
102. Nothing in this Defence involves any waiver of Ukraine's right to assert sovereign immunity.
103. The length of this Defence is within the scope of the permission granted by The Honourable Mr Justice Knowles CBE on 25 May 2016.

BANKIM THANKI Q.C.

SIMON ATRILL

STATEMENT OF TRUTH

The Defendant believes that the facts stated in this Defence are true.

I am duly authorised by the Defendant to sign this statement.

Signed.....

Name: Oleksandr Danyliuk

Title: Minister of Finance of Ukraine

Date: 26 May 2016