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BULLETIN

YUKOS DECISION: THE IMPACT

Last week, there was another dramatic turn in the high stakes *Yukos* dispute when The Hague District Court quashed the record breaking USD 50 billion PCA Tribunal award against Russia in the long running saga on the dismantling of what was once Russia's largest oil producer. In these two briefings Karen Maxwell analyses the impact of the District Court's decision on the shareholders' case and what options remain for them moving forward, and Monica Feria- Tinta explores the impact on investment treaty arbitration and users' buy-in to the process for the future.

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YUKOS INVESTORS - DOWN BUT NOT OUT

Karen Maxwell

The much-anticipated decision of the Hague District Court in the *Yukos* case was published last week. The Dutch proceedings concerned a PCA arbitration award against Russia – totalling over USD50 billion and reported to be the largest ever – made in proceedings under the Energy Charter Treaty. The award was controversial for a number of reasons, including a notorious spat concerning the role of the assistant to the arbitral tribunal. The Dutch court has now set the award aside. What are the implications of that decision?

The claimants are three shareholders of OAO Yukos Oil Company who alleged that Russia had unlawfully expropriated their investment in the company by various means, including the conduct of the Russian tax authorities. One of the principal issues in the arbitral proceedings arose from Russia's challenge to the tribunal's[1] jurisdiction. In 1994, Russia signed the ECT and thereby agreed to its provisional application. However, it had never ratified it. Article 45 of the ECT provides that, in such cases, a signatory consents to the provisional application of the ECT *"to the extent that such provisional application is not inconsistent with its constitution, laws, or regulations."* The jurisdictional issue that arose was whether the provisions of the ECT, specifically the arbitration provision in Article 26, was "inconsistent" with Russian law.

Russia argued that, as a matter of Russian law, disputes of a public law nature could not be referred to binding arbitration. The basis of the claims here (in particular, those relating to the conduct of the tax authorities in Russia) meant that they could not be validly referred to arbitration as a matter of Russian law. It followed that the dispute resolution provision of the ECT, Article 26, was not consistent with Russian law. The tribunal dismissed this argument. It focused on the wording of Article 45, in particular the words "such provisional application", and concluded that

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this provided for the provisional application of the entire ECT, rather than those specific provisions which were compatible with national law.

The Dutch court, however, found that it was necessary to examine each provision of the ECT to determine whether it was compatible with Russian law. Furthermore, it was not necessary for Russia to establish that any particular provision was prohibited by national law: it was enough to show that the provision was incompatible, in the sense that *"there is no legal basis for [the provision]…or – when viewed in a wider perspective – if it does not harmonise with the legal system or is irreconcilable with the starting points and principles that have been laid down in or can be derived from legislation."*[2] Applying this approach, Article 26 was not consistent with Russian federal law and could not take priority over it. It followed that Article 26 did not constitute an unconditional offer to arbitrate, and the claimants' notice of arbitration was not valid. The tribunal lacked jurisdiction, and the award must be quashed.[3] (The public international law implications of the decision are analysed in an article by Monica Feria-Tinta.)

The shareholders have indicated that they will appeal the decision all the way to the Dutch Supreme Court if necessary. In the meantime, though, what are the implications for the future? The shareholders have commenced enforcement proceedings in several countries (including England, France, Belgium, Germany, Netherlands, India and the US) and have managed to obtain security over assets in several jurisdictions, including (it has been reported) bank accounts, trade mission buildings, and debts to the Soyuz space agency. In December 2015, the French courts refused a stay of enforcement pending the outcome of the Dutch set aside proceedings. The question that now arises is whether those national courts will enforce the award, and/or maintain the security, notwithstanding that the award has been set aside at the court of the seat.

Under Article V(1)(e) of the New York Convention, the fact that the award has been set aside entitles, but does not require, the court to refuse to enforce. Article V(1)(e) has been approached differently in different jurisdictions. France is probably one end of the spectrum: the setting aside of an award is not enumerated as a defence to enforcement in the relevant French legislation, and the French courts are willing to enforce set-aside awards.[4] By contrast, courts of other jurisdictions will generally refuse to enforce – for example, in the US, "extraordinary circumstances" such as public policy grounds are generally required to justify recognition of the set-aside decision. The issue has been debated at length in recent years, with two broad strands of theory emerging: the delocalized, or transnational, approach (which would permit enforcement) and the so-called territorial approach (under which the set-aside decision means that there is no longer any award that can be enforced). In England, the courts have adopted a somewhat nuanced approach, holding that Article V(1)(e) does not give rise to an untrammelled discretion: there must be some recognized basis for refusing to recognise the set-aside decision under ordinary English conflicts of law rules. The focus therefore lies on the enforceability of the set-aside decision itself.[5]

A further, related, complication arises from the doctrine of issue estoppel. Is the decision of the Dutch court, that the tribunal lacked jurisdiction, binding as between the parties in subsequent enforcement proceedings? As a matter of English law, an issue estoppel could in principle arise from a decision on defences to enforcement.[6] In a previous decision also involving companies in the

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Yukos group, the Court of Appeal held that a Dutch judgment on issues of public policy arising in the enforcement context did not bind the parties, because the issue before the English court (one of English public policy) was different in substance to that which had arisen in the Dutch proceedings.[7] Nevertheless, the issue is not free from controversy: recognition of issue estoppel arguably expands the defences to enforcement under the New York Convention, and cuts down the enforcing court's competence to rule on them.

Even if the award is reinstated on appeal, further issues will inevitably arise. The Dutch court has not ruled on the five further defences to enforcement raised by Russia. Furthermore, in the weeks before the Dutch decision, it was reported that a new ground had been identified by a Russian Investigative Committee, which had found evidence of fraud (allegedly concealed from the tribunal) in relation to the acquisition of the shares. And, obviously, there will be substantial disputes relating to sovereign immunity in each jurisdiction where enforcement is sought.

When the award was first issued in 2014, commentators estimated that it would probably take 10-12 years to enforce. This latest decision in the saga suggests that, if anything, that estimate may be on the optimistic side.

Footnotes

1. Strictly, there were three separate arbitral references. However, the same arbitrators were appointed to each.
2. Para 33 of the judgment
3. Russia was awarded the costs of the proceedings – "provisionally estimated" at 16,801.80 euros, which seems a little wide of the mark.
4. See, eg, *PT Putrabali Adyamulia v Rena Holding*, Cass civ 1, 29 June 2007, Rev arb 2007, page 515
5. See, eg, *Yukos Capital SARL v OJSC Rosneft Oil Company* [2014] EWHC 2188 (Comm), *Malicorp Ltd v Government of the Arab Republic of Egypt and ors* [2015] EWHC 361(Comm), *Y v S* [2015] EWHC 612 (Comm)
6. *Thai-Lao Lignite (Thailand) Co Ltd v Laos* [2012] EWHC 3381 (Comm), *Diag Human v Czech Republic* [2014] EWHC 1639 (Comm).
7. *Yukos Capital SARL v OJSC Rosneft Oil Company* [2012] EWCA Civ 855

ANNULMENT OF THE YUKOS AWARD: A SORE SPOT IN INVESTMENT ARBITRATION?

Monica Feria-Tinta

Investment arbitration was created to provide parties to an investment dispute with a quick remedy. By comparison to other ways of dispute resolution, its great advantage lies in its swiftness.

In that context, does the annulment of the *Yukos* award, an award that took over 10 years to obtain, on the grounds of lack of jurisdiction by a District Court in The Hague last week, constitute a serious blow to Investment arbitration? Is this recent development in the *Yukos* saga putting its finger on the sore spot of investment arbitration, namely the erasing of its great advantage –a swift decision?

Moreover, beyond reconciling the *Yukos* situation with the efficacy of the investment arbitration system itself, what are the key observations to be drawn from the decision last week, from the perspective of public international law?

PIL- the "steel frame" of Investment arbitration

Yukos illustrates the extent to which the steel frame of public international law runs through investment arbitration. The entire edifice of the *Yukos* award essentially crumbled on a single point of public international law: a point of treaty interpretation.

> "IS THIS RECENT DEVELOPMENT IN THE YUKO SAGA PUTTING ITS FINGER ON THE SORE SPOT OF INVESTMENT ARBITRATION, NAMELY THE ERASING OF ITS GREAT ADVANTAGE – A SWIFT DECISION?

The axis upon which everything else rested was the 'limitation clause" contained in Article 45 (1) of the Energy Charter Treaty (ECT) which provides that each signatory agreed to the provisional application of the Treaty pending its entry into force for said signatory, "*to the extent* that such provisional application is not inconsistent with its constitution, laws or regulations"(My emphasis). The Russian Federation had signed the ECT but not ratified it.

In order to establish the effect to be given to this 'limitation clause", the Court turned to the rules of treaty interpretation contained in Article 31 of the Vienna Convention on the Law of Treaties 1969,[1] a "bread and butter" provision for public international law specialists. In accordance with the techniques of interpretation enshrined in such provision, the Court placed paramount importance to the ordinary meaning of the term *"extent"* concluding that the term "to the extent" in common parlance signifies a degree of application, scope, expressed also in several other language versions of the treaty. In interpreting Article 45 (1) the Court turned further to its context, in particular its connection to Article 45(2).[2] The Court noted that Article 45 (2) (c) does not contain a reference to the Constitution. It held that the arbitral tribunal had "failed to clearly address the meaning of Article 45 paragraph 2 under c". The Court agreed with the Russian Federation in noting that in their approach the investors had lost sight of the interaction between paragraphs 1 and 2 of Article 45 ECT. The Court concluded that the ordinary meaning of term *"to the extent"* in paragraph 1, partly in the context of the term, results in an interpretation of the Limitation Clause in which the option of provisional application is focused on and depends on the compatibility of separate treaty provisions with national laws; the position advanced by the Russian Federation.

The Court further disagreed with the arbitral tribunal in its assertion that such interpretation advanced by Russia was in conflict with the object and purpose of the Treaty, understood as "providing a legal framework to promote long-term cooperation in the area of energy, based on mutual benefit and complementarity". The Court held that the arbitral tribunal "had failed to specify to what extent a limited application of the treaty provisions-under Article 45 ECT- would be contrary to this object." It further stated that "A state that relies on a conflict between a treaty provision and national law, on sound grounds and referencing

> "YUKOS ILLUSTRATES THE EXTENT TO WHICH THE STEEL FRAME OF PUBLIC INTERNATIONAL LAW RUNS THROUGH INVESTMENT ARBITRATION. THE ENTIRE EDIFICE OF THE YUKOS AWARD ESSENTIALLY CRUMBLED ON A SINGLE POINT OF PUBLIC INTERNATIONAL LAW: A POINT OF TREATY INTERPRETATION.

the Limitation Clause, does not act contrary to the *pacta sunt servanda* principle, nor to the principle of Article 27 [of the Vienna Convention on the Law of Treaties]'. Whilst the *pact sunt servanda* principle refers to "agreements must be kept", Article 27 of the Vienna Convention states the principle that a party may not invoke the provisions of its internal law as justification for its failure to comply with a treaty.

The Court thus found that the Russian Federation was only bound by the treaty provisions reconcilable with Russian law. The Court concluded that based only on the signature of the ECT, the Russian Federation was not bound by the provisional application of the arbitration regulations of Article 26 ECT. As a consequence, it held that the Russian Federation never made an unconditional offer for arbitration, in the sense of Article 26 ECT. As a result, the investors 'notice of arbitration" had not formed a valid arbitration agreement. The Court held that therefore the Tribunal had wrongly declared itself competent in the arbitration and had no jurisdiction to issue the award.

Should the Court of Appeal revisit this decision Article 31 VCLT will be once again, the 'master key" (to use a term applied to Art 31 of the VCLT by the International Law Commission) for untangling the law in the case.

Setting aside awards

Last week's decision by The Hague District Court is not the sole case in which domestic courts reverse assertion of jurisdiction by arbitral tribunals in *Yukos*, albeit the overturning of the US$50 billion award represents the largest damages award set aside. On 18 January 2016, the Svea Court of Appeal in Stockholm, delivered judgment on a case relating to Spanish investors in *Yukos,* affirming that the *Renta 4 v Russian Federation* arbitral tribunal had no jurisdiction to decide the case brought by Spanish investors against the Russian Federation on 25 March 2007.[3]

On the other hand, whilst those acting for the investors before The Hague domestic tribunals have already announced that they would appeal The Hague District Court decision, one cannot but reflect on the time protracted litigation is taking: the legal battle already echoing long-term proceedings in other investment arbitration contexts such as those which sought annulment of awards in the *Vivendi* case[4] and the *CMS* [5] case, both ICSID arbitrations against Argentina.

When the arbitral award in *Yukos* was rendered back on July 18 2014, it was announced that this award was final and binding, and enforceable in 150 States under the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. How is one to reconcile the present situation with such a statement without losing confidence in the efficacy of investment arbitration?

Arbitration – a Law unto itself?

To some the outcome of the decision on *Yukos* last week may be an example of a strained relationship between courts of the seat of arbitration and arbitral tribunals, which has created a dystopian scenario beyond the

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Netherlands (the complexities of which are discussed by Karen Maxwell in her article). Yet, this outcome may illustrate quite well, at the same time, a point made recently by Lord Mance, in his lecture "Arbitration-a Law unto itself?":[6] that international arbitration is not an autonomous transnational legal order and that decisions of the court of the seat reflect the choice of the parties. Lord Mance pointed out:

"Empirical evidence suggests that the choice of seat is usually the result of a careful consideration of the legal consequences and not merely a matter of convenience. To view arbitral awards as autonomous of national courts is a step back in terms of the comity of nations and also contradicts the wording of the New York Convention."

He stated further:

"On the face of it, parties who agree a particular seat deliberately submit themselves to the law of the seat and whatever controls it exerts. They do this in the interests of certainty."

Admittedly however, he pointed out that

"English authority suggests that there can be exceptional circumstances in which the setting aside of an award in its seat need not prevent its enforcement in another state. This is not because English courts have suddenly begun to see attractions in the French approach or in article VII of the New York Convention. Rather, it is for a reason grounded more solidly in the Convention- the perceived flexibility of the word "may" in the English version of article V.1 [of the New York Convention], carried through into section 103(2) of the 1996 [Arbitration] Act.[7]

[….]

The current English view is therefore that a foreign enforcing court may, consistently with the New York Convention, take a different view of an award to that taken by the law and courts of the seat, by relying on the word "may" in article V.1. But this is only in exceptional circumstances when justified on some recognized common law principle, and not as a matter of open discretion. In other circumstances, a decision of the law and courts of the seat setting aside an award will prevail."

Immunity: a further caveat

A further and important caveat in any enforcement scenario relates to the issue of State immunity. The key holding in the Dutch decision in that respect, is that the investors 'notice of arbitration" had not formed a valid arbitration agreement. Lacking an arbitration agreement means that the Russian Federation had not waived jurisdictional immunity. For a discussion of this notion in the context of enforcement of awards please see a recent article I wrote entitled *Foreign State Immunity and enforcement of International Awards,* available here.

Footnotes

1. Article 31(1) of the Vienna Convention on the Law of Treaties reads:
   A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. Article 45 (2) of the ECT reads:
   (2) (a) Notwithstanding paragraph (1) any signatory may, when signing, deliver to the Depository a declaration that it is not able to accept provisional application. The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration. Any such signatory may at any time withdraw that declaration by written notification to the Depository.
   […]
   (c) Notwithstanding subparagraph (a), any signatory making a declaration referred to in subparagraph (a) shall apply Part VII provisionally pending the entry into force of the Treaty for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its laws or regulations.
3. Svea Court of Appeal, Judgment of 18 January 2016, Case T 9128-14.
4. *Compañía de Aguas del Aconquija SA and Vivendi Universal v Argentina Republic,* ICSID Case No. ARB/97/3.
5. *CMS v Argentina*, ICSID Case No. ARB/01/8.
6. Lord Mance, 30th Annual Lecture organized by The School of International Arbitration and Freshfields Bruckhaus Deringer, 4 November 2015.
7. Article VII of the New York Convention reads:
   1. The provisions of the present Convention shall not affect the validity of multilateral or bilateral agreements concerning the recognition and enforcement of arbitral awards entered into by Contracting States *nor deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law or the treaties of the country where such award is sought to be relied upon.* […] [My emphasis]

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About the authors

Karen practises in all aspects of commercial law, with a particular emphasis on arbitration. After being called to the Bar, Karen joined 20 Essex Street, where she developed a broad commercial law practice in both international arbitration and litigation. She then spent time at Practical Law, where she established and led Practical Law Arbitration. While at Practical Law, Karen wrote and developed guidance and current awareness covering all legal and practical aspects of English and international arbitration, including both commercial and investment treaty arbitration, and multi-jurisdictional resources. Karen returned to practice at the Bar in 2015.

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Monica Feria-Tinta practises in public international law, energy and natural resources, conflict of laws and international arbitration. Monica has broad experience acting for States and private parties. Prior to the bar she worked for international tribunals and appeared as counsel before regional and UN organs in landmark cases. She has expertise in all areas across the field of PIL including Sources, Jurisdiction, Immunities, Expropriation, Treaty Law, State Responsibility, Investment Arbitration, and their interfaces with commercial matters. Her international litigation work received the 2007 Gruber Justice prize. Her working languages are English and Spanish. She is fluent in French and has intermediate German.

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