Gaillard and Banifatemi on Strategy Insights into the Yukos Arbitration at Harvard Law School

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On Friday, February 6, Emmanuel Gaillard, Head of the International Arbitration Group for Shearman & Sterling LLP, and Yas Banifatemi, Head of the Public International Law practice of the same firm, visited Harvard Law School to give a talk about the recent award in the Yukos case. Both of these practitioners represented claimants in three arbitrations initiated in 2005 by the majority shareholders of the former Yukos Oil Company against the Russian Federation. According to Gaillard, "Yukos represents the largest award ever in the history of arbitration by far." The second largest award was for 2.5 billion dollars in the dispute of Dow Chemical against Kuwait followed by the 1.7 billion dollars award in Occidental Petroleum v. Ecuador.

Gaillard began the talk by describing Yukos as a "highly political case" and acknowledging that the tribunal treated it as such. "The case shows that investment instruments such as BITs and the Energy Charter Treaty, in this case, are international law that can be part of the political framework in the international community," he added.

"A panoply of complex issues," the case raised questions about topics such as the application of the denial of benefits clause, the clean hands doctrine and the functioning of tax referral mechanisms used to expropriate investments. All of these issues "make this case interesting from the legal stand point of those who follow investment arbitration," Gaillard said.

Yas Banifatemi started her presentation about the jurisdictional stage of the proceedings by remembering, "at the time when we started the arbitration, everybody told us we were nuts… we were trying to sue Russia under a treaty that Russia had not ratified." Indeed, the Energy Charter Treaty (ECT) was never ratified by the Russian Federation. Nevertheless, Russia had accepted the provisional application of the treaty, which meant that – pending ratification – they agreed to apply the treaty to the extent that it was consistent with their own constitutions, laws and regulations. Banifatemi explained that their team had to prove that under international law and substantive Russian law, the provisional application of a treaty had been accepted. They accomplished that task, relying mostly on expert testimony on Russian law.

Focusing on the other issues related to the merits of the dispute, Banifatemi addressed Article 17 of the ECT, which contains a denial of benefits clause that allows a contracting state to deny a benefit of investment protection to a company if two requirements are met:

- First, the claimant is owned or controlled by nationals of a third party state; and
- Second, the claimant does not have a substantial business activity in that country.

Given the corporate structure of Yukos, whose ownership indirectly rested on Russian nationals as ultimate beneficiaries of a trust, Banifatemi pointed out, “it was an extremely complex issue which required us to explain to the tribunal issues of trust law.” The Tribunal held that the denial of benefits provision in Article 17(1) did not affect the dispute resolution mechanism in the Treaty and could not be exercised as to defeat the investors’ legitimate expectation of substantive treaty protection under Part III of the Treaty. Also, the Tribunal found that a ‘third State’ under this provision refers to a non-Contracting State and therefore does not include the State hosting the investment, which in this case was Russia.

The ECT also contains a taxation carve-out clause in Article 21 that prohibits tax claims from being arbitrated under the ECT dispute resolution system. However, article 21(5) of the ECT contains an exception to that rule; the so-called “claw-back” provision, according to which actions that are taken only under the guise of taxation, but in reality aim to achieve an entirely unrelated purpose – such as the destruction of a company or the elimination of a political opponent – cannot qualify for exemption from Article 21 protection. The tribunal agreed with the claimants’ argument that Article 21(1) did not apply to the case because Russia labeled all of its measures as taxes with the sole purpose of expropriating Yukos.

Banifatemi added, “if you want to write a thesis about the perfect expropriation, this is the case. You have the executive targeting against Yukos and the Russian courts upholding the application of the expropriation measures hidden under tax law. Everything in the Russian state was deeply driven to destroying Yukos.” Banifatemi expressed that the political motivation was one of the “hardest factors for us conducting this case.”

The panelists also emphasized that not only was the amount awarded massive, but also the entire litigation process was conducted on a massive scale. The arbitration lasted over 10 years. The document production was massive: Russia produced over 50,000 pages of documents, 500-page memorials on the claimant side and an 800-page memorial on the respondent side. The hearing on jurisdiction lasted 10 days and hearings for the merits stage lasted 5 weeks. In the room where the hearings took place (at the Peace Palace), 16 lawyers were present representing the claimant and 33 lawyers represented Russia. “The room was packed,” Banifatemi added.

Even though the Russian Federation has challenged the award before The Netherlands local courts, Shearman & Sterling intends to defend the validity of the award and, simultaneously, continue its efforts to enforce the award both inside and outside of Russia.