Arbitrating with States in CEE and CIS

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In the midst of the second edition of the Paris Arbitration Week, Jeantet hosted, on Thursday 12 April 2018, a roundtable on the topic "Arbitrating with States in CEE & CIS". The speakers of the roundtable were: *Cosmin Vasile (Zamfirescu Racoti & Partners)*, *Yas Banifatemi (Shearman & Sterling)*, *Davor Babić (University of Zagreb)*, *Yasmin Mohammad (Vannin Capital)*, *Matthias Cazier-Darmois (FTI Consulting)* and *Ivana Blagojević (ICC International Court of Arbitration)*. They all intervene in international arbitration procedures in different roles and at different stages, allowing the discussion to address a number of complex topics. The roundtable was moderated by *Ioana Knoll-Tudor (Jeantet)*. The discussion resulted in a lively debate on the specificities of international arbitration proceedings involving States and state entities from the CEE & CIS region, among the speakers but also between the speakers and a very active audience. Some of the issues discussed during this event are addressed in this article.

Introductory Remarks

The significant participation of CEE & CIS States and state entities in international arbitration is a reality, which can be justified by two main reasons: (i) the structure of the national economies in this region, whereby States and public entities remain important interlocutors for investors even though these countries started their transition from a centralized to a market economy in the 1990s; and (ii) a very "dynamic" regulatory policy involving frequent changes in national regulations aiming, sometimes, at protecting local actors.

Correlatively, the number of cases where States and state entities appear as a party has increased. 15.4% of ICC cases were filed in 2017 with a state, a parastatal or public entity as a party (here). 32% of the cases for which the PCA provided registry services in 2017 arose under contracts involving a State, intergovernmental organization or other public or private entity (here). In terms of geographic distribution, 36% of the ICSID cases registered in 2017 involved a State from Eastern Europe and Central Asia, from 14 different countries (here).

Distinction Between Commercial and Investment Arbitration

Both commercial and investment arbitration have provided for a rich body of cases involving CEE & CIS parties. The rules of the arbitral institutions administrating both commercial and investment arbitration cases usually show few procedural differences in the management of these two types of disputes. The ICC, for example, registers a limited number of investment cases (7 BIT claims in 2016), as only 18% of the BITs from the CEE & CIS region allow for ICC arbitration, and therefore does not provide procedural rules specific to investment disputes. Distinctions between commercial and investment arbitration are observed on a case-by-case basis and usually arise on matters subject to the parties' own considerations (selection of counsels, appointment of arbitrators).

Investment arbitration in the region, however, raises the very specific issue of the application of EU law. In particular, issues arise when States are required to adapt their legislation and regulatory framework in order to comply with EU requirements. In the context of investment arbitration, questions thus arise as to the treatment of national regulations modified in order to comply with the mandatory EU obligations and which violate fair and equitable treatment, result in expropriations etc. (the obligation to comply with EU law is one of the most frequent arguments invoked by States).

The Scope of Application of International Arbitration Rules

If the procedural rules of arbitral institutions do not differ considerably between commercial and investment cases, most arbitral institutions adapted their rules to accommodate the specificities of States and state entities. The PCA, for instance, issued a set of new rules in 2012 that constitutes a consolidation of four sets of PCA Rules drafted in the 1990s and includes special provisions adapted to arbitrations involving public entities. That same year, the ICC released its revised Arbitration Rules allowing the Court to directly appoint an arbitrator where "*one or more of the parties is a state or may be considered to be a state entity*" (Article 13.4). This particular amendment was intended to address concerns regarding the perceived lack of neutrality of ICC National Committees in appointing arbitrators at the time, especially in Eastern European countries. In 2016, the ICC further published its updated Practice Note, establishing that draft awards involving a State or a state entity have to be reviewed during a Plenary Session of the Court (para. 103 of the Practice Note).

Parties

As with most other regions, the parties involved in investment arbitration in the CEE & CIS regions are diverse, ranging from individuals (the Micula brothers) to state-owned companies (Naftogaz) and large international corporations (Veolia). One specificity of the region, as noted by the speakers, is the situation where individuals who left their home country subsequently return to make substantial investments.

Commercial arbitration provides an even wider variety of parties and disputes. For example, investors often face post-privatization issues similar to those encountered in post-acquisition disputes (commitment to keep a plant in operation, to maintain a certain number of employees, etc.).

Preliminary steps

First, with regard to the **appointment of arbitrators**, a change of trend is occurring. From a practice of appointing their own nationals or individuals sharing strong connections with the State (such as former Ministers of Justice or advisors involved in the drafting of the piece of legislation in dispute), Eastern European countries start to recognize that securing one vote on the tribunal is not necessarily the best strategy. Such practice not only puts tremendous pressure on the arbitrator but it also creates occasions for challenges of the said arbitrator by the other party. Therefore, States are now more inclined to appoint experienced arbitrators outside of their jurisdiction.

Second, the **selection of counsels** proves to be particularly sensitive when a State or a state entity appears as a respondent. In such cases public tenders can be extremely lengthy and burdensome and, sometimes, arbitral tribunals have to wait 1-2 years for the state party to secure representation. For example, in Romania, a state entity is able to retain external legal services only after the approval of the Budgetary Supervisor.

Finally, the region constitutes a fertile ground for **third-party funding**. Despite difficulties to enforce arbitral awards in the CEE & CIS, funders are relatively comfortable financing disputes against States and state entities. Third-party funders however acknowledge the need for a more thorough due

diligence due to the opacity in the chain of command and in the identity of the ultimate beneficiary, often encountered in the region.

Conduct of the Proceedings

From an arbitrator's perspective, **time management** is often an issue when dealing with a State or state entity from the region. Negotiated settlements happen rarely and cases usually last longer, partly because State parties tend to request time extensions and to exhaust every possible legal argument. For arbitral institutions and arbitrators, such situations require not only a lot of patience but also a delicate balance between, on the one hand, the necessity to comply with the procedural timetable agreed by the parties, and, on the other hand, the respect of the parties' right to be heard, in order to limit due process challenges.

During the conduct of the proceedings, arbitrators often have to adapt to parties used to their national courts' inquisitive practice and take procedural measures accordingly. The recent publication of the draft **Inquisitorial Rules on the Taking of Evidence in International Arbitration** (The Prague Rules) constitutes an interesting development in this context. The drafters of the Prague Rules promote a traditional inquisitorial procedural model in international arbitration, limiting document production as well as cross-examination, and replacing them with an interrogation of witnesses conducted primarily by the arbitral tribunal.

As some of the speakers experienced, CEE & CIS States display at times a very **disciplined and professional attitude** when dealing with arbitration-related issues. Occasionally, after the receipt of the Notice of Arbitration, some States accepted to sit down with their adversaries and settle their dispute in a confidential manner. Likewise, more and more States are reserving the amounts in dispute in their accounts in order to be able to comply with an award, if case be, in an efficient manner.

Finally, assessing **damages** can prove tedious. While universality seems to prevail concerning the guiding principles – put the claimant in the situation where it would be had there been no breach – their application is more intricate as publicly available information is scarcer than in other regions and it is much more complicated to extract reliable data from the parties themselves.

Enforcement and recognition

Many CEE & CIS States made commercial reservations under Article I (3) of the New York Convention. Arbitrability is still an issue in the region and awards might not be enforced in jurisdictions where, for instance, a State-to-business contract is not considered commercial, or where the contract involves real estate, public-private partnership agreements or any other matter falling under the exclusive jurisdictions of national courts.

In the last years, the involvement of the EU Commission in international arbitration rendered the enforcement of investment arbitration awards uncertain. For example, in the *Micula* case, the Commission took the position that payment by Romania based on an arbitral award constituted state aid (prohibited by EU law). Most recently, the ECJ's *Achmea* decision shook the arbitration world by declaring arbitration clauses contained in intra-EU BITs incompatible with EU law. Without the possibility to rely upon the intra EU-BITs investors can only rely on the legal provisions and judicial mechanisms available in EU Member States, which do not always offer a comparable level of protection of investments as the one guaranteed by BITs. This situation is of a major concern as two-thirds of the cases in the CEE & CIS region are related to intra-EU BITs.

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