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That Other Crisis: Extraterritorial Application of Investment Standards During Occupation and Annexation

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The Crimea crisis has received attention by UNCLOS and investment tribunals, as well as by the Swiss Federal Tribunal in appeals and annulment proceedings. However, their analyses have been limited to jurisdiction. The implicated issue was whether the (bilateral) investment treaties (BIT) of the occupying, and *a fortiori* annexing, State could be applied extraterritorially. These bodies have held so, at least implicitly. Most authors, including this one, have agreed and tried to provide some reasoning. As most jurisdictional hurdles have been overcome, this post will highlight some substantive issues for the upcoming merits phases and future cases of occupation/annexation.

Which treaty should apply in cases of occupation and annexation?

The claimant in formulating its claim will have to elect an applicable BIT. Thus far, only Ukrainian claimants have claimed under Article 9 of the Russia-Ukraine BIT. As Russia's occupation and subsequent annexation cannot be recognised legally, they have alleged interference with their investments by the acting *de facto* sovereign. Accepting that the aggressor-State's *treaties* apply may lead to a straightforward application of their *provisions/obligations*. Yet, applying treaties extraterritorially may create important dilemmas. First, it seems counter to the very concept of investor-State arbitration, namely that investors of one contracting State invoke a BIT against the other State.

Second, such claims place before tribunals several issues, including the assessment of the occupation's (il)legality and thus legitimisation of an illegal but acquiesced *status quo*, over which they have respectively no jurisdiction nor competence. Inter-State arbitration for the "interpretation and application" of e.g. "territory" could offer a way out in that regard (exceptionally provided for in Article 10). Moreover, the latter could restore the concept of heightened damages for serious breaches of international peace and security (*Chorzów Factory*), now prevalent in investor-State arbitration, to its former glory. Likewise, heightened competence of arbitrators, preferably versed in general international law, should also be required.

This post suggests that, to overcome these issues, the question could be reframed.

Instead of adopting jurisdictional legal fictions to apply the Russia-Ukraine BIT to Russia as *de facto* sovereign of Crimea, one could apply the *obligations* of the Russia-Ukraine BIT to Russia extraterritorially. This would obviate the need, and *ius cogens* prohibition, of recognising Russia's *de facto* effective control. Crimea could thus still be considered territorially part of Ukraine. The difference would be that Russia would be argued to have violated its investment obligations extraterritorially on that soil rather than within its own territory. This could, moreover, circumvent the Soviet/Russian practice of limiting arbitral jurisdiction to the assessment of damages (*Renta 4 v Russia*, Preliminary Objections, §§17–67), by postponing the responsibility decision to the quantum phase.

An investor seeking to invoke a BIT to make a claim about (Russia's) extraterritorial conduct (in Crimea) might invoke the provisions protecting against expropriation, fair and equitable treatment (FET), or provisions applicable to armed conflict, such as full protection and security (FPS) and 'war' clauses. This post considers the potential extraterritorial reach of each of these obligations in turn.

Expropriation

The prohibition of (in)direct expropriation without compensation seems the most obvious – and popular – choice. In *Ukrnafta*, claimants alleged that Russia's economic measures after the Crimea Accession Treaty constituted expropriation of petrol investments under Articles 5 and 9(2(c) Russia-Ukraine BIT. Such a direct expropriation would normally presuppose legal sovereignty over the territory, triggering questions of recognition (see e.g. *Wichert v Wichert*, Swiss Federal Tribunal, 1948). Any finding of a direct expropriation (or confiscation: Article 46 Hague Rules of Land Warfare) during occupation/annexation might therefore indirectly also recognise Russia's sovereignty over the territory. It ought to be noted that many expropriation provisions (including Article 5(1)) limit the prohibition to expropriations in "the territory of" the host State. However, a less territorially-based argument might be a claim of indirect expropriation. Leaving an object/purpose and evolutionary approach aside, the concept of indirect expropriation – a substantial deprivation of the investor's investment – could encompass remote expropriation. The analysis in such a case would turn on attribution rather than an argument that the tribunal has competence based on a given territorial jurisdiction. A parallel for the Crimea situation could be drawn from the *Loizidou* case before the European Court of Human Rights (Preliminary Objections, §62), only awarding damages for the denial of ownership and access by the aggressor-State's or separatist forces (cfr. Judgment, §13). Likewise, Ukrainian investors would still be considered the legal owner in this scenario.

Fair and Equitable Treatment

FET comes into play for situations outside physical violence (FPS) and substantial economic deprivation (expropriation). It includes the availability of a stable and

predictable legal framework, non-discrimination, and due process. FET provisions usually state that protection is granted "*at all times*" and should thus subsist during occupation/annexation. FET's language is indeed the easiest to apply extraterritorially. Occupation and annexation may raise additional challenges like asset-freezing and new laws, including re-registration of companies. Crimean banks had to stop their operations under Russian law of April 2014 with almost immediate effect (*Privatbank*). FET will thus probably be invoked as an additional basis to expropriation, possibly permitted under the language of Articles 2 and 4 Russia-Ukraine BIT.

It has been argued that domestic investors whose State no longer controls the territory of the investment can be discriminated against if one excludes occupied territory from the BIT's definition of "territory", triggering the underlying non-discrimination standard of FET. All claims regarding Crimean investments have been filed by Ukrainian investors. Such a *prima facie* intraterritorial application seems a factually desirable rather than a legal solution. Furthermore, arguably re-registration is a requirement for *intuitu personae* investments in Russia as host State. Under this post's alternative, however, the original BIT still applies, without the need to include former intra-State investors: all investments are covered, whether or not they have re-registered, as long as they have a material investment in Crimea within the definition of Article 1.

Full Protection and Security

The most significant protection for investments in occupied/annexed territory is the FPS standard. Often cited in one breath with FET, FPS could overlap or be interpreted separately. *Prima facie*, there is no FPS provision in the Russia-Ukraine BIT, at least not in the usual wording of "full [legal] protection and security". However, imposing "*complete and unconditional* legal protection of investments" (Article 2(2)) could support legal rather than mere physical protection (e.g. *Siemens* §303). If so, the re-registration requirement could fall within its scope, especially since FPS continues after armed hostilities have ended (*Wena Hotels v Egypt*, §§82-95).

No matter who has *legal* sovereignty, investors enjoy *full* and *physical* protection through the host State's due diligence obligations. The related duty to take precautionary measures places not only the occupying State's population, but also foreign investors and other temporary subjects "under its control" (cfr. Article 58 Additional Protocol II to the Geneva Conventions), implying mere *de facto* rather than legal control over the territory. The presumption is that having no control over territory (anymore) will lead to the lack of responsibility of the State, and *vice versa*. However, a FPS claim against the *occupied* State, Ukraine, will be unlikely as it could invoke *force majeure*.

In the Crimea scenario, rather than whether the State has failed its due diligence obligations, the question is one of *which* State has to offer the protection (attribution of responsibility). In terms of evidence, the *American Manufacturing & Trading Inc. v Zaire* tribunal (§6.13) held the fact that soldiers wore official uniforms irrelevant,

"*without any one being able to show either that they were organized or that they were under order, nor indeed that they were concerted*" (§§7.08-7.09). Requiring the claimant to prove the absence of military necessity, as in *Asian Agricultural Products Ltd. v Sri Lanka* (§56-64) seems too high a burden of proof for investors in Crimea. At the outset, the aggressor-State's actions are often difficult to trace. The solution seems to lie in the *Corfu Channel* case, allowing the use of inferences when territorial control precludes the victim from providing direct proof.

'War' Clauses

The basic 'war' (or armed conflict) clause prohibits discrimination between investors in armed conflict areas and investors of the most-favoured nation (Article 6 Russia-Ukraine BIT), the host State's nationals, or both, but only if reparations are paid (distinguishing them from compensation-for-loss clauses). The claimant should prove that (s)he has received less than others, less than e.g. German investors in the Crimea. The development of war clauses further supports the claim that (investment) treaties stay in place during armed conflict, and *a fortiori* occupation/annexation. Moreover, arguably 'free-transfer-of-funds' clauses (Article 17 Russia-Ukraine BIT), heavily depending on a functioning financial market, become operative again during a stabilised occupation.

To conclude, although a "straightforward" extraterritorial application of treaties would be preferred, this proposal circumvents the *ius cogens* prohibition of (recognising) annexation and gives Ukrainian investors non-artificial standing. This solution does not preclude foreign claims under respective BITs with Russia (though those seem unlikely given that 60% of foreign direct investment in Crimea was Russian). However, arguing that investment provision can apply extraterritorially does not mean that those obligations are necessarily violated, and the burden of proof may be higher.

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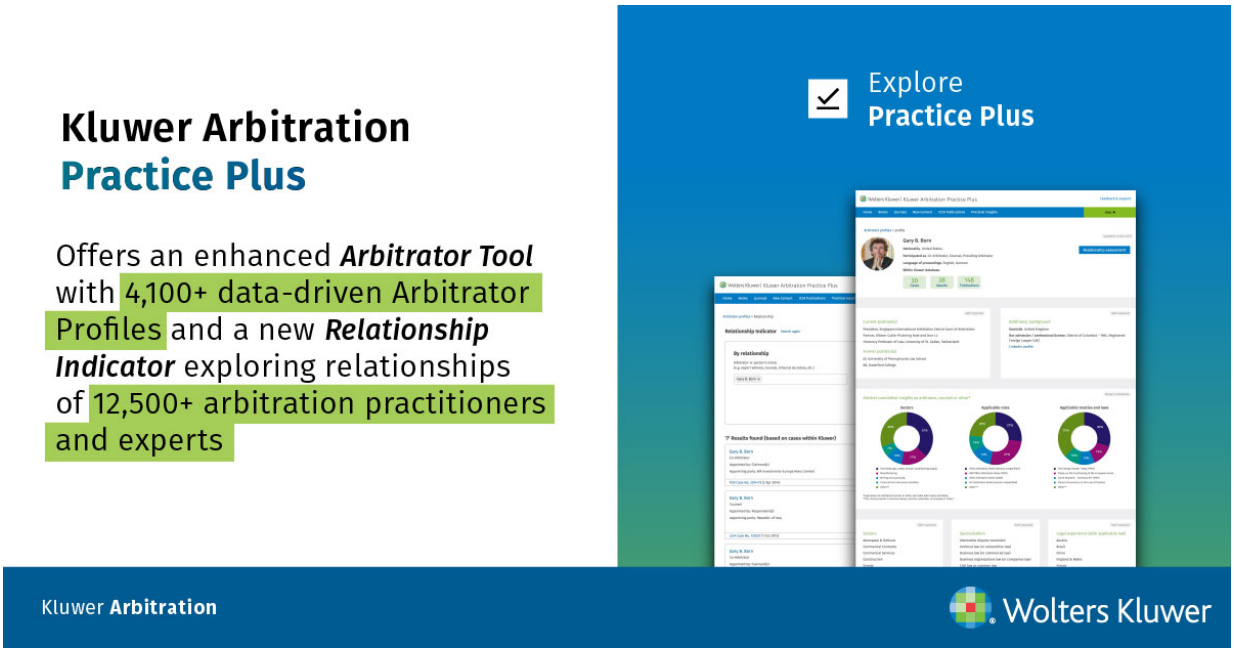

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