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ICC Austria: Emerging Expropriations and Investment Protection in Russia

Herfried Wöss (Wöss & Partners SC) and Nikos Lavranos (NL-Investmentconsulting) · Tuesday, June 28th, 2022

On May 2, 2021, the ICC Austria organized a seminar on investment protection in Russia in light of its limited-scope investment agreements and the ongoing military crisis. The key speakers were Dr. Herfried Wöss, a partner of Woess & Partners LLC and founder of the Investment Arbitration Forum, and Prof. Dr. Nikos Lavranos, Of Counsel at Woess & Partners LLC and Secretary-General of EFILA. The seminar focused on overcoming limited-scope investment agreements with Russia considering the emerging expropriations in Russia and Ukrainian territory occupied by the former state.

1. Investment Arbitration Proceedings Initiated under Limited-Scope BITs are Rarely Successful

Dr. Herfried Wöss started with a short overview of the different phases of investment arbitration regarding jurisdiction, merits, and damages. He then turned to explain the new Russian draft law of April 8, 2022, concerning the external management of companies leaving the Russian market and the Russian retaliation against foreign investors. The speaker explained that this law allows Russian authorities to take control of investments in "unfriendly" countries (EU, US, Canada, among others) and to take over essential industries with more than 100 employees and a US$12 million book value that aim to withdraw from the Russian market. The law is intended to apply retroactively and enter into force on February 24, 2022. This adds to Resolution Nr. 299 of March 6, 2022, regarding eliminating patent protection of patent holders of unfriendly countries alongside other measures.

He took as a starting point the Austria-Russian BIT (1990) (BIT or Treaty), which contains the typical international standards for investment protection such as Fair and Equitable Treatment (FET), Full Protection and Security (FPS), Most Favored Nation (MFN), compensation for direct and indirect expropriation, payment transfer guarantees, as well as State-to-State arbitration and Investor-State arbitration.

The speaker recalled that the contracting parties exchanged letters on the same day of signing the BIT, and they agreed that the text of the treaty did not allow for the importation of more favorable standards through either the MFN Clause of the National Treatment Protection. Moreover, the

National Treatment Standard is not even mentioned in the BIT. Unsurprisingly, article 7 of the Austria-Russia BIT limits the scope of Investor-State arbitration to (i) the amount of compensation and (ii) the payment modalities of compensation and payment transfer restrictions. This means that arbitral tribunals do not have jurisdiction to rule on the violation of the investment protection standards contained in the BITs, subject whose jurisdiction is retained in domestic courts.

This limitation is similar to the first-generation Chinese BITs. In this respect, *Marc Bungenberg* and *Manjio Chi*, in their chapter on "Chinese Investment Law," commented:

> *"By and large the confines of China's consent to dispute settlement in the first generation of its investment treaties [to determining the amount of compensation due for expropriation and only after exhaustion of local remedies] inexorably reduce the effectiveness of the investor-State dispute settlement mechanism relegating it to a largely symbolic role."*

The German-Russia BIT (1989) contains the same restrictions but was further amended in a 1990 protocol attached to the BIT, to include a provision whereby the contracting parties agree that the investor has a right to compensation in case of a "substantial detriment to business activities of a company affecting its capital investment." This may have helped Franz J. Sedelmayer win and execute an SCC investment arbitration case in Stockholm under the Germany-Russia BIT in 1998, where the tribunal awarded US$2.35 million plus interest, amounting to US$10 million.

Another keynote speaker, Prof. Dr. Nikos Lavranos, explained that most of the 27 investment arbitrations against Russia were filed and won by the investor under full or broad scope BITs. For instance, *Valle Esina v. Russia* was filed under the Italy-Russia BIT 1996, and the tribunal awarded the investor US$11.3 million in compensation. This BIT was negotiated during the window of economic liberalism before President Putin came to power in 2000. Similarly, *Yukos v. Russia* (US$ 50 bn) was arbitrated under ECT, and the Crimea cases – *Everest v. Russia* (US$150 million), *Ukranafta v. Russia* (US$44,5 million), and *Stabil v. Russia* (US$34.5 million) – under the Ukraine-Russia BIT. However, he underlined that full or wide-scope investment agreements with Russia are the exception, and the grand majority are limited-scope investment agreements.

Apart from the *Sedelmayer* award, few investment arbitrations under the Russia or China-type limited-scope agreements have been successful. A prominent example is the *Tza Yap Shum v. Peru* under the first-generation China-Peru BIT, where Christian Armando Carbajal, a partner at Woess & Partners LLC, played an important role. The tribunal made a detailed analysis of the wording of the jurisdictional provisions of the BIT and confirmed its jurisdiction in the Decision on Jurisdiction and Competence.

2. Solutions to the Dilemma of Limited Scope Russia BITs?

Dr. Herfried Wöss and Prof. Dr. Nikos Lavranos presented the following three different solutions to the dilemma of limited-scope BITs: (a) shift of ownership or control to a jurisdiction with a more favourable BIT, (b) the use of the MFN clause to import more generous BIT-provisions, and (c) State-to-State Investment Arbitration followed by investor-State arbitration.

Shift of ownership or control to a more favorable jurisdiction

Concerning the shift of ownership or control to a jurisdiction with a more favorable BIT, Professor Lavranos cited the UK-Russia BIT (1991) and the Norway-Russia BIT as examples of treaties with wider scopes. However, the transfer of control of the investment is likely to be barred by temporary limitations as established in *Philipp Morris v. Australia*, where the tribunal argued that the claimant's complaint was an abuse of right since Phillip Morris' corporate restructuring was undertaken with the sole purpose of gaining protection under the treaty when an investment dispute was foreseeable thus, deeming the claims inadmissible (paras. 585-588). As mentioned above, the Russian law on external control is supposed to enter into force retroactively on February 24, 2022. Therefore, treaty shopping does not seem viable for investors seeking protection.

Use of the MFN standard to import more generous BIT-provisions

A good example of using MFN previsions to circumvent narrow wording in investment treaties is the *Berschader v. Russian Federation case.* Here, the claimant under the Belgium-Russia BIT sought to import more favorable treaty provisions from the Norway-Russia BIT; however, it was not successful. The arbitral tribunal, in this case, stated that *"An MFN provision in a BIT will only incorporate by reference an arbitration clause from another BIT where the terms of the original BIT clearly and unambiguously so provide or where it can otherwise be clearly inferred that this was the intention of the Contracting Parties."* (para.155). On the other hand, a wider interpretation of the UK – Russia BIT was made by the tribunal in *RosinvesetCo UK v. Russian Federation*, which allowed the application of investment protection standards in the Denmark-Russia BIT because the origin treaty (UK-Russia BIT) contained the terms "use" and "enjoyment" in article 3 regarding the treatment of investments (para.130). Therefore, applying the MFN standard to import favorable provisions depends on treaty wording, but certainly, this rule would not apply under the Austria-Russia BIT.

State-to-State Investment Arbitration followed by investor-State arbitration.

Regarding the third solution, Dr. Herfried Wöss observed that all of the revised Russian BITs provide for State-to-State investment arbitration applying all international investment standards contained in the respective BITs as analysed in detail in an article by Anthea Roberts and an OECD working paper by David Graukrodger. It is, therefore, possible – according to Dr. Wöss – that States enter into investment arbitration against Russia to obtain a ruling on liability. In the case of the European Union, this could be coordinated through the European Commission in conjunction with the Member States acting under their respective BITs, considering the provisions of the EU-Russia Partnership and Cooperation Agreement.

Once the ruling on liability has been obtained, the individual investors could then file for investor-State arbitrations concerning the amount of compensation for expropriation and transfer provisions. A leading case in this matter is *Mexico v. United States in the matter of Cross-Border Trucking Services.* Under Chapter 20 of NAFTA, Mexico claimed that the United States had violated its treaty obligations to afford National Treatment and Most-Favoured Nation treatment to Mexican

cross-border trucking services. Mexico argued that these breaches derived from the United States' failure to lift a moratorium on processing applications by Mexican-owned trucking firms. The Chapter 20 panel determined that the moratorium was inconsistent with NAFTA "even if Mexico cannot identify a particular Mexican national or nationals that have been rejected." (para.182).

After this initial ruling, in 2009, *CANACAR* (Cámara Nacional del Autotransporte de Carga) brought an UNCITRAL investor-State arbitration under NAFTA Chapter 11 to seek compensation for violation of national treatment, MFN, and the minimum standard of treatment. However, the case was suspended when the US moratorium was lifted.

3. Enforcement and the Iran-US Claims Tribunal Model

Concerning the enforcement of individual investor-State arbitral awards against the Russian Federation, Nikos Lavranos referred to the model of the Iran-US Claims Tribunal. First, the Tribunal froze US$14 billion of Iranian deposits in the US as a consequence of the US hostage crisis due to the Iranian revolution in 1979. Then, both Iran and the US agreed that the Algerian central banks would receive US$ 1 billion of Iranian funds frozen in the US to pay out successful arbitral awards, and Iran would be obliged to maintain those funds at a minimum of US$500 million leading to more than 1,000 arbitral awards since 1981.

The keynote speaker suggested that the model of the Iran-US Claims Tribunal could be applied to the foreign exchange reserves of the Russian Federation deposited in the Swiss Central bank. However, the precise mechanism would certainly require further analysis.

In fact, the European Commission President Ursula von der Leyen, while speaking at the World Economic Forum in Davos, said that the EU "should leave no stone unturned" for Ukraine's reconstruction, "including, if possible, [using] the Russian assets that we have frozen."

Moreover, EU Commissioner Valdis Dombrovskis announced that the "freeze and seize taskforce"— which was set up in April to coordinate the seizure of €30bn worth of assets belonging to Russian oligarchs — will now investigate if "there is an EU basis for confiscation [of central bank assets] within international criminal law."

Despite the limitations of many BITs concluded by Russia, we have highlighted several options that should be pursued. Most importantly, they need to be complemented by the creation of an international claims' tribunal that would be able to effectively administer the claims by companies and individuals who are affected by the Russian war against Ukraine.

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