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The Applicability of the Ukraine-Russia BIT to Investment Claims in Crimea: A Swiss Perspective

Simon Bianchi (LALIVE) · Saturday, March 16th, 2019 · Young ICCA

Since the annexation of Crimea by the Russian Federation in 2014, a substantial number of investment claims, in particular expropriation claims, have been raised by Ukrainian nationals against the Russian Federation in relation to investments made in Crimea prior to the annexation. In this regard, a fundamental legal issue concerns the applicability of the Agreement on the Encouragement and Mutual Protection of Investments entered into in 1998 between Ukraine and the Russian Federation (the "Ukraine-Russia BIT") to such investments. In a landmark decision 4A_396/2017 dated 16 October 2018, the Swiss Supreme Court upheld an award on jurisdiction (the "Award on Jurisdiction"), rendered by an arbitral tribunal in the case PCA No. 2015-34 (the "Arbitral Tribunal"), recognizing that (i) investments made by a Ukrainian company in Crimea prior to its annexation were protected under the Ukraine-Russia BIT and thus (ii) the Arbitral Tribunal had jurisdiction to hear the corresponding investment claims.

Background

On 21 March 2014, following the annexation of Crimea, the Russian Federation adopted the treaty of accession of Crimea and, in this context, took various economic measures relating to Crimea, in particular to the energy sector. Within this framework, PJSC Ukrnafta, a Ukrainian company active in the fuel market ("PJSC"), alleged that the measures implemented by the Russian Federation interfered with and ultimately expropriated its investments in petrol stations located in Crimea and violated the Ukraine-Russia BIT.

On 3 June 2015, PJSC initiated arbitration proceedings under the UNCITRAL Arbitration Rules against the Russian Federation based on Article 9(c) of the Ukraine-Russia BIT and sought payment of USD 50,314,336 as compensation for the alleged expropriation (the "Dispute"). The Russian Federation contested the jurisdiction of the Arbitral Tribunal, refused to take part in the arbitral proceedings and did not appoint an arbitrator nor submit an answer to PJSC's statement of claims.

On 26 June 2017, the Arbitral Tribunal rendered the Award on Jurisdiction acknowledging its own jurisdiction to hear the Dispute and made the following findings:

- The territorial scope of application of the Ukraine-Russia BIT was fulfilled as the concept of

"territory" defined in Article 1(4) encompassed regions over which a contracting State exercised *de facto In casu*, the Russian Federation exercised *de facto* control over Crimea and it was unnecessary, for the purpose of the application of the Ukraine-Russia BIT, to determine whether the annexation of Crimea was lawful under public international law.

- The Dispute fell within the scope *ratione materiae* of the Ukraine-Russia BIT since the notion of "investments" (Article 1(1) of the Ukraine-Russia BIT) did not require that the relevant investments be initially made in the territory of the Russian Federation. Investments located in the territory of the Russian Federation only as a result of subsequent border changes were also protected under the Ukraine-Russia BIT.
- PJSC, being a company duly incorporated under the laws of Ukraine and legally capable of carrying out investments in the territory of the Russian Federation, qualified as an "investor" according to Article 1(2)(b) of the Ukraine-Russia BIT (scope *ratione personae*).

In light of the above, the Arbitral Tribunal concluded that it had jurisdiction to hear the Dispute under Article 9(c) of the Ukraine-Russia BIT.

The Swiss Federal Supreme Court Decision

On 14 August 2017, the Russian Federation lodged an appeal to the Swiss Supreme Court against the Award on Jurisdiction and contested the jurisdiction of the Arbitral Tribunal based on three main arguments.

First, the Russian Federation submitted that the concept of "territory" in the Ukraine-Russia BIT only encompassed territories belonging to a contracting State at the time of contracting and any subsequent extension to further territories had to be agreed between the contracting States. Second, PJSC facilities, subject of the alleged expropriation, did not constitute "investments" under the Ukraine-Russia BIT as the latter required an act of a cross-border investment at a certain point in time. Third, PJSC did not qualify as an "investor".

The Supreme Court rejected the Russian Federation's appeal and confirmed the jurisdiction of the Arbitral Tribunal to hear the Dispute on the following grounds.

Concerning the notion of "territory", the Supreme Court noted that the Russian Federation did not contest that (i) the legality of the annexation of Crimea was irrelevant for the purpose of the application of the Ukraine-Russia BIT and (ii) the notion of "territory" encompassed regions over which a contracting State exercised *de facto* control. This said, the Supreme Court recalled that, under Article 29 of the Vienna Convention on the Law of Treaties ("VCLT"), an international treaty is binding upon each contracting State in respect of its entire territory. Therefore, even in case of subsequent territorial changes, a treaty remains applicable to the entire territory of each contracting State, without the need for a supplementary agreement. In the present case, Crimea became a territory of the Russian Federation as the latter has exercised *de facto* control since 21 March 2014 at least. Therefore, the Supreme Court confirmed that Crimea was a territory of the Russian Federation under Article 1(4) of the Ukraine-Russia BIT.

With regard to the notion of "investments", the Supreme Court recalled that such notion had to be interpreted pursuant to the principles set out in Article 31 of the VCLT and resorted to various methods of interpretation to determine whether the Ukraine-Russia BIT covered only investments made *ab initio* in the territory of the Russian Federation or also investments being located in its

territory as a result of subsequent border changes.

First, the Supreme Court found that the wording of Article 1(1) of the Ukraine-Russia BIT in itself did not support the restrictive position defended by the Russian Federation.

Second, the limitation of the notion of "investments" to investments initially made in a foreign State (cross-border investments) results from the "transaction-based" model, which reflects earlier bilateral investment treaties focused on liberalisation of capital movements. On the contrary, the "asset-based" model includes the protection of investments in the form of assets and rights which are not directly related to a cross-border transaction. As Article 1(1) of the Ukraine-Russia BIT contained a non-exhaustive list of assets qualifying as investments, the Supreme Court found that the definition of "investments" was broad and followed an "asset-based" model. Thus, it did not refer to specific cross-border transactions, which could be attributed to a specific point in time, and did not contain a limitation with regard to the moment of border crossing.

Further, a teleological interpretation supported the fact that the Ukraine-Russia BIT served two purposes, *i.e.*, the promotion and protection of investments. For this reason, the Supreme Court did not follow the argument of the Russian Federation according to which the purpose of protection was only secondary. Furthermore, a broad protection of investments, including investments located in the territory of the Russian Federation only as a result of subsequent border changes, did not contradict the meaning and purpose of the Ukraine-Russia BIT. Indeed, the general principle underlying bilateral investment treaties is that the host State should not interfere with or expropriate investments made by nationals of the other contracting State without compensation. *In casu*, the protection offered by the Ukraine-Russia BIT only took effect at the time of the alleged expropriation. Therefore, the necessary conditions to benefit from the protection granted by the Ukraine-Russia BIT should be fulfilled at the time of such infringement (and not at the time of contracting). This also corresponds to the well-established principle that the conditions for jurisdiction *ratione person*ae (*i.e.*, nationality or seat) must be fulfilled at the time of the infringement.

In the view of the Supreme Court, neither a systematic interpretation of the Ukraine-Russia BIT, in particular Articles 1(2)(a), 2(1) and 12, nor the principle of good faith could support a limitation of the protection solely to investments made *ab initio* in the territory of the Russian Federation. On the contrary, such limitation would exclude from protection investments made within the *ratione temporis* scope of application of the Ukraine-Russia BIT (*i.e.*, after 1 January 1992 according to Article 12) and would be incompatible with the principle of good faith and the purpose of the Ukraine-Russia BIT.

As to the concept of "investor", the arguments raised by the Russian Federation were similar to those related to the notion of "investments"; thus, there was no reason to dismiss the Arbitral Tribunal's conclusion that PJSC qualified as an "investor".

In conclusion, the Swiss Federal Supreme Court confirmed that the Ukraine-Russia BIT was applicable and that the Arbitral Tribunal had jurisdiction to hear the Dispute. In my opinion, the takeaways of this decision are twofold:

- The Swiss Supreme Court does not hesitate to use its broad power of review when assessing an arbitral tribunal's legal reasoning on jurisdiction.
- A majority of the judges of the Supreme Court tend to adopt a broad definition of the notion of

investments relying on the purpose and meaning of bilateral investment treaties and to reject a more restrictive definition based on a historical and/or literal interpretation.

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