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Investment Claims Against Russia in the Economic Sanctions Era

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The commencement of the war in Ukraine triggered the imposition of unprecedented sanctions affecting almost all sectors of the Russian economy. Many foreign companies operating in Russia ceased or temporarily put on hold their business activities. In response, the Russian government adopted several retaliatory measures.

This post offers an overview of these measures and their legal implications for foreign investors; investigates avenues available to foreign investors to assert their rights through investor-state dispute settlement (ISDS) proceedings; and discusses challenges that foreign investors may face at the enforcement stage as a result of economic sanctions currently in place.

FDI in Russia

Until recently, Russia accounted for more than 40% of foreign direct investment (FDI) inflows in the so-called transition economies of South-East Europe, the Commonwealth of Independent States (CIS), and Georgia. In 2020, the level of FDI into Russia amounted to USD 8,6 billion and Russia was, up until the military conflict, still ranked among the top 20 European investment destinations.

Measures Affecting Foreign Investments

In response to the brisk suspension of business operations by foreign companies after Russia's invasion of Ukraine on 24 February 2022, the Russian government adopted retaliatory measures directed primarily against companies from designated "unfriendly countries," *i.e.* countries that had imposed sanctions against Russia, including the US, all EU member states, the UK, and Japan.

The key measure is a proposal for a federal law On External Administration for the Management of an Organization. The draft law, which proposes to impose external administration on companies that discontinue their operations without clear economic reasons, was adopted by the Duma on 24 May 2022 and is expected to come into force shortly. External administration, which may be imposed only by way of court decision, could affect any company that is at least 25% owned or controlled by a person with a connection to an "unfriendly country," and whose activity is crucial

to the stability of the Russian economy, *e.g.* a manufacturer of first necessity products. The stated objective of the draft law is not to nationalise foreign assets, though it remains to be seen whether, in practice, the law will effectively be applied only in limited circumstances with a forced bankruptcy solely as a remedy of last resort.

Other measures that can interfere with foreign investments and limit the free transfer of funds are restrictions on transactions with persons and companies from "unfriendly countries," laid down in the Governmental Decree dated 6 March 2022 (No 295). The Decree provides that the transfer of shares and securities as well as real estate transactions must be approved by the Government Commission on Monitoring Foreign Investment, which oversees foreign investments in Russia. Authorisations must also be obtained for the transfer of foreign currency outside of Russia. If an investor decides to sell its assets to a Russian company, the approval of the board of directors of the Central Bank of Russia must be obtained according to the Decree of the President of 18 March 2022 (No 126).

Claims Under BITs

The measures discussed above have far-reaching consequences and will inevitably affect foreign investments in Russia.

As Russia has entered into bilateral investment treaties (BITs) with most of the said "unfriendly countries," a foreign investor adversely impacted may have recourse to investment arbitration proceedings under any such applicable BIT. BITs between Russia and "unfriendly countries" consistently guarantee foreign investors *inter alia* fair and equitable treatment (FET), protection against expropriation and discrimination under most-favoured nation (MFN) and national treatment (NT) clauses, as well as the right to freely transfer funds. The scope of arbitration clauses varies, however, from one BIT to another, with some clauses encompassing only disputes regarding compensation in case of expropriation and/or the guarantee of free transfer of funds (though such limitations may potentially be overcome through use of MFN provisions in the relevant treaties[1)]).

Enforcement Challenges in Case of Asset Freeze

Arbitral awards rendered against the Russian Federation are binding and enforceable under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (NYC).[2)] Given, however, Russia's systematic failure to honour awards, enforcement proceedings appear virtually inevitable. Such proceedings, challenging in and of themselves, become all the more burdensome when economic sanctions are in place.

Even if Russian assets that are not shielded by sovereign immunity are identified, Russia will likely seek to rely on some of the grounds laid down in Article V NYC in order to resist enforcement, including public-policy-related arguments (Article V(2)(b) NYC). Enforcement endeavours may yet be further complicated if assets against which enforcement could be sought are frozen, as is currently the case of the assets of hundreds of Russian individuals and entities, including state-owned enterprises and subsidiaries thereof.

Under blocking sanctions, all assets and economic resources owned, held or controlled by designated persons and entities are blocked and no funds or economic resources may be made available, directly or indirectly, to them or for their benefit (see, for example, Council Regulation (EU) No 269/2014, Article 2). That said, many sanctions programs provide that an authorisation (or licence) may, in certain circumstances, be granted for the release of frozen assets. Accordingly, the question to be investigated is whether an award-creditor might be able to secure such an authorisation so as to enforce an award against frozen assets. Note that should a licence for the release of frozen funds be granted by the competent authorities of the state of enforcement, this obviously means that the use of such assets for purposes of satisfying the award is no longer prohibited; *a fortiori*, enforcing the award against released assets cannot be deemed to be in conflict with the public policy of the enforcement state, even if the award-debtor itself remains listed.

The question of the need to secure a licence might in fact arise even before the actual enforcement, if the award-creditor is seeking to attach the award-debtor's frozen assets. An attachment may be necessary, under the laws of the place of enforcement, to create a forum for enforcement proceedings or it may simply be sought as a protective measure if the award-creditor wishes to ensure the right to be paid on a priority basis over other creditors. Should an attachment be deemed, under the applicable law, to have the legal effect of changing the destination of frozen assets (this is not the case under all laws), the attachment might itself require a licence or authorisation from the competent authority, even if it does not entail an actual removal of frozen assets from the designated person's estate.[3)]

Switzerland's Ordonnance instituant des mesures en lien avec la situation en Ukraine du 4 mars 2022 stipulates that payments from frozen accounts, transfers of frozen assets and the release of frozen economic resources may exceptionally be authorised to honour debts pursuant to a judicial, administrative or arbitral decision (Article 15(5)(c)).

As regards US sanctions against Russia, Executive Order 14065 of 21 February 2022 provides that the assets of listed individuals and entities are frozen "*except to the extent provided by statutes, or in regulations, orders, directives, or licenses that may be issued pursuant to this order* […]" (section 2(b)). § 589.506(d) of the Ukraine-/Russia-Related Sanctions Regulations also stipulates, *inter alia*, that "[…] *the enforcement of any* […] *arbitral award* […] *purporting to transfer or otherwise alter or affect property or interests in property blocked pursuant to § 589.201 is prohibited unless licensed pursuant to this part.*" Thus, an award-creditor must secure a licence from the US Department of the Treasury Office of Foreign Assets Control (OFAC) to be able to enforce an award against blocked property. This was recently confirmed in the Opinion of 2 March 2022 (Case No. 17-mc-151-LPS) of the US District Court for the District of Delaware in *Crystallex International Corporation v. Bolivian Republic of Venezuela*. Crystallex had obtained an ICSID award against Venezuela and sought to enforce it against the assets of the state-owned enterprise Petróleos de Venezuela S.A. (PDVSA). The US District Court stated, in respect of the auction of shares owned by PDVSA, that while it would "*proceed with the sale process, up to and including selecting a winning bid*[,] [it would] *not, however, permit the sale to be executed unless and until OFAC grants a specific license (or unless and until the sanctions regime is materially changed).*"

As to the EU sanctions program, Article 5(1)(a) of EU Council Regulation No 269/2014 only allows authorisations for the release of funds intended to satisfy arbitral awards rendered prior to the relevant listing (in stark contrast to the possibility of funds being released to satisfy judicial and administrative decisions rendered in the EU even thereafter). In addition, it is required that "*the*

funds or economic resources will be used exclusively to satisfy claims secured by such a decision or recognised as valid in such a decision […]*; the decision is not for the benefit of a* [listed] *natural or legal person, entity or body* […]*; and recognition of the decision is not contrary to public policy in the Member State concerned*" (Article 5(1)(b) through (d)). Importantly, granting enforcement of an award against released assets is compatible with Article 11 of EU Council Regulation No 269/2014, which prohibits only the satisfaction of claims made *by* "*designated natural or legal persons, entities or bodies listed in Annex I* [or] *any natural or legal person, entity or body acting through or on behalf of one of the* [latter]," not the satisfaction of claims (including claims for the recognition or enforcement of arbitral awards (Article 1(a)(v))) made *against* listed individuals and entities.[4)]

Finally, it is noteworthy that some states, such as the US and Canada, have initiated procedures to adopt statutes intended to allow the seizure and repurposing of frozen assets. The legality of such measures and whether they could somehow be relied upon to satisfy investment claims against Russia remains to be seriously investigated.

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References

?1 *RosInvestCo v. Russia*, SCC No. V079/2005, Award on Jurisdiction, 2007, ¶ 133.

?2 Russia ratified the NYC on 24 August 1960. It has not ratified the ICSID Convention.

?3 See the ECJ Judgment of 11 November 2021 in Case C-340/20, ¶¶ 38 *et seq*.

?4 Regarding the interpretation of Article 38(1) of EU Council Regulation No 267/2012, the wording of which is close to that of Article 11(1) of EU Council Regulation No 269/2014, see *Ministry of Defence & Support for Armed Forces of the Islamic Republic of Iran v International Military Services Ltd* (24 July 2019) High Court of Justice [2019] EWHC 1994 (Comm) and Court of Appeal [2020] EWCA Civ 145.

This entry was posted on Tuesday, May 31st, 2022 at 8:00 am and is filed under Russia, Sanctions
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