Kluwer Arbitration Blog

Russia's Narrow Arbitration Clauses – Can Foreign Investors Bring BIT-Claims For Expropriation Under MFN Clauses?

Elisabeth Tretthahn-?Wolski, Marija Dobri? (Binder Grösswang) · Tuesday, July 5th, 2022

Following the Russian military invasion of Ukraine, dozens of states imposed sanctions against Russia. In response, Russia imposed or threatened to impose severe countermeasures on foreign investments associated with such "unfriendly states". In this regard, several news outlets reported that Russia is in the process of implementing legislation that will interfere with foreign investments in Russia, and might potentially even lead to investors being expropriated. Russia concluded more than 60 bilateral investment treaties (BITs) that should – in theory – protect foreign investors from expropriation without adequate and timely compensation by allowing investors to bring claims in investor-state arbitration (ISDS). However, the road to investor-state arbitration is more cumbersome for some investors than for others. This post analyses BITs concluded by Russia containing narrow dispute resolution clauses that limit the scope of disputes to the amount of compensation for expropriation. The post also discusses the utility of most-favoured-nation (MFN) clauses as a tool to bypass these narrow dispute resolution mechanisms.

Dilemma of Narrow Dispute Resolution Clauses

Several BITs concluded by the former USSR and Russia contain dispute resolution clauses that limit the jurisdiction of arbitral tribunals *inter alia* in expropriation cases to disputes relating "*to the amount of compensation or the method of its payment*" (*see, e.g.* Germany-Russia BIT, Austria-Russia BIT) or "*concerning the procedure and the amount of compensation*" (*e.g.* Switzerland-Russia BIT). Arguably, the wording of these BITs – if interpreted narrowly – excludes arbitration of disputes about whether an expropriation has actually occurred, resulting in tribunals declining jurisdiction if they have to decide on this matter as a preliminary issue prior to ruling on the amount of compensation.

Such narrow dispute resolution clauses may have made sense in the past, where states directly expropriated foreign investors and disputes only concerned the amount of compensation. Today, however, states rarely expropriate investors directly, but rather carry out regulatory indirect expropriations through forced sales, excessive taxation, deprivation of profits, and interference with management, among others (*see, e.g. Tecmed v. Mexico*, paras 114 et seqq). In this regard, it is arguable that the countermeasures imposed by Russia against "unfriendly investors" could likely manifest as creeping, rather than direct, expropriations.

When filing claims under narrow scope BITs, investors have frequently argued that if arbitral tribunals have jurisdiction to determine the amount of compensation for expropriation, the jurisdiction clause in such BIT must be interpreted broadly to allow the arbitral tribunal to also rule on whether the state measure is to be qualified as an expropriation (direct or indirect).

Accordingly, some tribunals have ruled that clauses containing wording such as *"[a]ny dispute […] relating to the amount or method of payment of the compensation due"* are sufficiently broad as to allow tribunals to determine whether an expropriation had taken place in the first place. For instance, in *Renta 4 S.V.S.A.*, the tribunal found that any case in which expropriation is disputed by the state constitutes a dispute on whether compensation is "*due*" (para 28); therefore, the tribunal asserted jurisdiction to hear the entirety of the case. Similarly, in *Tza Yap Shum v. Republic of Peru*, the tribunal found that a "*dispute involving the amount of compensation for expropriation*" not only includes the mere determination of the amount but also, other issues inherent to an expropriation, including the question on whether the property had been in fact expropriated (para 188). Furthermore, in *Sedelmayer v. Russia*, the tribunal asserted jurisdiction under the narrow scope of the Germany-Russia BIT, and ruled on whether Russia's presidential decree constituted an act of direct expropriation, finding that, in fact, it did (pp 73, 83 et seq).

On the other hand, contrary to the rulings cited above, the *Berschader* tribunal rejected jurisdiction based on the narrow arbitration clause contained in the Belgium/Luxemburg-Russia BIT. The tribunal held that a comparative analysis of other BITs concluded by the Soviet Union showed a deliberate intention to limit the scope of arbitration to disputes concerning the amount or method of valuation of compensation for expropriation (para 155). This conclusion, however, is not compelling. The tribunal in *Renta 4 S.V.S.A.*, for instance, expressly dismissed this argument (paras 47 et seqq).

Given the inconsistent case law and the (slightly) different wordings of BITs, it is not entirely clear whether an investor can successfully bring a BIT claim to determine whether an expropriation has occurred without having to overcome – in some cases – significant hurdles. In the present case, it is yet to be seen how investment tribunals will interpret jurisdiction clauses to allow investors to bring investment disputes related to sanctions impacting "unfriendly investors".

MFN Clauses as a Possible Solution?

To lower these jurisdictional hurdles, it might be worth looking at MFN clauses included in almost all BITs signed by Russia (*see, e.g.*, Germany-Russia BIT; Austria-Russia BIT.)[1)] In general, MFN clauses extend the benefits granted to investors of third states to nationals of the contracting state by requiring the state to afford "*treatment that is no less favourable*". While it is widely recognised that "*treatment*" encompasses substantive treaty obligations (e.g. FET, FPS, expropriation), it is less clear whether it also includes procedural issues, particularly the scope of arbitrable matters imported from other BITs. The latter question is especially important bearing in mind that several Russia BITs provide for narrow dispute resolution clauses on the one hand – *see, e.g.*, article 10(2) of the Germany-Russia BIT, article 7(1)-(2) of the Austria-Russia BIT and article 8(2)(a) Switzerland-Russia BIT) – but broad clauses on the other hand (*see e.g.*, article 8(1)-(2) Sweden-Russia BIT, article 8(1)-(2) Denmark-Russia BIT).

In *RosInvestCo UK v. Russia*, the tribunal heard treaty claims under the narrow UK-Russia BIT

that limits jurisdiction regarding expropriation to "*the amount or payment of compensation*" and "*concerning any other matter consequential upon an act of expropriation*". By operation of the MFN clause contained in this BIT, the *RosInvestCo* tribunal asserted jurisdiction for the preliminary question of whether an expropriation had occurred in the first place, basing its jurisdiction on the broad dispute resolution clause in the Denmark-Russia BIT (paras 135 et seqq).

Applying a similar rationale, the tribunal in *Le Chèque Déjeuner v. Hungary* also found that the MFN clause in article 4(1) of the France-Hungary BIT could be used to extend a more favourable treatment by importing a more favourable arbitration clause from another BIT (paras 216 et seqq).

In the same vein, the *Maffezini* tribunal reached a similar conclusion by "replacing" the procedural waiting period provided in the applicable Argentina-Spain BIT by importing a more favourable Spanish BIT provision which did not require a waiting period (para 64).

Consequently, the 2015 ILC report determined that a majority of arbitral tribunals found MFN clauses that refer e.g. to *"all treatment"* or *"all matters"*, or clauses that qualify treatment with words such as *"use"*, *"management"*, *"maintenance"*, *"enjoyment"*, *"disposal" or "utilization"* to be broad enough to include dispute settlement provisions (paras 197-198).

However, this is far from being set in stone. For instance, in the *Austrian Airlines* and *Plama* cases the tribunals did not allow the investors to rely on an MFN clause to import more favourable arbitration clauses. In *Austrian Airlines* the tribunal rejected jurisdiction asserting that the MFN clause did not invalidate the restrictive dispute settlement mechanism established in the BIT (paras 135 et seqq). Similarly, in *Plama*, the tribunal found that investors could not – by operation of the MFN clause – replace a specific agreement on dispute resolution by a different dispute resolution mechanism, unless the contracting states had expressly agreed to do so, in contradiction to the narrow dispute resolution clause (paras 209, 212). In its reasoning, the *Plama* tribunal also found that the MFN clause does not extend to dispute resolution because the arbitration clause is separable and autonomous from the main treaty or contract granting the tribunal jurisdiction. The tribunal noted the distinction between importing substantive and jurisdictional clauses and stated that "*This matter can also be viewed as forming part of the nowadays generally accepted principle of separability (autonomy) of the arbitration clause. Dispute resolution provisions constitute an agreement on their own […]*" (para 212). However, this reasoning is rather questionable since the distinction between substantive treaty obligations and dispute settlement clauses does not alone justify refusing the extension of jurisdiction based on the MFN clause. Despite the autonomy of the dispute resolution clause, dispute resolution mechanisms are still part of an international treaty and states should not refuse to comply with MFN obligations arguing that the dispute resolution clause in the more favourable BIT is separable from the rest of the treaty. Consequently, the scope of the particular MFN clause will be determined under articles 31 and 32 Vienna Convention on the Law of Treaties (VCLT).

Outlook

In the past, investors successfully filed BIT claims in treaty arbitration even in cases where narrow arbitration clauses applied either based on the wording of the dispute resolution clause itself or by relying on MFN clauses. However, case law is far from uniform and whether an investment tribunal will assume jurisdiction in case any dispute is filed for Russia's "unfriendly investors"

expropriations, highly depends on the wording of the applicable BIT.

Therefore, it is by no means impossible that an investor who is affected by the current and expected Russian countermeasures can successfully bring a BIT-claim for expropriation, even if confronted with a narrow dispute resolution clause.

References

?1 However, see the exchange of diplomatic notes between Russia and Austria of February 8, 1990, in which Russia and Austria derogated from MFN.

This entry was posted on Tuesday, July 5th, 2022 at 8:00 am and is filed under Investment, Investment Arbitration, Investment Disputes, Investment protection, Russia, Ukraine
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.