Energy Charter Treaty—international investment arbitration—expropriation—state responsibility—attribution—political interference—unclean hands—contributory fault—relationships among international courts

HULLEY ENTERPRISES LTD. (CYPRUS) v. RUSSIAN FEDERATION. PCA Case No. AA 226. *At* http://www.pca-cpa.org.
YUKOS UNIVERSAL LTD. (ISLE OF MAN) v. RUSSIAN FEDERATION. PCA Case No. AA 227. *At* http://www.pca-cpa.org.
VETERAN PETROLEUM LTD. (CYPRUS) v. RUSSIAN FEDERATION. PCA Case No. AA 228. *At* http://www.pca-cpa.org.
Ad Hoc Arbitral Tribunal, July 18, 2014.

On July 18, 2014, the Arbitral Tribunal (Tribunal) constituted in accordance with Article 26 of the Energy Charter Treaty (ECT)[1] and the 1976 UNCITRAL Arbitration Rules[2] under the auspices of the Permanent Court of Arbitration issued its long-awaited final awards in the famous arbitral proceeding related to the demise of oil giant Yukos.[3] The Tribunal held unanimously that a coordinated set of actions by the Russian government (including arrests, tax reassessments, fines, and the forced sale of Yukos) amounted to an indirect expropriation of Yukos in breach of Russia's obligations under the ECT, and that Russia was liable to pay prompt, adequate, and effective compensation for that breach. The Tribunal concluded that Yukos's claims were not barred by the company's own illegal acts or because of the "carve-out" for taxation measures under Article 21 of the ECT. Instead, the Tribunal concluded that the claimants had contributed to the prejudice they suffered and it therefore reduced the awards and reimbursement for legal costs by 25 percent. Even accounting for this reduction, the composite final award is still, by far, the largest known arbitral award ever rendered. The Tribunal ordered the Russian Federation to pay damages totaling US$50,020,867,798, in addition to arbitral and legal costs. Post-award interest is due on any outstanding amounts of damages and costs not paid starting from January 15, 2015, and is to be compounded annually thereafter.

The background of the cases is complex, compelling, and unusual. The arbitration began in February 2005, when three controlling shareholders of OAO Yukos Oil Co. (Yukos)—Hulley Enterprises Ltd., a company organized under the laws of Cyprus, Yukos Universal Ltd., a company organized under the laws of the Isle of Man, and Veteran Petroleum Ltd., a company organized under the laws of Cyprus—initiated arbitrations against the Russian Federation (Russia).

The three arbitrations were heard in parallel and discussed together as a single proceeding, except where circumstances necessitated separate treatment (para. 2). The three final awards are therefore almost identical. In the awards, the Tribunal—composed of Yves Fortier (president), Charles Poncet (appointed by the claimants), and Stephen M.

[1] Energy Charter Treaty, Art. 26, *opened for signature* Dec. 17, 1994, 2080 UNTS 95, 34 ILM 360 (1995).

[2] United Nations Commission on International Trade Law, UNCITRAL Arbitration Rules, Apr. 28, 1976, 15 ILM 701 (1976), *available at* http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf.

[3] Hulley Enters. Ltd. (Cyprus) v. Russian Fed'n, PCA Case No. AA 226 (Ad Hoc Arb. Trib. July 18, 2014); Yukos Universal Ltd. (Isle of Man) v. Russian Fed'n, PCA Case No. AA 227 (Ad Hoc Arb. Trib. July 18, 2014); Veteran Petroleum Ltd. (Cyprus) v. Russian Fed'n, PCA Case No. AA 228 (Ad Hoc Arb. Trib. July 18, 2014) [hereinafter Final Awards], *all at* http://www.pca-cpa.org. The awards, which are nearly identical, will be cited hereinafter as one.

Schwebel (appointed by the respondent)—addressed the respondent's objections to jurisdiction and admissibility that had not been decided by the three Interim Awards on Jurisdiction and Admissibility,[4] as well as the claimants' complaints on the merits, and the issue of the quantum of damages.

The proceeding lasted more than ten years and captured the media's attention. The Tribunal itself called them "mammoth arbitrations" (para. 4). Beginning in February 2005, the Tribunal held five procedural hearings with the parties and issued eighteen procedural orders. It held a ten-day hearing on jurisdiction and admissibility in the fall of 2008, and in November 2009 issued the interim awards, each over two hundred pages long. It found, inter alia, that the ECT was provisionally applicable to Russia from the time Russia had signed it in 1994 until sixty days after it notified the depositary of the treaty of its intention not to ratify it in 2009.[5] A twenty-one day hearing on the merits took place in The Hague in October and November 2012. The parties submitted more than four thousand pages of arguments and over eighty-eight hundred exhibits. The final awards themselves are almost six hundred pages long.

The dispute arose from various measures taken by Russia against Yukos and associated companies between July 2003 and November 2007 (para. 63). The claimants alleged that Russia's various actions were politically motivated and aimed at destroying and expropriating Yukos, which, at the end of 2002, had been Russia's largest oil company in terms of daily crude oil production. At its peak in 2003, the company boasted around one hundred thousand employees, six main refineries, and a market capitalization estimated at more than US$33 billion (para. 73).

The claimants contended that Russia had taken a series of actions beginning in the summer of 2003 to undermine Yukos's ability to manage the business, including by arresting the Yukos chief, Mikhail Khodorkovsky, and his associate, Platon Lebedev, and targeting, intimidating, prosecuting, and harassing the company's employees, managers, and related persons. Russia was also accused of conducting widespread and aggressive searches and seizures, appropriating the claimants' shares in Yukos, and threatening to revoke Yukos's oil licenses (para. 108).

The claimants further alleged that in December 2003, the Russian Tax Ministry had ordered a tax re-audit for Yukos for the year 2000, which resulted in the reassessment of US$3.4 billion in alleged taxes, interest, and fines, on the basis of unlawful tax evasion arising from the abuse of Russian low-tax-region programs by Yukos trading companies (paras. 74–80). The Tax Ministry then issued similar additional tax claims for the years 2001–04 for a total of US$24 billion, of which US$5.2 billion constituted allegedly evaded taxes, and the other sums comprised value-added tax, interest, and fines.

In addition, the claimants asserted that Yukos had been prevented from settling its alleged tax debts. Instead, in July 2004, the Ministry of Justice announced its intention to sell Yuganskneftegaz (YNG), Yukos's core production subsidiary, which accounted for

[4] Hulley Enters. Ltd. (Cyprus) v. Russian Fed'n, PCA Case No. AA 226, Jurisdiction and Admissibility (Ad Hoc Arb. Trib. Nov. 30, 2009); Yukos Universal Ltd. (Isle of Man) v. Russian Fed'n, PCA Case No. AA 227, Jurisdiction and Admissibility (Ad Hoc Arb. Trib. Nov. 30, 2009); Veteran Petroleum Ltd. (Cyprus) v. Russian Fed'n, PCA Case No. AA 228, Jurisdiction and Admissibility (Ad Hoc Arb. Trib. Nov. 30, 2009), *all at* http://www.pca-cpa.org.

[5] On the jurisdictional decision, see Chiara Giorgetti, *The* Yukos *Interim Awards on Jurisdiction and Admissibility Confirms Provisional Application of Energy Charter Treaty*, ASIL INSIGHT (Aug. 3, 2010), *at* http://www.asil.org.

approximately 12 percent of Russia's oil output, to satisfy the debts. YNG was auctioned in a ten-minute auction at the opening bid of US$9.37 billion, well below its estimated value, on a Sunday in December 2004. The winner, Baikal Finance Group, was a previously unknown company established at the address of a neighborhood bar in a provincial town on December 6, 2004, with capital of US$395. A few days later, the state-owned oil company Rosneft announced its purchase of Baikal Finance Group. Subsequently, a syndicate of Western banks filed a petition to declare Yukos bankrupt, after signing a secret agreement with Rosneft, which agreed to (and did) repay a loan of US$1 billion (on which Yukos had defaulted in December 2005). Yukos was removed from the Russian registry of companies in November 2007. Thereafter, the Russian Federation received, either directly or indirectly, approximately 99.71 percent of the bankruptcy proceeds and over 95 percent of Yukos's remaining assets.

The claimants thus concluded that, taken together, Russia's actions "can only be reasonably understood as a deliberate and sustained effort to destroy Yukos, gain control over its assets and eliminate Mr. Khodorkovsky as a potential political opponent" (para. 108, sec. II(D)(61)). For these reasons, the claimants asserted that Russia had breached Article 10(1) of the ECT[6] by (1) denying them fair and equitable treatment, (2) failing to accord them the basic requirements of procedural propriety and due process, and (3) discriminating against their investments during the bankruptcy proceedings and before and after Yukos was acquired by Rosneft. The claimants also contended that Russia had violated ECT Article 13(1)[7] because its expropriation of Yukos was not in the public interest, and was discriminatory, accomplished without due process, and unaccompanied by any compensation.

On its side, Russia contended that Yukos had fraudulently evaded billions of dollars in tax liability by abusing the low-tax-regions program, so that its tax assessments and fines against

[6] The ECT, *supra* note 1, Article 10(1) (Promotion, Protection and Treatment of Investments) provides in pertinent part:

> Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment.
>
> Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations.

[7] *Id.*, Article 13(1) (Expropriation) provides in part:

> Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:
>
> (a) for a purpose which is in the public interest;
>
> (b) not discriminatory;
>
> (c) carried out under due process of law; and
>
> (d) accompanied by the payment of prompt, adequate and effective compensation.
>
> Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date").

Yukos were proper. Moreover, it noted that the European Court of Human Rights had unanimously rejected Yukos's challenge of the tax assessments at issue in the arbitration.[8] According to Russia, Yukos was responsible for the consequences of the tax assessment because it could have paid the amounts due while continuing to challenge the assessment. Russia contended that it had acted properly as regards both its enforcement of the tax assessment by auctioning YNG and the Yukos bankruptcy, involving which certain critical conduct was not attributable to Russia (para. 109). Thus, the Tribunal lacked jurisdiction over the claims, or must dismiss them on the basis of the illegal conduct of the claimants and Yukos's managers. In any event, Russia argued, the claimants were not entitled to compensation because of their illegal conduct and failure to mitigate the company's tax liability.

In its detailed, well-reasoned, and lengthy analysis, the Tribunal sided with the claimants on most issues. On the central issue of the way the Russian tax authorities, bailiffs, and courts treated Yukos with respect to the new tax assessments for the 2000–04 period, and the imposition of fines and value-added taxes, the Tribunal determined that the "primary objective of the Russian Federation was not to collect taxes but rather to bankrupt Yukos and appropriate its valuable assets" (para. 756). The Tribunal used some robust language in assessing the evidence, finding itself "sustained in this central and all important conclusion" (para. 759) by other disturbing facts, including "the campaign of harassment carried out by the Russian authorities" (*id.*),[9] which included arrests, interrogations, and searches and seizures of Yukos's senior executives and employees. The Tribunal also noted that Russia had rejected all of the company's "repeated, reasonable attempts" to settle its tax debts, and that the seizure of YNG had resulted from its auction "in questionable circumstances" and for "an inadequate price" (*id.*).[10]

The Tribunal therefore concluded on the merits that the auction of YNG was "in effect a devious and calculated expropriation by Respondent" (para. 1037). It considered the auction "the point of no return" (para. 1038) for the survival of Yukos, and indeed found it evident that the totality of the bankruptcy process that followed the auction was the final act of destruction of Yukos by Russia (para. 1180).

* * * *

The *Yukos* awards are momentous for many reasons. First, the Tribunal found that Russia had undeniably violated its obligations under the ECT. In the panel's view, the claimants should have anticipated that their tax avoidance operations could have resulted in some adverse reactions from Russia, but not that Russia's actions would be so extreme as to include arrests, tax reassessments, fines, and the forced sale of YNG (paras. 1577–78). The Tribunal held that the measures taken by Russia had an effect equivalent to nationalization or expropriation in violation of Article 13 of the treaty and the conditions specified by it, in particular because the expropriation was not carried out under due process of law and no compensation was provided

[8] OAO Neftyanaya Kompaniya Yukos v. Russia, App. No. 14902/04, Merits (Eur. Ct. H.R. Sept. 20, 2011); *see also* OAO Neftyanaya Kompaniya Yukos v. Russia, App. No. 14902/04, Just Satisfaction (Eur. Ct. H.R. July 31, 2014). Judgments of the European Court of Human Rights cited herein are available at http://hudoc.echr.coe.int.

[9] *See also* Final Awards, paras. 795, 815, 820.

[10] *See also id.*, para. 1037.

(paras. 1579–84). Given the extent of the evidence in the record, the conclusion on expropriation is correct and convincingly argued. Indeed, it is consistent with decisions of other tribunals that have ruled on similar investor claims, which include cases involving the provisional application of the ECT.

Interestingly, in a short paragraph without any additional explanation, the Tribunal also decided that, having found the respondent liable for breaching ECT Article 13, it did "not need to consider" whether the respondent's actions violated ECT Article 10 on fair and equitable treatment (para. 1585). This conclusion may be justified by the fact that the finding of expropriation already fully compensated the claimants' investment, but, in view of the extensive evidence and the Tribunal's meticulous analysis in other sections of the awards, a more detailed conclusion and explanation of why the Tribunal did not see a need to consider violations under Article 10 would have been useful.

The Tribunal dismissed Russia's argument that taxation measures were carved out from the Tribunal's jurisdiction under ECT Article 21. In line with findings of other tribunals, the Tribunal rejected Russia's broad interpretation of the carve-out and correctly held that Russia's moves were not taxation measures made in good faith, but measures "under the guise of" taxation aimed at bankrupting Yukos (paras. 1431–32).

On the issue of attribution, the Tribunal found that Russia was responsible for the actions taken by its executive, judicial, and administrative organs against Yukos and its shareholders, and that Russia had accepted responsibility for Rosneft's acquisition. Specifically, the Tribunal quoted a televised statement by President Putin on the acquisition of YNG by the 100 percent state-owned Rosneft: "[T]he state, resorting to absolutely legal market mechanisms, is looking after its own interests. I consider this to be quite logical" (para. 1470).[11] The Tribunal emphasized that it considered Putin's declaration a public acceptance of the state's actions and interests in the acquisition of Yukos—a renewed *mise-en-garde* of the weight carried by unilateral statements of government officials on questions of attribution.[12] In so doing, the panel underscores that investment tribunals will address high-stakes conflicts between corporate and political interests, and thus make effective dispute resolution available to international investors.

A notable finding of the awards relates to claimants' contributory negligence. The respondent had raised the issue of claimants' "unclean hands" as a preliminary objection. But after reviewing the vast evidentiary record and other arbitral awards, the Tribunal dismissed Russia's objection that their unclean hands deprived the claimants of ECT protection. It agreed that a party whose investment had been obtained by acting in bad faith or violating laws of the host state could not benefit from the protection of the ECT, even if the requirement is not specifically found in the text of the ECT (paras. 1273–1352). The Tribunal was not persuaded, however, by Russia's assertion that the right to invoke the ECT must be denied when an illegality is committed not only in the making of the investment, but also in its performance, as was the case in this arbitration (paras. 1354–55).

[11] Quoting President of Russia, Press Conference with Russian and Foreign Media (Dec. 23, 2004), *at* http://www.en.kremlin.ru/events/president/transcripts/22757.

[12] On the related issue of the importance of unilateral governmental statements in international investment law, see W. Michael Reisman & Mahnoush H. Arsanjani, *The Question of Unilateral Governmental Statements as Applicable Law in Investment Disputes*, 19 ICSID REV. 328 (2004).

Instead, the Tribunal reasoned that even though the respondent's clean hands argument had failed as a preliminary objection, some of claimants' actions that the respondent complained about could have an impact on the Tribunal's assessment of liability and damages (paras. 1373–74). Thus, the Tribunal considered the issue when assessing liability as one of contributory fault, holding that the abuse of the low-tax regions by Yukos and some of its trading entities and its questionable use of the Cyprus-Russia Double Taxation Agreement[13] had contributed in a material way to the prejudice they suffered and that the claimants should pay a price for it (para. 1634). Exercising its wide discretion, the Tribunal set the cost to the claimants of their contribution to the prejudice they had suffered from Russia's destruction of Yukos at 25 percent (paras. 1635–37). Surprisingly, the panel spent no ink explaining why it fixed the price of this misconduct at 25 percent (which amounted to some US$16 billion) and indeed dedicated only one paragraph to this issue (para. 1637).

The magnitude of the awarded compensation alone makes the decision noteworthy. The final awards total a staggering US$50 billion. Among the different valuation methods proposed by the claimants, the Tribunal held that the comparable companies approach, as corrected by Russia's experts, was the "most tenable" and yielded the best available estimate of the damage suffered by the claimants for what Yukos would have been worth but for the expropriation. The claimants were awarded three heads of damages: the value of their shares in Yukos, the value of the lost dividends, and interest on both. As for the date of the expropriation, the Tribunal found that a substantial and irreversible deprivation of claimants' assets occurred on December 19, 2004, the date of the YNG auction (para. 1762).

The Tribunal also determined that, in the case of unlawful expropriation such as the present one, the claimants could select either the date of expropriation (December 19, 2004) or that of the awards (June 30, 2014) as the date of valuation, and they would be entitled to the higher of the two, in this case June 30, 2014 (paras. 1763–69). This procedure accords with several recent decisions dealing with illegal expropriation and is supported by the Tribunal's reading of ECT Article 13.[14]

It remains to be seen how much Russia will actually pay. Indeed, enforcement of the awards will be an intriguing and essential dispute to follow.

The parties accumulated enormous legal costs in the course of the arbitration, some US$78 million for the claimants' legal representation and more than US$11 million for the arbitral tribunal. Analysis of these expenses reveals that the bill of the assistant to the Tribunal, Martin Valasek, was for €970,562, more than half of the amount earned by the Tribunal's chair. That a nonmember of the panel earned this considerable fee is bound to be criticized, and indeed Russia has already used it as an argument for its set-aside request pending in Dutch courts, asserting that the Tribunal breached its mandate to decide the claims by allowing its assistant to perform a substantive role in the arbitration.

[13] Agreement for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, Cyprus-Russ., Dec. 5, 1998, Cyprus Official Gazette No. 3306, Feb. 26, 1999, at 87, *available at* http://www.mof.gov.cy/mof/taxdep.nsf/ (follow hyperlink "Double Taxation Agreements").

[14] In particular, see Kardassopoulous v. Republic of Geor., ICSID Case Nos. ARB/05/18, ARB/07/15 (Mar. 3, 2010), *at* http://www.italaw.com (also interpreting the ECT), *cited in* Final Awards, para. 1769.

Finally, the awards stand out for the complexity of the case and the Tribunal's meticulous treatment of parallel and related litigation.[15] In many instances the Tribunal reviewed the findings of other arbitration tribunals or the European Court of Human Rights in detail, comparing its reasoning with theirs and explaining its concurrent or different conclusions.[16] Given the increasing occurrence of parallel and related litigation in international forums, this detailed treatment sets a good example.[17]

CHIARA GIORGETTI
Richmond University Law School

European Convention on Human Rights—Article 41—just satisfaction—state responsibility

CYPRUS v. TURKEY. App. No. 25781/94. *At* http://hudoc.echr.coe.int.
European Court of Human Rights, Grand Chamber, May 12, 2014.

In a judgment rendered on May 12, 2014,[1] the Grand Chamber of the European Court of Human Rights (Court) ordered Turkey to pay Cyprus unprecedented sums for nonpecuniary damage suffered by the relatives of missing persons and by the "enclaved" Greek Cypriot residents of the Karpas Peninsula stemming from the Turkish invasion of Cyprus in 1974 and its aftermath. In doing so, the Court applied Article 41 on just satisfaction of the European Convention on the Protection of Human Rights and Fundamental Freedoms (European Convention or Convention)[2] to an interstate complaint for the first time.

Turkey invaded the northern part of Cyprus during July and August 1974 and has occupied that part of Cyprus ever since, resulting in the de facto division of the island. Cyprus challenged the Turkish actions, first before the (former) European Commission on Human Rights and then before the Court, alleging violations of various rights of Greek Cypriot missing persons and their relatives, the home and property rights of displaced persons, and the rights of enclaved Greek Cypriots in northern Cyprus. On May 10, 2001, the Grand Chamber found (in its "principal judgment") numerous violations of the Convention by Turkey arising out of the

[15] The events that resulted in the expropriation of Yukos were at the center of several international proceedings in diverse forums. The *Yukos* Tribunal specifically analyzed the decisions of the European Court of Human Rights in OAO Neftyanaya Kompaniya Yukos v. Russia, *supra* note 8, Merits; Quasar de Valores SICAV S.A. v. Russian Fed'n, Award (Stockholm Ch. Comm. [SCC] July 20, 2012), *at* http://www.italaw.com [hereinafter *Quasar*]; RosInvestCo UK Ltd. v. Russian Fed'n, SCC No. V (079/2005), Final Award (SCC Sept. 12, 2010), *at* http://www.italaw.com.

[16] For example, the Tribunal noted that its findings were consistent with those of the *RosInvestCo* and *Quasar* tribunals, which found many aspects of the YNG auction "more than suspect" and concluded that "the auction of YNG was rigged." Final Awards, para. 986 (quoting *Quasar*, *supra* note 15, para. 116, and *RosInvestCo*, *supra* note 15, para. 620(d), respectively); *see also id.*, paras. 1181, 699–700 (referring to *RosInvestCo* and *Quasar*, and quoting *OAO Neftyanaya Kompaniya Yukos*, *supra* note 8, Merits, paras. 601–02, respectively).

[17] *See* Chiara Giorgetti, *Horizontal and Vertical Relationships of International Courts and Tribunals—How Do We Address Their Competing Jurisdiction?*, 30 ICSID REV. 98 (2015).

[1] Cyprus v. Turkey (Just Satisfaction), App. No. 25781/94 (Eur. Ct. H.R. May 12, 2014) [hereinafter Judgment]. Judgments of the Court cited herein are available at its website, http://hudoc.echr.coe.int.

[2] Convention for the Protection of Human Rights and Fundamental Freedoms, Nov. 4, 1950, ETS No. 5, 213 UNTS 221, *as amended by* Protocol No. 14, May 13, 2004, CETS No. 194 [hereinafter Convention]. Article 41 of the Convention provides: "If the Court finds that there has been a violation of the Convention or the Protocols thereto, and if the internal law of the High Contracting Party concerned allows only partial reparation to be made, the Court shall, if necessary, afford just satisfaction to the injured party."