How to Protect Investments in Russia and Ukraine Through International Arbitration

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Overview

Russia has threatened to retaliate against Western investors and business interests for sanctions imposed by the US, EU, and others in response to Russia’s annexation of Crimea. Russia’s response may take the form of measures ranging from outright expropriation of an investment to unilateral changes in the regulatory, royalty, pricing or tax regimes. These retaliatory measures could fundamentally undermine the economic basis on which the investment was made. Ukraine may take similar measures against foreign investments in Ukraine, particularly those perceived to be aligned to its previous administration or to Russia.

Legal rules have been developed to protect foreign investors in such circumstances. Foreign investors are often able to bring their claims before an independent international arbitral tribunal, and awards rendered by those tribunals are enforceable around the world. Investors in Russia or Ukraine should start thinking now about tools available to protect their rights (and recover their losses) in case the Russian or Ukrainian governments take adverse action against them.

In this bulletin, we provide an overview of the international arbitration mechanisms that are available to investors in Russia or Ukraine. Those interested in this subject may also be interested in our bulletins of March 18, 2014 and March 21, 2014 concerning Western sanctions.

I. Protection of Investments in Russia and Ukraine

The most significant sources of legal protections that may be of assistance to those with investments in Russia or Ukraine are bilateral and multilateral investment treaties and contracts.

A. Arbitration Under a Bilateral Investment Treaty

Bilateral investment treaties (BITs) require that each state that is party to them accord specified rights and protections to the nationals of the other state when those nationals invest in its territory. “Nationals” includes corporations and individuals. The most common protections include fair and equitable treatment, full security and protection, treatment at least as good as that provided by the host state to its own nationals (national treatment), treatment at least as good as that provided by the host state to nationals of third states (most favored nation treatment), repatriation of investments and returns, no expropriation unless against prompt, adequate and effective compensation, and a promise to observe obligations with regard to investments (known as umbrella clauses). BITs provide these protections to covered investors whether or not the investor has a contractual relationship with the host state and commonly provide protected foreign investors with the right to bring a claim before an independent international arbitral tribunal. Our previous newsletter has an overview of the nature of these protections. Although BITs only apply to “investments” made by foreign investors into the host state, this term is defined very broadly in most BITs to cover “every kind of asset,” including shares, concessions, debt instruments, land and moveable property.

Both Russia and Ukraine have entered into BITs with a large number of countries. Russia has BITs that are in force with 51 states (including Canada, France, Germany, Italy, the Netherlands, and the UK), while Ukraine has BITs that are in
force with 55 states (including Canada, France, Germany, Italy, the Netherlands, the UK, and the US).

The treaties listed in brackets are particularly significant because it is common practice to structure foreign investment into countries such as Russia and Ukraine through these key jurisdictions. By way of example, although the BIT between the US and Russia is not yet in force, US businesses with investments in Russia may nevertheless be protected if they have structured their investments through one of the 51 states that have a BIT with Russia.

Investors with investments in the Crimea may be protected by the terms of the BITs between Russia and the investor’s home state following Russia’s purported annexation of the Crimea, though this is likely to be a highly contentious issue. It is uncertain how an international tribunal will treat the annexation.

B. Arbitration Under the Energy Charter Treaty

Both Russia and Ukraine have signed the Energy Charter Treaty (ECT), which contains protections similar to those found in BITs. In particular, the ECT includes a right to international arbitration in regard to investments in the energy sector. The ECT is in force among 48 states (primarily European and Commonwealth of Independent States members). This includes Ukraine, so the ECT provides an additional layer of protection to those with investments in Ukraine’s energy sector.

A claim against Russia under the ECT would be more difficult to arbitrate than a BIT claim. Russia signed the ECT in 1994, but never ratified it, so the Treaty has not formally entered into force for Russia. The ECT provides, however, that its provisions must be applied provisionally pending its formal entry into force as long as the ECT’s provisions are not incompatible with the signatory state’s laws. One tribunal has already rejected Russia’s argument that there was no provisional application because of this limitation. Russia has, in any event, effectively terminated the ECT’s provisional application to it from October 18, 2009; therefore, arguably only those who had invested in the Russian energy sector prior to this date would be in a position to bring a claim.

The US is not a party to the ECT. If, however, a US business has structured its investment in Russia or Ukraine through jurisdictions that have ratified the ECT, US investments in Ukraine and (potentially) Russia may be protected.

C. International Commercial Arbitration

Those with business interests or investments in Russia or Ukraine should also review any contractual arrangements that they have with the government of their host state or any entities owned by that government (State Contracts). Many contracts involving foreign investment in Russia and Ukraine will include clauses providing for international arbitration of disputes arising out of a breach of contract. Businesses whose contracts provide no such right should bear in mind that any applicable BIT may contain an umbrella clause, which may permit claims for breach of contract to be brought to an international arbitral tribunal. In addition, businesses should consider the effect on their liabilities if sanctions prevent them from fulfilling the obligations under their State Contracts.

II. Moving Forward

The availability of international arbitration, whether based on an investment treaty or a contract, can be an important means to help deter adverse government action, protect interests if such action occurs, and recover compensation if damages are inflicted. Careful advance planning and preparation is often critical to the success of such a legal strategy.

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