A New Hope for the Yukos Shareholders – PCA Awards Revived by the Hague Court of Appeal

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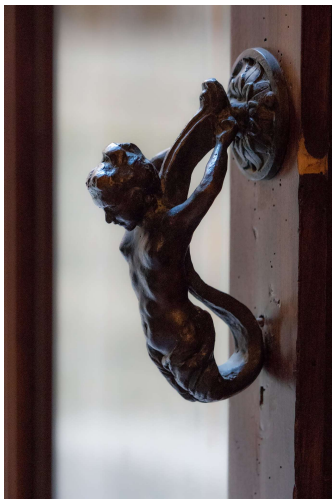
By Johannes Fahner March 4, 2020



Four years ago, the Hague district court gave an unexpected twist to the dispute between Russia and shareholders of the former oil company Yukos, setting aside the 50 billion USD awards issued by an investment arbitration tribunal under the auspices of the PCA on grounds of Russia's breach of the expropriation clause of the Energy Charter Treaty (ECT). The district court found that the arbitration clause of the ECT was not provisionally applicable to Russia and that the tribunal had wrongly assumed jurisdiction. This judgment has now been reversed by the Hague Court of Appeal (see here in Dutch), ruling that the provisional application of the ECT's arbitration clause was not inconsistent with Russian law. The Court of Appeal also rejected Russia's other grounds for annulment, which had not been assessed by the district court, including arguments based on the ECT's tax carve-out, the alleged illegality of the investment, and the role of the tribunal's assistant in drafting the awards.

Provisional Application: a New Middle Way Approach to Article 45 ECT

Under Dutch arbitration law, courts review the validity of arbitration agreement *de novo*. Accordingly, the Court interpreted the ECT's provisional application clause in accordance with the VCLT rules, reaching an independent conclusion as to whether Russia was bound by the ECT's arbitration clause through the provisional application of the treaty. Article 45 paragraph 1 ECT reads:

> 'Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations' (the underlined phrase is known as the Limitation Clause).

In the debates before the tribunal and the district court, the wording of this clause has proven extremely ambiguous and a variety of interpretations have emerged. According to the tribunal, the clause precludes the provisional application of the ECT if domestic law does not allow the provisional application of treaties as a general matter (Interim Award, 329). This so-called 'all-or-nothing approach' was followed in an unpublished award in another Yukos case, Luxtona v Russia, but the Hague district court adopted a different approach, ruling that Article 45 limits the provisional application of the ECT to provisions that are themselves not

contrary to national law (5.18, 5.23). The court justified this so-called 'piecemeal approach' with the argument that a general prohibition of provisional application was unlikely to be found in 'regulations'.

Neither of these interpretations satisfied the Court of Appeal. Instead, referring to the unpublished award in Yukos Capital v Russia, the Court found that the limitation clause applies if domestic law excludes the provisional application of certain (types of) treaty provisions (4.5.33). According to the Court, this interpretation fits best with the wording of Article 45 (in particular the phrase 'to the extent that') and with paragraph 2 of Article 45, which gives signatories the possibility to declare that they do not accept the ECT's provisional application at all. The Court considered that this interpretation also corresponds with one of the ECT's objects, namely to secure a stable and transparent legal framework for investments. An investor would not easily be able to assess the compatibility of any ECT provision with any rule of national law, but it would be relatively feasible to identify the domestic rules on the provisional application of treaties, and assess whether they would preclude the ECT's provisional application. The Court was not convinced of the existence of subsequent State practice in the sense of Article 31(3)(b) VCLT, but saw its interpretation confirmed by the *travaux préparatoires* of the ECT in accordance with Article 32.

The Content of the Consistency Criterion

The next controversy concerned the terms 'not inconsistent with'. According to the district court, the provisional application of the ECT's arbitration clause would be inconsistent with domestic law, not only if domestic law prohibited investor-State arbitration, but also if this form of dispute settlement had no legal basis in domestic law (5.33). The Court of Appeal rejected this argument, considering that it would deprive a provisional application clause of much of its practical value (4.5.47). Instead, the Court considered that an inconsistency exists when the application of one rule leads to the violation of another rule. The absence of a domestic legal basis for the application of a specific ECT provision would not in itself constitute such an inconsistency (4.5.48).

In applying its interpretation of Article 45 ECT to the case at hand, the Court focused on Article 23(1) of the Russian Federal Law on International Treaties (FLIT), which provides:

> An international treaty or a part thereof may, prior to its entry into force, be applied by the Russian Federation provisionally, if the treaty itself so provides or if an agreement to such effect has been reached with the parties that have signed the treaty.

According to the Court, this provision does not pose any limitations to the provisional application of treaties (4.6.1). Consequently, the limitation clause did not apply to Russia and the ECT was provisionally applicable.

For the sake of completeness, the Court addressed Russia's arguments that the provisional application of Article 26 ECT nonetheless violated domestic law. In this context, the Court noted that the FLIT had entered into force after the signing of the ECT, but it observed that the FLIT did not substantially change the Russian approach. Moreover, the Court considered that States can, in accordance with the principle of good faith, only remove inconsistencies, and not introduce new ones (4.7.12, 4.7.31). Accordingly, if legislation had become more consistent with the provisional application of the ECT, the newer legislation should be assessed for the purposes of the limitation clause. In response to the Russian argument that Russian law does not allow arbitration for public law disputes, the Court considered, amongst other things, that the dominant view in Russia holds that investor-State disputes are not public but private law disputes (4.7.35). In reviewing the Russian Laws on Foreign Investment of 1991 and 1999, the Court repeated that the relevant question was not whether these laws provided for investor-State arbitration but if such arbitration was inconsistent with these laws (4.7.47), which was not the case (4.7.57). The Court attached weight, in that context, to Russia's treaty practice, which does not show any hesitation towards investor-state arbitration (4.7.37).

Evaluation: Provisional Application v. the Domestic Separation of Powers

The mechanism of provisional application gives legal effect to a treaty before it has entered into force. According to the ILC's special rapporteur, its purpose is 'to give immediate effect to … the substantive provisions of a treaty without waiting for the completion and effects of the formal requirements for entry into force' (para 25). While provisional application can encourage ratification, the mechanism is not without risk, as it can also create a conflict between international and domestic law. Moreover, provisional application can be dubious from a domestic constitutional point of view, especially if it aims at evading domestic requirements concerning approval by a competent legislative body. This type of concerns clearly motivated the Hague district court in *Yukos*. The court noted that under Russian constitutional law, Parliament has the exclusive competence to make a final determination on whether to be bound by an international treaty, especially when that treaty deviates from or supplements domestic legislation (5.93). Accordingly, the Russian Constitution and the principle of the separation of powers precluded a situation where a representative of the executive would be able to commit the Russian state to investor-State arbitration even though there was no basis for such arbitration in domestic law (5.73).

The Court of Appeal rejected these arguments, considering that the principle of the separation of powers does not in itself determine how different powers are distributed over different institutions. Rather, the Russian legislature had given the government the unlimited power to bind Russia provisionally to international treaties. The Court saw this approach confirmed by several resolutions of the Russian Constitutional Court. In its Resolution 6-P of 19 March 2014, that Court had reviewed the constitutionality of the Crimea Treaty between

Russia and the Republic of Crimea, finding that this treaty contained a valid provisional application clause and that the Crimea became part of Russia as of the date of signing (see here for a critical review of this Resolution).

Even if the mechanism of provisional application raises legitimate concerns in light of a constitutional separation of powers, the ECT contains several escape clauses that address such concerns. The most obvious one is Article 45(2), which allows a signatory to make a declaration that it is not able to accept provisional application (arguably complementing the general right to exclude provisional application by means of a reservation). In addition, the limitation clause of Article 45(1) addresses the situation where provisional application would conflict with domestic law. In theory, this clause can prevent an abuse of provisional application by government actors seeking to bypass domestic legislative bodies. However, the application of the clause is clearly a precarious matter, especially when domestic institutions and authorities provide conflicting views on the question of consistency.

Arguably, the limitation clause can only be successfully invoked after the start of arbitration proceedings if the alleged inconsistency was somehow foreseeable. Although the limitation clause does not require a 'manifest' inconsistency, as pointed out by the Court of Appeal (4.5.26), the obligation to execute treaties in good faith seems to preclude a resort to the limitation clause on grounds of a controversial inconsistency once the treaty's provisional application is no longer considered opportune. As confirmed by the Court of Appeal, it should be feasible for an investor to assess potential obstacles to provisional application before making an investment. If the limitation clause renders the treaty's provisional application forever uncertain, there is not much point in having a provisional application clause at all. A certain degree of foreseeability is also fair to other contracting States, because the limitation clause, unlike declarations under Article 45(2), has no reciprocal effect.

Other Issues: Host State Control, Legality Requirement, Tax Carve-Out

The *Yukos* judgment of the Hague Court of Appeal addresses a variety of other controversial questions concerning the interpretation and application of the ECT, which were not addressed by the district court. The Court ruled that foreign control of the investment is not required by the definitions given in Article 1 of the ECT (5.1.6). The Court further held that implicit legality requirements and the clean hands doctrine concern only illegalities related to the establishment of the investment by the claimants (5.1.11.2, 9.8.7) and that such illegalities would not necessarily bar jurisdiction (5.1.11.5). On Article 21, the ECT's tax carve-out, the Court ruled that this provision does not affect jurisdiction (5.2.5), that it covers only *bona fide* tax measures (5.2.13) and that it does not apply to questions of expropriation (5.2.22). The Court agreed with Russia that the tribunal should have made a referral to the Russian tax authorities in accordance with Article 21(5) ECT, but the tribunal's failure to do so was not serious enough to justify the setting aside of the award (6.3.2).

The Role of the Tribunal's Assistant

Russia's most sensational challenge held that a substantial part of the final awards had been written by the tribunal's assistant, Mr Valasek (see here for a general discussion of this issue). The assistant had billed 2.625 hours, whereas the arbitrators themselves had billed only 1.661 hours on average. Linguistic experts also confirmed that Mr Valasek had probably written substantial parts of the awards. The Court nevertheless rejected Russia's claim, considering that even if the assistant had provided drafts that were incorporated in the awards, this did not necessarily imply that he had participated in the tribunal's decision-making. The Court considered that linguistic experts could not determine whether an author had written a text according to his or her own views or under someone else's supervision. In any case, the arbitrators had apparently decided to accept Mr Valasek's drafts and made them their own (6.6.10), a choice that the Court would review only with restraint (6.6.14.1). The Court further noted that the UNICTRAL rules do not contain concrete regulations concerning the role of an assistant and that there is no customary rule that prohibits an assistant from writing parts of a decision. The Court agreed that, if Russia's presentation of Mr Valasek's role was correct, the tribunal should have fully informed the parties about the role of Mr Valasek, but its failure to do so was not serious enough to justify annulment.

On to the Next Round

The Hague Court of Appeal's judgment addresses a range of contentious issues, even if its interpretation of the ECT's provisional application clause is probably less controversial than the one adopted by the district court. Russia has already announced its appeal to the Dutch Supreme Court, while similar questions are pending before ECT tribunals (both in Yukos-related and other disputes), various other domestic courts and the Court of Justice of the EU. When a spokesman of the Yukos shareholders vowed a 'lifetime of litigation' against the Russian authorities, he probably was not thinking of the intricacies and obscurities of the ECT. Nevertheless, the shareholders' quest for compensation will certainly remain embroiled, for another while, in questions of treaty interpretation that are quite distant from the merits of the case.