

## The Yukos Interim Awards on Jurisdiction and Admissibility Confirms Provisional Application of Energy Charter Treaty

By [Dr. Chiara Giorgetti](#)

### Introduction



The long-awaited Interim Awards on Jurisdiction and Admissibility (“awards”) in the *Yukos* litigation have finally appeared online,<sup>[1]</sup> several months after the Tribunal issued them on November 30, 2009. The awards in the three cases<sup>[2]</sup> are the first decisions against the Russian Federation (“Russia”) in an Energy Charter Treaty (“ECT”)<sup>[3]</sup> arbitration.

The ECT is a multilateral convention which entered into force in April 1998. It was created to encourage and protect investments and trade in the energy field, and to ensure reliable transit and efficient energy use.<sup>[4]</sup> It is binding on over fifty parties,<sup>[5]</sup> including all the members of the European Union and many energy-rich countries of Eastern Europe. The ECT also provides for binding investor-State arbitration as a dispute resolution mechanism to allow investors to enforce their rights under the Treaty.

The arbitrations are being administered by the Permanent Court of Arbitration (“PCA”) in The Hague, under the United Nations Commission on International Trade Law (“UNCITRAL”) Arbitration Rules.<sup>[6]</sup> The three claimant companies allege arbitrary and discriminatory measures and expropriation of their oil investment by Russia, and claim a total of USD \$100 billion in damages, making it one of the largest claims in investment arbitration history.

The awards confirm that Russia is bound to provisionally apply the ECT as provided under Article 45 of that Treaty, in conformity with established principles of international law. This is particularly important for qualified investors in the Russian energy sector, for which binding international arbitration under the ECT may remain an available option for all investments made prior to October 19, 2009, the day when Russia’s withdrawal from the ECT entered into effect. The Tribunal also found that the claimants, which are shareholder companies, qualify as protected investors under the ECT definition. The awards also reject Russia’s assertion that the ECT’s “denial of benefits” clause (Article 17 ECT) bars the claimants from bringing a claim. This *Insight* will briefly discuss the main arguments before the Tribunal and the resultant awards.

### I Background of the Case and Procedural History

The claimants are three shareholders of Yukos Oil Corporation (“Yukos”), namely: Yukos Universal Ltd., a company organized under the laws of the Isle of Man; Hulley Enterprises Ltd.; and Veteran Petroleum Trust, both organized under the laws of Cyprus. They collectively owned over 60% of the shares in Yukos.

The dispute between the claimants and Russia arose between July 2003 and August 2006, when Yukos had become the largest oil company in Russia. The claimants allege that measures taken by Russia against Yukos and its associated companies led to the bankruptcy of Yukos in August 2006, and thus adversely affected their investments.<sup>[7]</sup> Each claimant filed its Notice of Arbitration and Statement of Claims against Russia in February 2005,<sup>[8]</sup> claiming that Russia expropriated and failed to protect its investment in Yukos, resulting in “enormous loss.” Each sought all available relief

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including damages.<sup>[9]</sup>

The three arbitrations were heard in parallel by the same arbitrators, and the interim awards stem from a single set of jurisdictional and admissibility proceedings. The arbitrators in the cases were Mr. Charles Poncet (appointed by claimants)<sup>[10]</sup> and Judge Stephen Schwebel (appointed by Russia). The PCA, acting as appointing authority under the UNCITRAL Rules, appointed Maître L. Yves Fortier as presiding arbitrator.

The Tribunal received two rounds of written pleadings before the hearing.<sup>[11]</sup> The Tribunal denied the claimants' requests for interim measures for the preservation of Yukos documentation in Russia's possession on November 22, 2007 and June 11, 2008, while remaining seized of the matter.<sup>[12]</sup>

The hearing on jurisdiction and admissibility was conducted at the Peace Palace in The Hague in November and December of 2008. Based on the parties' written and oral submissions, the Tribunal decided that several issues were ripe for decision.

## II Provisional Application of the ECT

The first and central question for the Tribunal was whether Article 45 of the Treaty required Russia to provisionally apply the ECT with respect to the claimants' investments. Article 45(1) provides for the provisional application of the ECT pending its entry into force for each signatory "to the extent that such provisional application is not inconsistent with its constitution, laws or regulations" (the so-called "Limitation Clause").<sup>[13]</sup> Article 45(2) states that that "[n]otwithstanding paragraph (1) any signatory may, when signing, deliver to the Depository a declaration that it is not able to accept provisional application." By doing so, the signatory would not be obligated to provisionally apply the ECT. Further, under Article 45(3), a signatory can notify the Depository of its intention not to become a party—as Russia did on August 20, 2009, with the result that Russia's provisional application terminated sixty days thereafter, on October 18, 2009. However, under Article 45(3)(b), Russia remains bound to provisionally apply Parts III and V of the ECT until October 18, 2029, to any investments made in Russia before October 18, 2009.

The parties agreed that Russia signed the ECT on December 17, 1994, the day it was opened for signature, and that the Treaty was submitted for ratification to the Parliament on August 26, 1996, but never ratified. They also agreed that Russia made no declaration under Article 45 at the time of signing or thereafter.<sup>[14]</sup> Russia argued that, in application of Article 45 ECT, it was not obligated to provisionally apply the dispute settlement provisions of Part V of the ECT because these provisions were allegedly inconsistent with its constitution and laws.

The Tribunal dissected the issue in three successive steps. The Tribunal first considered whether Russia was required to make a declaration under Article 45(2) in order to benefit from the Limitation Clause of Article 45(1). In holding that no declaration was necessary, the Tribunal sided with Russia and found that the ECT provided for two separate regimes of provisional application.<sup>[15]</sup> The Tribunal held that the declaration referred to in Article 45(2) "is a declaration which is not necessarily linked to the Limitation Clause of Art. 45(1)." To reach its conclusion, the Tribunal referred to applicable rules of treaty interpretation, and specifically Articles 31 and 32 of the Vienna Convention on the Law of Treaties ("VCLT").<sup>[16]</sup> The Tribunal relied on the ordinary meaning of the terms of the Treaty, together with State practice of some ECT signatories, especially noting that six States<sup>[17]</sup> relied on the Limitation Clause without delivering a formal declaration under Article 45(1).<sup>[18]</sup>

Having determined that Russia could indeed rely on the Limitation Clause, the Tribunal then examined the effect that should be given to the Limitation Clause itself. Russia contended that a piecemeal approach was appropriate, while the claimants argued that an "all-or-nothing" approach was required, by which either the ECT was entirely applied or not at all. The Tribunal agreed with the claimants and, in a detailed discussion which referenced directly the VCLT,<sup>[19]</sup> found that Russia had "agreed that the Treaty as a *whole* would be applied provisionally pending its entry into force unless *the principle* of provisional application itself was inconsistent 'with its constitution, laws or regulations.'"<sup>[20]</sup>

This is an especially important finding of the Tribunal which reinforces the binding nature of international law. Under the cardinal principle of *pacta sunt servanda* (Article 27 VCLT), a State is normally prohibited from referring to its internal legislation to justify its failure to perform. In applying this principle, the Tribunal concluded that allowing Russia to “modulate (or, as the may be, eliminate) the obligation of provisional application, depending on the content of its internal law in relation to the specific provisions found in the Treaty, would undermine the principle that provisional application of the treaty creates binding obligations.”<sup>[21]</sup>

The Tribunal then had to establish whether the Russian legal system allowed for the principle of provisional application of an international treaty, or whether the concept of provisional application was itself contrary to the Russian legal system. It concluded that the provisional application of treaties was consistent with Russia’s constitution, laws, and regulations, as demonstrated, *inter alia*, by the long tradition of provisional application in Russia’s treaty practice and the forty-five treaties that Russia was applying provisionally at the time.<sup>[22]</sup> Thus, the Tribunal concluded that Russia had to provisionally apply every provision of the ECT, including its dispute resolution clause.

The Tribunal considered the termination of Russia’s provisional application as of October 18, 2009 and found that this did not affect its conclusions. The Tribunal held that, in applying Article 45(3) ECT, from the date of Russia’s signature of the ECT on December 17, 1994 to October 18, 2009, the ECT was provisionally binding upon Russia. Further, pursuant to the same provision, any investment made in Russia prior to October 19, 2009 will continue to benefit from the Treaty’s protections for a period of twenty years, i.e., until October 19, 2029. This conclusion is particularly relevant for all investors in the energy sector in Russia who can claim protection under the ECT.

### III The Claimants Are Investors Under the ECT

Next, the Tribunal examined whether the protections afforded to investors by the ECT were available to these claimants.<sup>[23]</sup> Russia objected that the claimant companies were not protected investors under the ECT because they were “shell companies,” beneficially owned and controlled by Russian nationals.<sup>[24]</sup> Respondent also argued that the claimants’ investment was not protected under the ECT.<sup>[25]</sup>

The Tribunal found that claimants were indeed organized in accordance with applicable law in that Contracting Party (in this case the countries of incorporation of claimants: Cyprus and the Isle of Man) and that Article 1(6) of the ECT contained the widest possible definition of an interest in a company, including shares. Thus, the Tribunal held that claimants owned an investment protected by the ECT and concluded that the terms of the ECT did not permit it to find otherwise.<sup>[26]</sup>

The Tribunal found that the ECT applied to an investment owned nominally by a qualifying investor. It held that it knew of no general principles of international law that would require investigating how a company operates and it was not allowed to write additional requirements under the ECT. The Tribunal also noted that it had decided to defer to the merits phase Russia’s arguments that the claimants had “unclean hands” and that their corporate personalities should be disregarded because they were instrumentalities of a “criminal enterprise.”<sup>[27]</sup>

### IV Claims Are Not Barred by the “Denial-of-Benefits” Provision

Russia also asserted objections under Article 17 of the Treaty, which provides that a Contracting Party “reserves the right” to deny the advantages of certain parts of the ECT to “a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized.” Such “denial of benefits” clauses can be found in other bilateral investment treaties, in particular those signed by the United States, and aim at allowing a state “to reserve the right to deny the benefits of the treaty to a company that does not have an economic connection to the state on whose nationality it relies.”<sup>[28]</sup>

The Tribunal concluded that the Contracting Party must exercise the right to

deny benefits in order to claim it, and Russia had not done so.<sup>[29]</sup> Specifically, the Tribunal found that Article 17(1) ECT did not deny *simpliciter* the advantages of Part III of the ECT to a legal entity just because citizens or nationals of a third State owned or controlled such entity and that entity did not have substantial business in the Contracting Party in which it is organized, but that it rather “reserves the right” of each Contracting Party to deny the advantages of that Part to such an entity. This imports that, to affect denial, the Contracting Party must exercise the right. The Tribunal further concluded that neither the claimants nor Russia were nationals of a “third state,” and Article 17 was therefore inapplicable.<sup>[30]</sup>

The Tribunal also denied Russia’s argument that the claims were barred by the ECT’s “fork-in-the-road” clause.<sup>[31]</sup> They deferred to the merits Russia’s objection under Article 21 that the claims were barred by the ECT’s general exclusion of claims regarding “taxation measures.”<sup>[32]</sup>

## Conclusion

The Award is a well-reasoned and detailed analysis of several jurisdictional provisions of the ECT. It is particularly solid because of its strong reliance on the VCLT and prior ECT jurisprudence. Its conclusion accepting provisional application of the Treaty reflects the common understanding of this principle in treaty law.<sup>[33]</sup> The award also sheds some light on the ongoing debate concerning the definitions of protected investor and investment.<sup>[34]</sup>

The parties have entered the merits phase of the dispute, which typically includes another two successive exchanges of written submissions and a hearing on the merits. In the merits phase, the Tribunal will consider the Yukos investors’ claims of expropriation and denial of full protection and security, as well as Russia’s “clean-hands” and “criminal enterprise” arguments and its objection under Article 21 ECT.

The next step, which will decide the merits of the case, is eagerly anticipated.

## About the Author

Dr. Chiara Giorgetti, an ASIL Member, is an International Attorney in the Arbitration Group of White & Case LLP and Adjunct Professor of Law at Georgetown Law Center. She co-chairs the International Courts and Tribunals Interest Group. Any views expressed herein are the author’s own and do not necessarily reflect the views of White & Case or its clients.

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## Endnotes

[1] *Investor-State Dispute Settlement Cases*, Energy Charter, <http://www.encharter.org/index.php?id=213&L=0#Alstom> (last visited July 13,

2010) (providing the three Interim Awards (items 6-8)). For the purpose of this note, citations refer to the Interim Award on Jurisdiction and Admissibility in *Yukos Universal Ltd v. Russia* ("Award").

[2] *Yukos Universal Ltd. v. Russian Federation*, Interim Award on Jurisdiction and Admissibility, PCA Case No. AA 227 (Nov. 30, 2009), *available at* <http://ita.law.uvic.ca/documents/YULvRussianFederation-InterimAward-30Nov2009.pdf>; *Hulley Enterprises Ltd. v. Russian Federation*, Interim Award on Jurisdiction and Admissibility, PCA Case No. AA 226 (Nov. 30, 2009), *available at* <http://ita.law.uvic.ca/documents/HELvRussianFederation-InterimAward-30Nov2009.pdf>; *Veteran Petroleum Trust v. Russian Federation*, Interim Award on Jurisdiction and Admissibility, PCA Case No. AA 228 (Nov. 30, 2009), *available at* <http://ita.law.uvic.ca/documents/VPLvRussianFederation-InterimAward-30Nov2009.pdf>. The Tribunal is hearing these three cases together.

[3] Energy Charter Treaty, Dec. 17, 1991, 2080 U.N.T.S. 100, 34 I.L.M. 360 [hereinafter ECT].

[4] See *About the Charter*, Energy Charter, <http://www.encharter.org/index.php?id=7&L=0> (last visited July 13, 2010).

[5] Signatories of the Charter are: Albania, Armenia, Australia, Austria, Azerbaijan, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, European Communities, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Kazakhstan, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, Mongolia, the Netherlands, Norway, Poland, Portugal, Romania, Russian Federation (until October 18, 2009), Slovakia, Slovenia, Spain, Sweden, Switzerland, Tajikistan, The former Yugoslav Republic of Macedonia, Turkey, Turkmenistan, Ukraine, United Kingdom, Uzbekistan, and the former Yugoslav Republic of Macedonia.. A number of states have also become observers: Afghanistan, Algeria, Bahrain, Canada, China, Egypt, Indonesia, Iran, Jordan, Korea, Kuwait, Morocco, Nigeria, Oman, Pakistan, Palestinian National Authority, Qatar, Saudi Arabia, Serbia, Syria, Tunisia, United Arab Emirates, United States of America, and Venezuela. See *Members and Observers*, Energy Charter, <http://www.encharter.org/index.php?id=61&L=0> (last visited July 13, 2010).

[6] The Tribunals are composed of L. Yves Fortier, Charles Poncet, and Stephen Schwebel.

[7] See *generally* Award, ¶¶ 35-68.

[8] Note that Article 26(2) ECT requires an attempt by the parties to resolve their dispute amicably prior to filing a request for arbitration. Accordingly, claimants delivered to the Russian President a notification of claims on November 2, 2004 and sought to settle the dispute amicably. Having failed to do within the prescribed three months, they filed their Notices of Arbitration in February 2005. Hulley and Yukos Universal filed their Requests on February, 3 2005; Veteran Petroleum filed its Request on February 14, 2005. See *id.* ¶¶ 3-4.

[9] See *id.* ¶¶ 3-6.

[10] Claimants had first appointed Mr. Daniel Price as an arbitrator. He resigned on May 31, 2007, and claimants subsequently selected Mr. Charles Poncet after a successful challenge by respondent of Professor Gabrielle Kaufmann-Kohler. Respondent had challenged her appointment on the grounds of certain circumstances, disclosed by her, connecting her then law firm to claimants and claimants' counsel. The Secretary General of the PCA was requested to rule on the challenge under the applicable UNCITRAL Rules and sustained respondent's request. See *id.* ¶¶ 14-16.

[11] *Id.* ¶¶ 3-34 (procedural history). Interestingly, the Award contains a summary of all the witnesses' statements of both respondent and claimants. See *id.* ¶¶ 81-242. Russia called nineteen witnesses. Claimants had four witnesses, including Professors James Crawford and Michael Reisman, both of whom were relied upon by the Tribunal in its conclusions. See, e.g., *id.* ¶¶ 316-18, 320.

[12] *Id.* ¶¶ 26, 28.



[13] ECT art. 45 reads:

(1) 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. (2) (a) Notwithstanding paragraph (1) any signatory may, when signing, deliver to the Depository a declaration that it is not able to accept provisional application. The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration. Any such signatory may at any time withdraw that declaration by written notification to the Depository. (b) Neither a signatory which makes a declaration in accordance with subparagraph (a) nor Investors of that signatory may claim the benefits of provisional application under paragraph (1). (c) Notwithstanding subparagraph (a), any signatory making a declaration referred to in subparagraph (a) shall apply Part VII provisionally pending the entry into force of the Treaty for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its laws or regulations. (3) (a) Any signatory may terminate its provisional application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty. Termination of provisional application for any signatory shall take effect upon the expiration of 60 days from the date on which such signatory's written notification is received by the Depository. (b) In the event that a signatory terminates provisional application under subparagraph (a), the obligation of the signatory under paragraph (1) to apply Parts III and V with respect to any Investments made in its Area during such provisional application by Investors of other signatories shall nevertheless remain in effect with respect to those Investments for twenty years following the effective date of termination, except as otherwise provided in subparagraph (c). (c) Subparagraph (b) shall not apply to any signatory listed in Annex PA. A signatory shall be removed from the list in Annex PA effective upon delivery to the Depository of its request therefor.

[14] Note that at the time of signing, Norway, Iceland, and Australia filed declarations stating that they did not accept provisional application.

[15] Claimants and their experts had argued that Article 45(1) established the principle of provisional application, while Article 45(2) provided the procedure according to which Article 45(1) could become operational.

[16] Award, ¶¶ 260-64. See Vienna Convention on the Law of Treaties art. 31, 1155 U.N.T.S. 331, 8 I.L.M. 679 (1969) [hereinafter VCLT] (General rule of interpretation) reads:

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. 3. There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) any relevant rules of international law applicable in the relations between the parties. 4. A special meaning shall be given to a term if it is established that the parties so intended." Article 32 (Supplementary means of interpretation) states "Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly

absurd or unreasonable.

The VCLT is available at [http://untreaty.un.org/ilc/texts/instruments/english/conventions/1\\_1\\_1969.pdf](http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf).

[17] Austria, Italy, Luxembourg, Portugal, Romania, and Turkey.

[18] Award, ¶ 265.

[19] For example, the Tribunal found “that the ordinary meaning of the terms of Article 45(1), in the context and in the light of the object and purpose of the Treaty,” which are all direct references to Articles 30 and 31 VCLT.

[20] Award, ¶ 301 (citing the VCLT, the Tribunal found that “the ordinary meaning of the terms of Art. 45(1), in their context and in the light of the object and purpose of the Treaty” favored claimants’ interpretation). See *id.* ¶¶ 301-29 (providing the entire reasoning of the Tribunal).

[21] *Id.* ¶ 314; see also *id.* ¶¶ 313, 315-20.

[22] *Id.* ¶ 337; see also *id.* ¶¶ 370-92.

[23] ECT art. 1(7)(ii) (defines an Investor as “a company or other organization organized in accordance with the law applicable to that Contracting Party.” Art. 1(6) defines an investment as “every kind of asset, owned or controlled directly or indirectly by an Investor and includes . . . (b) a company or business enterprise, or shares, stock or other forms of equity participation . . .”).

[24] Award, ¶¶ 406-10.

[25] *Id.* ¶¶ 418-29.

[26] *Id.* ¶¶ 411-17, 430-35.

[27] *Id.* ¶ 436 (referring to Procedural Orders Nos. 2 and 3 of September 8 and October 31, 2006, respectively).

[28] Rudolph Dolzer & Christoph Schreuer, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 55 (2008). See also Loukas A. Mistelis & Crina Mihaela Baltag, *Denial of Benefits and Article 17 of the Energy Charter Treaty*, 113 PENN ST. L. REV. 1301 (2009).

[29] Award, ¶¶ 456-59.

[30] *Id.* ¶¶ 460-555.

[31] *Id.* ¶¶ 598-600. The “fork-in-the-road” provision bars disputes pursued in domestic courts from also being brought as investment claims. The relevant part of the provision of the ECT states

Art. 26 (1) Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably. (2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution: (a) to the courts or administrative tribunals of the Contracting Party to the dispute; (b) in accordance with any applicable, previously agreed dispute settlement procedure; or (c) in accordance with the following paragraphs of this Article. (3) (a) Subject only to subparagraphs (b) and (c), each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration or conciliation in accordance with the provisions of this Article. (b) (i) The Contracting Parties listed in Annex ID do not give such unconditional consent where the Investor has previously submitted the dispute under subparagraph 2(a) or (b).

[32] *Id.* ¶¶ 556-86.

[33] See, e.g., *OPPENHEIM'S INTERNATIONAL LAW* 1238 (Sir Robert

Jennings & Sir Arthur Watts eds., 9th ed. 1992) (affirming that a treaty may provide that it is wholly or partially to be applied provisionally, pending its entry into force, and stating that the General Agreement on Tariffs and Trade 1947 had been applied provisionally for over forty years); René Lefeber, *The Provisional Application of Treaties*, ESSAYS ON THE LAW OF TREATIES 81, 89 (Jan Klabbers ed.) (also cited by the Tribunal in n.55).

[34] See Alison Ross, *Lawyers React to Yukos Awards*, GLOBAL ARB. REV. (Feb. 16, 2010), *available at* [www.globalarbitrationreview.com](http://www.globalarbitrationreview.com).

