JURISDICTION: ARBITRATORS SAY TAX EXEMPTION NOT SELF-JUDGING, AND REFERRAL BY YUKOS TO LOCAL AUTHORITIES WOULD BE FUTILE; LEGALITY DUTY ON INVESTORS PROVES TOOTHLESS DUE TO IDENTITY-CHANGE

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(Editor's Note: This is the first article in a three-part series examining in detail the recent awards rendered in a trio of arbitrations by majority shareholders of the Yukos oil company against the Russian Federation. This article discusses certain jurisdictional issues. Article 2 focuses on liability holdings and is available here. Article 3 discusses the damages valuations and is available here.)

Tribunal second-guesses Russia’s claimed ‘taxation measures’

One central jurisdictional issue, held over from the tribunal’s 2009 decisions in a trio of related claims by the majority shareholders in the Yukos oil company, was the applicability of the tax ‘carve-out’ and ‘claw-back’ found in the Energy Charter Treaty (ECT).

Russia had contended that its measures constituted ‘Taxation Measures’ under Article 21(1) of the ECT, and as such were completely exempted from scrutiny by the tribunal. Russia emphasised the policy rationale of an exemption for the sensitive area of taxation, and noted that similar provisions had been applied to defeat jurisdiction in other investment treaty cases.

However, the ECT also contained a ‘claw-back’ in Article 21(5), which provided that, notwithstanding the ‘carve-out’, the ECT’s clause prohibiting expropriation would apply to ‘taxes’. Furthermore, if any tax was alleged to constitute an expropriation, the investor was required by Article 21(5)(b) to submit the question to domestic tax authorities, who would endeavour to resolve the matter within six months.

In relation to the ‘claw-back’, Russia argued that ‘Taxation Measures’ was a broader term than ‘taxes’, meaning that the initial ‘carve-out’ was more extensive than the limited ‘claw-back’.

The claimants, meanwhile, argued that Russia’s measures, while purporting to relate to tax, were not bona fide, and so did not constitute ‘Taxation Measures’ for the purposes of Article 21. Additionally, the claimants contended that the ‘claw-back’ must have the same scope as the ‘carve-out’ to avoid leaving a ‘gaping hole’ in the ECT for expropriatory taxation. As for the referral procedure to domestic authorities, the claimants alleged that this would be obviously futile and should be ignored by the tribunal.
On this issue, the tribunal sided entirely with the claimants. Notably, it held that Russia did not enjoy the sole prerogative to determine whether its measures constituted exempted ‘Taxation Measures’ under the ECT. Instead, the tribunal would make an assessment of this itself (noting that the RosInvestCo and Quasar tribunals had similarly indicated that, while tax was not generally considered expropriation in itself, states could not avoid investment treaty obligations merely by labelling a measure as a ‘tax’). Given its earlier factual findings, the tribunal concluded that Russia’s measures were not *bona fide* tax measures, and so the carve-out did not apply.

Alternatively, the tribunal held, if the carve-out did apply, the claw-back would also apply, meaning that the tribunal had jurisdiction in any case (at least over claims of expropriation). The ordinary meaning of ‘tax’, for the tribunal, was the same as ‘Taxation Measures’; to hold otherwise would defeat the object and purpose of the ECT by creating a major loophole for states.

The tribunal also agreed that the domestic referral procedure was futile and could be ignored, since the Russian tax authorities clearly could not digest the enormous evidential record in the case to produce a ruling on expropriation within six months.

**Legality requirement can be read into ECT, but not for post-investment conduct**

A second jurisdictional issue left looming from the 2009 decision was the alleged ‘unclean hands’ of the claimants, stemming from a range of illegalities and improprieties allegedly committed during the 1990s and 2000s. These were said to include, amongst others: efforts to prevent competitors from bidding in the initial privatisation of Yukos in the mid-1990s; attempts to squeeze-out minority shareholders; illegally siphoning off profits from Yukos to offshore entities; abusing a Cyprus-Russia double tax agreement; sabotaging the auction of Yukos’ main production asset, Yuganskneftegaz (YNG); lying to auditors; and violating Dutch law by appropriating and hiding assets in Dutch investment vehicles.

The tribunal began by noting that the ECT did not mention any principle of ‘clean hands’, or even contain an explicit requirement that investments be made legally, unlike many other investment treaties. However, it agreed with other tribunals that such a requirement could be read in to the ECT, denying treaty protection for investments made unlawfully or in bad faith. (The tribunal saw no need to determine whether illegality was a question of jurisdiction, admissibility or merits.)

But this *implied* legality requirement could only apply to conduct at the time of the investment, the tribunal held, rather than post-investment conduct (which could be addressed through domestic law, as Russia had indeed done here).

The tribunal considered whether post-investment conduct might still be captured via the doctrine of ‘clean hands’, which Russia argued was a ‘general principle of law’ in the sense of Article 38(1) of the ICJ Statute. However, the tribunal saw a “significant amount of controversy” over this principle in international law, finding no majority decision from an international court or tribunal applying the ‘clean hands’ principle to bar a claim.*

Thus, the only potentially relevant misconduct was the alleged efforts of the original purchasers of Yukos – entities connected with Bank Menatap, run by a group of Russian ‘oligarchs’ including Mikhail Khodorkovsky – to prevent competitors from bidding in the 1995-96 privatisation process, and other similar alleged misconduct. The tribunal observed that these parties were not the same as the three corporate claimants in the arbitration, and so any illegalities they committed could not affect the claimants, who had lawfully purchased their stakes in Yukos in 1999. (The tribunal's highly "formalistic" approach has been discussed in more detail in this commentary by Michael Goldhaber, of The American Lawyer magazine.)
As we discuss in separate coverage, the claimants' post-entry management of the investment was deemed relevant at the damages phase.

**Effect of parallel ECHR proceedings is re-floated by Russia, but swiftly dismissed by tribunal**

In its 2009 jurisdictional decision, the tribunal rejected Russia’s argument that the claimants had already chosen to litigate their dispute in the European Court of Human Rights and could not therefore choose arbitration under the ECT as well. In particular, the tribunal held that the ‘triple-identity’ test was not satisfied, since the Yukos company itself was claiming in the European Court for breaches of the European Convention, while the majority shareholders were claiming for breaches of the ECT in the present arbitration.

However, Russia sought to re-open this so-called ‘fork-in-the-road’ argument in the arbitration’s merits phase, pointing to the then-pending claim for compensation that Yukos presented to the Court following its 2011 liability ruling largely in favour of Yukos.

Russia contended that the ECHR and ECT claims both had the “same normative source”, since the two instruments did not “lay down independent standards by which Respondent’s conduct is to be judged”. Moreover, while the claimants had presented an undertaking that they would reduce their claims in the arbitration following any award from the Court, Russia contended that this simply confirmed that the claimants in each forum were ultimately the same entity.

Russia also pointed to the risk of conflicting rulings that the ECT’s ‘fork-in-the-road’ provisions were partly designed to avoid. It contended that the claimants were arguing issues that the European Court had already determined, such as the *bona fides* of Russia’s tax assessments against Yukos.

The tribunal, though, dismissed this objection in a single sentence, ruling that it had already decided the point and would not reconsider it.

(As discussed in our parallel coverage of the European Court’s ruling in the Yukos case issued today (July 31, 2014), the Court apparently did not have time to take account of the ECT tribunal’s ruling in its own judgment. It referred to the ECT arbitration as still pending, and side-stepped any arguments over the interaction between the two fora.)

**Tribunal finds Rosneft actions attributable to Russia, due to specific direction by President Putin**

A further preliminary issue addressed by the tribunal was whether the conduct of all relevant entities could be attributed to Russia. The tribunal focussed particularly on the conduct of Rosneft in collaborating with unknown company Baikal to purchase YNG at the 2004 auction, and on the conduct of Yukos’ bankruptcy administrator.

Russia argued that Rosneft’s creation as a corporate entity by the Russian state was insufficient in itself to make the state responsible for its actions. The tribunal agreed with this. However, it found evidence of specific direction by Russia given to Rosneft to arrange the purchase (via Baikal) of YNG following the auction. In particular, the tribunal highlighted statements by President Putin in December 2004, who had commented – in response to a question about Rosneft’s purchase of YNG – that “the state” was “looking after its own interests”.

For the tribunal, “it may reasonably be held that the highest officers of Rosneft who at the same time served as officials of the Russian Federation in close association with President Putin acted in
implementation of the policy of the Russian Federation”.

By contrast, the tribunal cited case-law from the ECHR and other investment tribunals (including the Plama v. Bulgaria and Oostergetel v. Slovakia cases) in the course of finding that the actions of the bankruptcy administrator were not attributable to Russia.

(As noted in our prior coverage of this case, the tribunal consists of Yves Fortier, Charles Poncet and Stephen Schwebel.)

* While the ‘general principles of law’ are typically recognised to be principles transposed to international law from domestic legal systems, the tribunal appeared unwilling to conduct any review of domestic legal systems for primary evidence of the ‘clean hands’ principle. Instead, it relied on the lack of secondary evidence supporting the principle’s existence in international law.

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