Case Comment:
(Former) Yukos v. Russian Federation
before the Permanent Court of Arbitration

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1. Introduction

The aim of the present article is to evaluate the crucial legal points of the arbitral decisions issued under auspices of the Permanent Court of International Arbitration (hereinafter the PCA) on the admissibility and jurisdiction of the claim addressed by Yukos Universal Limited and others against the Russian Federation
1 (hereafter: Yukos arbitration, Yukos decision or Yukos case).

The different aspects of the dispute brought a lot of attention for several reasons. The amount of the claim was the highest in the history of international investment law and raised up to 100 billion dollars
2. Moreover, the case was also political in nature and related to the shift in Russian natural resources policy. Different aspects and phases of the case have already served as the objects of an academic interest
3. Eminent scholars - the internationally recognized professors of law - were engaged in arbitration itself as experts
4.

This comment is focused on the key points of international investment law, which were analyzed by arbitrators in case. The first one involves the temporal scope of application of the Energy Charter Treaty
5 (hereinafter the ECT), which despite the termination of provisional application has still produced legal effects. The second question concerns the legal nature of “Limitation Clause” which identifies the legal nature of relation between the provisional application of ECT and the Russian law. The third question analyzed in this comment is related to the “Denial-of-Benefits” clause, which incorporates the principle of reciprocity to investment treaties. The final problem is related to the “Fork-in-the-Road” provision, which bars parties to bring claims in a situation when the same case is already an object of dispute settlement procedure before an another organ.

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2. Temporal scope of the ECT’s provisional application

One of the main problems in the first round of Yukos arbitration concerned the provisional applicability of the European Charter Treaty. An answer to that question – by its nature – conditions further claims.

According to art. 45 para. 1 of the Energy Charter Treaty “[e]ach signatory agrees to apply this Treaty provisionally pending its entry into force […]”. The provisional application of treaties is a well-established concept in international law. It was prescribed by the Vienna Convention on the Law of Treaties⁶ (hereinafter VCLT, see art. 25). Its rationale is to provide the applicability of a treaty before the time-consuming procedure of ratification by the negotiating parties is finalized.

The provisional application was a result of Russia’s signature of the ECT in December 1994. The agreement entered into force in 1998. Nevertheless, the Russian Duma refused to give its final approval in 1997 and 2001⁷.

With the appearance of Vladimir Putin as the head of Russian state, a remarkable shift in the policy of natural resources took place. In the period of Boris Yeltsin, the Russian state-owned enterprises were privatized, which often resulted in an accumulation of their ownership in the hands of powerful ‘oligarchs’. According to the Putin’s ‘New Energy Policy’, the natural resources should serve to regain the economical and political position of Russia after the collapse of the Soviet Union⁸. The ECT’s ratification procedure was pending until 20 August 2009, when the Russian authorities finally declared, that their country would not seek any longer for the ratification and informed the Portuguese Government about the termination of provisional application. By this declaration the art. 45. para 3 (a) became fulfilled. It states as follows:

“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.”

According to this provision the temporal application of the Energy Charter Treaty by Russia terminated to operate as of 20 October 2009⁹. Art. 45 para. 3 (b) importantly influences the ECT’s temporal applicability. “In the event that a signatory terminates provisional application […] the obligation of the signatory […] 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 […]”.

Art. 45 para 3 (b) allows to bring claims arised during the period of provisional application during twenty years following the termination of provisional application. The wording “during such provisional application” limits the temporal bases of the fact which constituted a breach of one of the ECT’s investor protection requirements. It gives a possibility of bringing claim during 20 years afterwards, i.e. until 19 October 2029. It should be however emphasized, that art. 45 para. 3 (b) does only prolong the temporal scope of invocability but not of protection as such. Therefore the acts which took place after 19 October 2009 would not be protected. However, investors may bring claims against acts which took place before this date up to 19 October 2029.

3. The legal nature of “Limitation Clause”

The arbitrators in the Yukos case explained the vague meaning of the “Limitation Clause”. There are two possible ways of limiting the provisional application of the ECT. Under the art. 45 (2) the exclusion of the temporal application is a result of a written declaration – an option exercised by several ECT state-parties, but not the Russian Federation. The second option is provided by art. 45 (1) which states: “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 ECT’s provisional application is therefore barred by its inconsistency with state-party’s internal law. It constitutes an exception to the well established principle of domestic’s law irrelevance in observance of international law, confirmed by the art. 27 of the VCLT: “A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty”.

The arbitrators clarify, that two opting-out regimes are separate. In case of inconsistency with the internal law there is no requirement of declaration in order to benefit from “Limitation Clause” of art. 45 (1). Even if during the negotiations states, “that had flagged legal problems with provisional applications” were encouraged to make a declaration in order to be transparent, “art. 45 (1) did not expressly require any form of declaration in order to allow the signatory to invoke the Limitation Clause”11. In conclusion, the Russian
Federation could rely on art. 45 (1) even if it made no previous declaration on consistency of provisional application with its domestic law.

The understanding of relation between paragraphs 45 (1) and 45 (2) of ECT represented in Yukos arbitration seems to confirm the previous interpretation presented in Kardassopoulos case. The arbitrators decided, that the application of the “domestic law exception” (art. 45 (1)) was not precluded by the lack of declaration on the ground of art. 45 (2). This coherence was not a big surprise, as both cases were presided by the same chairman: Yves Fortier.

However, the most important point of controversy did not concern the relevance of previous declaration, but the “Limitation Clause’s” nature. The Russian Federation represented a “piecemeal” approach, according to which, the expression “to the extent that” in art. 45 (1) referred to the “scope” or the “width” of the provisional application. Each temporally applied provision of ECT should be tested with the domestic law of contracting party in case. In consequence the ECT’s provisional application would differ from country to country even by the states which had no objection in principle to provisional application.

In its counter-argumentation former Yukos shareholders gave emphasis on terms “such provisional application”. As their standpoint was summarized: "Claimant asserts, each signatory agrees to be bound by the Treaty, if the principle of provisional application is consistent with the domestic law.

The arbitrators did not share the entire argumentation of neither parties, but in conclusion they took a position favorable with the claimant. They referred to words “such provisional application” in art. 45 (1), which relates to “the provisional application of this treaty”. In consequence, “by signing the ECT, the Russian Federation agreed that the Treaty as a whole would be applied provisionally pending its entry into force unless the principle of provisional application itself were inconsistent with its constitution, laws or regulations.” (italics in original) Therefore, the arbitrators opted for “all-or-nothing” approach, according to which the treaty is provisionally applicable as a whole, because the principle of provisional application is consistent with domestic “constitution, laws or regulations”.

It is worth noticing, that in this very crucial element of the dispute, the arbitrators used textual and contextual methods of interpretation by making reference to Black’s Law Dictionary and Merriam-Webster Collegiate Dictionary. According to the Tribunals Terms
of Appointment, the language of arbitration shall be English. However, the dispute is based on the ECT, which was also adopted in several other authentic languages: French, German, Russian, Italian and Spanish (art. 50). It raises a question, if the Tribunals textualistic reasoning should be reconfirmed in other authentic versions of the ECT. The linguistic limitation in the Terms of Appointment seems to refer only to conducting the procedure as such. This conclusion stems out from art. 17 UNCITRAL Arbitration Rules on which the proceedings were based. “[The] determination [of a language to be used in the procedure] shall apply to the statement of claim, the statement of defense, and any further written statements and, if oral hearings take place, to the language or languages to be used in such hearings.” Therefore it does not deprive a possibility to make arguments based on other authentic linguistic versions of a Treaty. Nevertheless, when making such a critical methodological remark one has to keep in mind, that the wordings equivalent to “apply this Treaty provisionally” and “such provisional application” in other languages: French “appliquer le présent traité à titre provisoire” and “cette application provisoire”, Italian: “applicazione provvisoria al presente Trattato” and “della applicazione provvisoria”, Spanish: “aplicar el presente Tratado de manera provisional” and “dicha aplicación provisional”, German: “diesen Vertrag […] vorläufig anzuwenden” and “die vorläufige Anwendung”, Russian “временно применять настоящий Договор” and “такое временное применение” seem to be very close to the English version. It should also be admitted, that the arbitrators in para. 545 referred to the French version of ECT, where it had an important meaning in explanation of the term “third state”.

In the aforementioned Kardassopoulos case the arbitrators analyzed the consistency of provisional application with the Georgian and Greek Law. In this operation they checked the legal premises of provisional application of treaties in those two legal systems and not the consistency of invoked ECT provisions with the domestic law. Moreover, they made a following statement which was quoted in Yukos arbitration: “It is this Treaty which is to be provisionally applied, i.e., the Treaty as a whole and in its entirety and not just a part of it […] [E]ach signatory State is obliged, even before the ECT has formally entered into force, to apply the whole ECT as if it had already done so.” Therefore the arbitrators in Kardassopoulos opted for “all-or-nothing” approach, which requires a consistency of provisional application of treaties with the ECT signatory’s domestic legal system and not for “piecemeal” approach which requires a consistency of each provision.
A conclusion similar to the one reached by the Yukos arbitrators was already proposed by Alex M. Niebruegge, however essentially based on a different argument. The “all-or-nothing” approach (called by the Author as “take-it-or-leave-it”) was preferred over “piecemeal” approach (called “pick-and-choose”) on the ground of a contextual argument. Art. 45 (2) refers to the declaration of acceptance of provisional application as such. Therefore, the same term used in the previous paragraph should be similarly interpreted, namely as referring to the principle of provisional application.

The understanding of “domestic law exception” similar to the one presented by the arbitrators in the Yukos case was already an object of a critique by certain scholars. Matthew Belz suggested that such an interpretation reversed the burden of proof, as the investor had to verify if the state, applied the treaty provisionally. The Kardassopoulos and in consequence the Yukos reasoning “reduces investor confidence in the ECT”24. However if “all-or-nothing” approach was consequently applied by the investment arbitrators, the “reduction of confidence” would be considerably lower, than in the case of the “piecemeal” approach. In the latter case the investor would have to check not only the consistency with domestic regulations of the provisional applicability of treaties, but to verify the consistency of entire ECT’s provisions with the whole domestic law of the state, where the investment was indenten. The latter task seems to be much harder.

4. Principle of reciprocity in international investment law - the “Denial-of-Benefits” clause

The disputing parties exchanged numerous arguments concerning the art. 17 of the ECT, which provides: “Each Contracting Party reserves the right to deny the advantages of this Part to:

(1) 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”.

The “Denial-of-Benefits” clause is not an entirely new concept in international law and is linked with the principle of reciprocity. Originally it was used to deny diplomatic protection to “enemy companies.” The clause was later imported into the treaties concerning protection of foreign investments.25 At present, the state-parties grant protection to investors of the other state in exchange of protection of their companies abroad.

Investor protection shall not be granted to the so called “shell companies” or “mailbox
companies”. These would be entities with – in the ECT language - “no substantial business” with the country of registration. Comparably as in Nottebohm case the ICJ required an “effective nationality”, an economic entity must fulfill the requirement of “genuine link” with the state of corporation. The goal of such regulation is to deny the advantages (i.e. investment protection) to “free riders” – companies which de facto operate from a state, which does not provide such a reciprocal protection.

The Tribunal in Yukos arbitration recalled a fundamental remark from Plama v. Bulgaria case, noting that art. 17 refers to advantages granted by Part III of ECT, whereas art. 26, a procedural relief for covered investor’s claims, is situated in Part V. Understanding the “Denial-of-Benefits” clause as giving a state a possibility to decide whether an investor has or not a right to bring a claim against it would be contrary to the well established principle nemo iudex in causa sua. It would give a license for deciding, whether an investor is covered by ECT at all. Therefore, as art. 17 does not relate to art. 26 and is not a procedural relief, “[w]hether or not Claimant is entitled to the advantages of Part III is a question not of jurisdiction but of the merits”. At the same time “the Tribunal took note of the fact that the Parties have treated the application of Article 17 as a question of admissibility, not jurisdiction”. For that reason, the arbitrators decided to consider the both parties’ arguments based on art. 17, but not in order to determine its own jurisdiction but to find out if the claim is admissible.

The invocation of the “Denial-of-Benefits” clause requires, under certain treaties as NAFTA, previous notification and consultation. In the view of Russian Federation, as ECT does not provide such a requirement, a contrario the responding state may invoke the denial of benefits solely on the ground of the lack of “substantial business”. Moreover, “[i]n order to benefit from Treaty protections, […] a company that comes within the scope of Article 17 must obtain a commitment from the host State, that it will be treated as a protected investor. No such commitments have been obtained.”.

The claimants based their argumentation on the distinction between “existence” and “exercise” of the right to deny the benefits, which was already applied in the Plama v. Bulgaria case. Concerning the investors alleged obligation to obtain a “commitment of protection” they also recalled the expert opinion of professor James Crawford: “[t]o place on an individual investor the task of obtaining express assurance as to the extension of advantages would change the ECT from a general framework for investment in the energy
sector to an invitation to establish, case-by-case, bilateral relations between investors and the host State. This was plainly not the intention."

The Tribunal shared the arguments presented by the claimants. Moreover, such denial of benefits may never be retrospective as it would be “incompatible with the objectives and principles of the Charter”. Paramount among those objectives and principles is (Promotion, Protection and Treatment of Investments) as specified by the terms of Article 10 of the Treaty”.

The arbitrators in Plama v. Bulgaria case explained, how such right to deny the benefits should be exercised: “[it] would necessarily be associated with publicity or other notice so as to become reasonably available to investors and their advisers. To this end, a declaration in a Contracting State’s official gazette could suffice; or a statutory provision in a Contracting State’s investment or other laws; or even an exchange of letters with a particular investor or class of investors. […] By itself, Article 17 (1) ECT is at best only half a notice; without further reasonable notice of its exercise by the host state, its terms tell investor little; and for all practical purposes, something more is needed”. The exercise of right must be therefore an explicit act of a state. ECT gives a state a competence to potentially exercise such right. Therefore, the Plama decision could be treated as a guidance: a prudent state will make a declaration in its official gazette regarding the exercise of the rights under Article 17 of the ECT.

In Yukos case the claimants conceded that they did not conduct “substantial business” in the Island of Man. The Tribunal analyzed the question of ownership and control issue, even if such a problem was moot as a consequence of the notification requirement. It was settled rather because of “the substantial effort and resources the Parties expended in order to present the relevant facts, arguments and expert opinions on this issue, […] also because it recognizes that […] the ownership/control structure more generally […] may well feature in Respondent’s arguments and allegations in any merits phase of this arbitration”. In its conclusions the Tribunal found that “transferring assets pursuant to a trust instrument is a centuries-old institution of the English common law […] recognized internationally today pursuant to the Hague Convention on the Law Applicable to Trusts and their Recognition of 1 July 1985. […] To do so would put into question the validity of the very concept of trusts at a time when their recognition goes well beyond the common-law countries.”. Acceptance of trusts in the Russian law was further postponed to be
developed in the merits phase. However, the Tribunal declared that the companies owning or controlling the claimant are “UK nationals, accordingly, they are not (nationals of a third state). Therefore, Article 17 (1) does not apply to Claimant.”

Moreover, the arbitrators analyzed the term “third state” which appears in art. 17. They concluded that this status may not be attributed to the Russian Federation as, as the language of the treaty distinguishes between “third states” and “contradicting parties”\(^{41}\). Russian Federation may not be treated as a “third state”, and in conclusion the “Denial-of-Benefits” clause is not applicable in case.


In Yukos arbitration, the Tribunal developed the meaning of the “Fork-in-the-Road” provision. It is a metaphor of an important decision which has to be taken by the claimant, when advancing its proceedings. Art. 26 (3) (b) provides that: “The Contracting Parties […] do not give such unconditional consent [to the submission of a dispute to international arbitration or conciliation] where the Investor has previously submitted the dispute under subparagraph 2 (a) or (b)”\(^{42}\). The rationale of the mentioned article is no exception in international law and requires the parties to submit their claims to one dispute settlement organ only. The aim is to reduce the number of claims submitted to such organs and to avoid their possible undermining of authorities by issuance of contradictory decisions.

“Fork-in-the-Road” provisions can be also found in various international agreements, for example art. 35 (2) (b) of the European Convention of Human Rights and Fundamental Freedoms: “The Court shall not deal with any application submitted under Article 34 that […] has already been submitted to another procedure of international investigation or settlement and contains no relevant new information”\(^{42}\). They are also present in Bilateral Investment Treaties and were already object of arbitrator’s analysis. Pantechniki case based on Albania-Greece BIT may serve as an example. Art. 10 (2) provides, that: “the Contracting Party concerned may submit the dispute either to the competent court or the Contracting Party or to an international arbitration Tribunal”\(^{43}\). The Claimant had to decide whether to bring a claim to a national or an international court. Because the claimant already submitted its proceedings to Albanian courts, the responded brought the “Fork-in-the-Road” argument in ICSID proceedings. The arbitrator based its reasoning on previous Woodruf
and Vivendi cases and applied the test of “fundamental basis of claims”, which aims to “assess whether the same dispute has been submitted to both national and international fora”. Because claims before national and international dispute settlement organs were based on contractual breaches, and the Greek-Albanian BIT contained no “umbrella clause”, the arbitrator concluded, that treaty claims had no autonomous existence to contractual claims. As one commentator remarked: “before Pantechniki, it was widely accepted that for a (The Fork-in-the-Road) clause to have been triggered, the parties and the claims in the proceedings before the domestic courts and under the treaty, before the investor-state tribunal, must be identical. Tribunals routinely ruled that claims under contract, governed by municipal law and seeking contractual remedies, were legally distinct from claims under an investment treaty, governed by public international law and invoking state responsibility. Pantechniki represents a marked departure from the prevailing jurisprudence by adopting a qualitative test that looks at the subject-matter of the claims, as opposed to their legal character.”

In the Yukos arbitration, which was issued only a few months after Pantechniki decision, the arbitrators returned to a more liberal understanding of the “Fork-in-the-Road” provision. The respondent raised the argument, that the claim was inadmissible as it was already submitted to Russian courts and the European Court of Human Rights. They arbitrators applied a “triple identity test”: identity of parties, cause of action and object of the dispute. They stated, “that by virtue of its claim under the ECT [the claimant] does not appeal from any decision of the Russian courts or seek to have determined by the present Tribunal whether any of those cases was rightly or wrongly decided as a matter of Russian law”. Therefore both proceedings are independent, and the “Fork-in-the-Road” exception does not preclude arbitrator’s jurisdiction in case.

6. Conclusions

It is beyond doubt, that the Yukos arbitration will constitute one of the most important international investment cases ever. Apart from its economical and political importance, the decision draws also a line of future jurisprudence concerning important international investment treaty clauses.

The interpretation of ECT’s art. 45 is particularly important as it prejudges that this treaty is provisionally applicable, when the concept (principle) of provisional application
of treaties is not inconsistent with the state-party’s internal law. The arbitrators opted for an “all-or-nothing” approach, instead of “piecemeal” approach, which would require an examination of each ECT’s provision with the state-party’s domestic law.

The “Denial-of-Benefits” clause (art. 17), which incorporates into the international investment law the principle of reciprocal protection, may not serve as “a hamper” of tribunal’s jurisdiction, and its invocation requires a previous exercise of the right to deny the benefits. Such exercise should constitute an explicit act of the state.

The Yukos arbitration is also a step towards a liberal interpretation of the “Fork-in-the-road” provision. The PCA did not share the previous conclusions of Pantechniki award and required a triple identity test of cases: identity of parties, cause of action and object of the dispute. As the dispute based on treaty did not constitute an appeal in the domestic procedure, the identity test was not fulfilled and the “Fork-in-the-road” exception was not applicable.

The decision confirms that international dispute settlement mechanisms may serve as efficient fora of defense of interests even against political superpowers. The Yukos decisions may create an encouragement for further investment claims against the Russian Federation based on the provisional application of the ECT. The developments around Yukos arbitration can be also seen as a part of a larger phenomenon which Kremlin has to take under consideration: the possible influence of private parties on its decision making process by the application of different international legal instruments which includes not only cases before the European Court of Human Rights.

Notes
1  PCA Case No. AA 227, In the Matter of an Arbitration before a Tribunal Constituted In accordance with Article 26 of the Energy Charter Treaty and the UNCITRAL Arbitration Rules 1976, between Yukos Universal Limited (Isle of Man) and the Russian Federation, Interim Award on Jurisdiction and Admissibility, 30 November 2009. On the same day the PCA issued other two decisions in a triplet case: PCA Case No. AA 226, In the Matter of an Arbitration before a Tribunal Constituted In accordance with Article 26 of the Energy Charter Treaty and the UNCITRAL Arbitration Rules 1976, between Hulley Enterprises Limited (Cyprus) and the Russian Federation, Interim Award on Jurisdiction and Admissibility, 30 November 2009 and PCA Case No. AA 228, In the Matter of an Arbitration before a Tribunal Constituted In accordance with Article 26 of the Energy Charter Treaty and the UNCITRAL Arbitration Rules 1976, between Veteran Petroleum Limited (Cyprus) and the Russian Federation, Interim Award on Jurisdiction and Admissibility, 30 November 2009. All three decisions were published in the beginning of February 2010 and are available at the ECT website: http://www.encharter.org/index.php?id=213&L=1%2F%2F%2F%5C%5C%5C%5C last seen on 24th June 2010. The texts of awards differ only in parts concerning the ownership and control of investment by three claiming enterprises (parts VIII.B. and C.3.) and in the rest are identical.
this comment I will refer to the text of award in the case brought by Yukos Universal Limited (Isle of Man), but conclusions should be related to all three arbitrations. The expression “Yukos” used in the title of the present article refers to Yukos Oil Company (Russian: ОАО Нефтянáя Компáния Ю КОC), which was declared bankrupt in 2006 in consequence of lack of settlement of Russian tax claims.

2 Sum of claims in all three cases mentioned in footnote 1.


7 Yukos arbitration, fn. 1, para. 37.

8 More on that subject see: Brenden Marino Carbonell, Concerning the Kremlin, fn. 3, 261-267.

9 Yukos arbitration, fn. 1, para. 39.

10 See Yukos arbitration, fn. 1, para. 339.

11 Id., para. 283.

12 Ioannis Kardassopoulos vs. Georgia, ICSID Case No. ARB/05/18.

13 Id. para. 228.

14 See Yukos arbitration, fn. 1, para. 294.

15 Id.

16 Id., para. 302.

17 Id., para. 295.

18 Id., para. 305.

19 Id., para. 301.

20 Id., para. 12.

21 Ioannis Kardassopoulos vs. Georgia, fn. 1 2, especially paras. 231-246.

22 Id., paras. 210, 211.

23 See Alex M. Niebruegge, Provisional Application, fn. 3, 368-369.


28 See Plama v Bulgaria, fn 2 7, para. 149.

29 See Yukos arbitration, fn. 1, para. 441.

30 Id., para. 443.

31 Id., para. 446.

32 Plama v Bulgaria, fn 2 7, para 155, quoted in Yukos arbitration, fn. 1, paras. 282 and 449.

33 Para. 118 of the Expert Opinion quoted in Yukos arbitration, fn. 1, paras. 281 and 448.

34 Yukos arbitration, fn. 1, para. 458.

35 Plama v Bulgaria, fn 2 7, para. 157.


37 Yukos arbitration, fn. 1, para. 461.

38 Id., para. 500.
39 Id., para. 535.
40 Id., para. 537.
41 Id., paras. 545, 546.
43 Pantechniki S.A. Contractors & Engineers (Greece) v. the Republic of Albania, ICSID Case No. ARB/07/21, para. 53.
44 Id., para. 61.
46 See Yukos arbitration, fn. 1, para. 71, Respondents Skeleton Argument para. 53.
47 See Yukos arbitration, fn. 1, para. 593.
48 Id., para. 600.
49 Alex M. Niebruegge, already reported on alleged breaches of investment protection in Sakhalin Project II, see Provisional Application, fn. 3, 371-373.