"Back in the U.S.S.R."

How Russia's Invasion of Ukraine May Invite Billions in Arbitration Claims

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On September 30, 2022, Russian President Vladimir V. Putin unlawfully annexed four regions in eastern and southern Ukraine—Luhansk, Donetsk, Zaporizhzhia, and Kherson. On that date, following a series of sham referenda that were met with near-universal international condemnation, President Putin began the process under Russian law of incorporating these four regions into the Russian state. As a result, from Russia's perspective, these regions became subject to Russian law, including Russia's international treaty obligations.

Russia's actions in these regions are reminiscent of the Kremlin's actions in Crimea in early 2014. There, too, Russia sought to give an air of legitimacy to its illegal occupation by enacting legislation that incorporated the territory into the Russian state as a matter of Russian law. Then, as now, Russia's actions have handed Ukrainian property owners—individuals and businesses alike—a powerful tool under international law that potentially exposes the Kremlin to billions of dollars in legal claims.

How exactly? Russia and Ukraine are parties to a bilateral investment treaty, commonly known as a BIT, in which each country has made a series of reciprocal commitments not to damage or otherwise harm the property of the other's nationals. Failure to comply with the BIT's obligations allows a protected foreign investor to file an international arbitration claim against the offending country and to recover damages for breach.

This article offers an introduction to the world of bilateral investment treaties, and it explores how Ukrainian investors in Russian-occupied territory can—and have—used the BIT between Russia and Ukraine to hold Russia accountable for its violations of their property rights.

What Are Bilateral Investment Treaties?

BITs are international agreements between two countries in which each country commits to treat investments of the other country's nationals in accordance with internationally recognized standards. The purpose of these treaties is to encourage foreign investment between the two countries. Common standards of protection include, for example, a guarantee to treat investors in a fair and equitable manner, not to discriminate against investors on the basis of nationality, and not to expropriate investments unless under certain conditions and upon payment of adequate compensation.

Under the dispute resolution provisions in BITs, countries agree to arbitrate disputes involving violations of the treaties' standards. The treaties therefore provide foreign investors with the opportunity to commence arbitration directly against the "host" country, without the involvement of the investor's "home" country. Arbitration, as a neutral forum separate from

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any domestic court system, provides an attractive—and effective—means for resolving these disputes.

BITs provide for arbitration in a variety of locations. A common location, or arbitral seat, for claims against Russia is The Hague, at the Permanent Court of Arbitration, an arbitral institution housed in the Peace Palace. BITs also typically provide for a three-member tribunal, with each side appointing an arbitrator and the two party-appointees agreeing on the third arbitrator, called the chairperson or president of the tribunal.

There are more than 2,000 BITs in force worldwide, as well as an extensive body of law on how the treaties are applied. Russia alone is party to more than 60 BITs currently in force. In addition to Ukraine, Russia's treaty counterparties include many European Union member states, as well as Canada, Japan, Korea, Switzerland, and the United Kingdom. Although there is no BIT between the United States and Russia, U.S. companies may nonetheless benefit from investment treaty protection if they hold their investments in Russia though a third country that has a BIT with Russia.

With tensions between Russia and much of the rest of the world at their highest levels in decades, the Kremlin has begun seizing property not only in parts of occupied Ukraine but also within Russia itself. Russia's actions have included retaliatory measures against foreign investors from countries it considers unfriendly, including the United Kingdom, Canada, and European Union member states, such as the French dairy company Danone and the Danish brewer Carlsberg. These seizures followed similar actions in the spring of this year against the Russia-based power assets owned by Finland's Fortum Oyj and Germany's Uniper SE.

For companies and individuals with businesses still operating in Russia, the country's broad network of BITs may provide a route to seek a remedy in the event that Russia interferes with or seizes those businesses.

As noted, Russia has not limited its interference with foreign investments to assets within its internationally recognized borders. For Ukrainian companies and individuals who now find themselves forcibly invested in Russian-controlled territory, the Russia-Ukraine BIT may provide a mechanism for redress. And there is strong precedent—Crimea.

How Ukrainian Investors Have Used the Russia-Ukraine BIT

Russia unlawfully annexed the Crimean peninsula in March 2014. Around this time, Russia invaded the region, orchestrated a sham independence referendum, and then adopted legislation formally incorporating Crimea and the city of Sevastopol into the Russian Federation under Russian law. In so doing, Russia also extended its legislation to the region, and it formally adopted a series of measures purportedly taken by the Russian-controlled authorities that it had installed in the weeks preceding the annexation.

As a result of Russia's annexation of Crimea, Ukrainian companies with billions of dollars in investments found themselves operating in Russian-controlled territory. Russia quickly took action against many of those companies, including through a series of sweeping expropriation measures. A number of Ukraine's largest companies then filed—and years later won—international arbitration claims against Russia. These cases involved claims

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for hundreds of millions to billions of dollars in damages for Russia's unlawful expropriation of the companies' property in Crimea, in violation of the Russia-Ukraine BIT. The largest claim, by the state-owned oil and gas company Naftogaz, resulted in an arbitration award of $5 billion, the largest Crimea award to date.

The Russia-Ukraine BIT protects investments "in the territory" of the host state—here, Russia. These cases therefore presented a novel question: Does the Russia-Ukraine BIT apply to Ukrainian-owned investments originally invested in the territory of Ukraine but over which Russia was now exercising de facto control? This question is at the heart of the arbitral tribunals' jurisdiction to hear the Ukrainian investors' claims because the BIT empowers tribunals to hear only the claims of (1) Ukrainian investors (2) with investments (3) *in the territory of* the Russian Federation.

To answer this question, tribunals were called upon to determine whether Russia had assumed responsibilities to Ukrainian investors, under the Russia-Ukraine BIT, "in the territory" of Crimea. We know from the publicly available awards that the tribunals that have examined this question have uniformly concluded that "territory"—as that term is used within the BIT—is not restricted to sovereign territory recognized under international law; rather, the term extends to territory over which Russia exercises "effective control." No fewer than seven well-respected investment tribunals, including the *Naftogaz* tribunal, have reached this conclusion. No tribunal has found otherwise.

That said, the tribunals have taken different approaches in assessing whether and when Russia exercised effective control over Crimea. Factors relevant to the tribunals' assessments have included a combination of physical control and Russia's exercise of its jurisdiction over Crimea, through Russia's own legislation. Some tribunals also observed that Russia's unilateral assertion of sovereignty over Crimea, while the Kremlin simultaneously tried to deny Ukrainian investors the protections of the BIT, was inconsistent with a good-faith interpretation of the treaty.

Russia initially declined to participate in the Crimea cases, objecting to the tribunals' jurisdiction to hear the investors' claims. But finding itself exposed to billions of dollars in liabilities, Russia later reversed course and hired prominent Western law firms to defend against the claims. In some cases, this meant Russia joined the proceedings partway through or even after a final award had been rendered. In parallel, Russia has sought to challenge these tribunals' findings, principally on jurisdiction, through domestic courts in the place of arbitration (a process commonly known as setting-aside proceedings). To date, courts in the Netherlands, France, and Switzerland have upheld these tribunals' jurisdictional conclusions, dealing Russia a series of further losses.

At least 10 investment arbitrations have been filed as a result of Russia's unlawful actions in Crimea. In each completed case, the investors have been awarded compensation, to be paid by Russia for its treaty breaches. These cases include not only the Naftogaz claim but also claims by Ukraine's state-owned bank, Oschadbank, as well as a number of claims brought by businesses with assets that include real estate, petrol stations, and even airports.

Beyond Crimea: Russia's Actions in Eastern and Southern Ukraine

Ukrainian companies with property in those parts of Luhansk, Donetsk, Zaporizhzhia, and Kherson controlled by Russia may well follow the precedent established in the Crimea cases.

Russia has illegally controlled parts of eastern Ukraine, in the Luhansk and Donetsk regions, dating back to 2014. Following its full-scale invasion of Ukraine in February 2022, Russia has extended its control across additional parts of Ukraine's sovereign territory, including into the Zaporizhzhia and Kherson regions. Russia then unlawfully annexed all four of these regions (Luhansk, Donetsk, Zaporizhzhia, and Kherson) in October 2022.

By annexing these regions, President Putin has increased the likelihood that Russia ultimately will be held accountable.

Russia's effective control of these four regions means that its international legal obligations extend to the regions—obligations that include those under the Russia-Ukraine BIT. As the Crimea cases have demonstrated, claims under the BIT do not require a Ukrainian company to accept that any one of these regions is under Russian sovereignty as a matter of international law. It may be enough simply that Russia exercises effective control over the relevant territory, including by physical occupation or through the formal incorporation of these regions into the Russian state under Russian law.

Importantly, an investment arbitration claim may not require that Russia indefinitely lay claim to these four regions. For whatever length of time these regions remain under Russian effective control, whether that be years or only months, Russia may owe treaty obligations to Ukrainian companies with investments in the regions in relation to Russia's conduct during that time.

This means, for example, that if the Russian military damages a Ukrainian-owned power plant or factory in Russian-occupied Donetsk, Russia may have obligations under its investment treaty

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with Ukraine to pay damages to the Ukrainian owner, even if Russia is later pushed out of Donetsk by the Ukrainian armed forces or otherwise concedes its claim to Donetsk. Or if the Russian-backed regional government in occupied Zaporizhzhia expropriates a Ukrainian-owned power plant or factory, Russia may also have treaty obligations to compensate the Ukrainian owner, even if Russia later surrenders its claim to this region as well.

Ukrainian investors have already begun to look again to the Russia-Ukraine BIT to hold Russia accountable for its unlawful conduct in these four regions. For example, the SCM Group, a group of companies owned by the Ukrainian businessman Rinat Akhmetov, has moved forward with arbitration proceedings against Russia related to its interference with certain SCM Group assets. According to a statement by the SCM Group, the claims relate to conduct by the so-called "Donetsk People's Republic" and "Luhansk People's Republic," which the SCM Group alleges have been acting under Russian direction and control since 2014. The assets at issue include the Azovstal Iron and Steel Works in Mariupol, which became a symbol of Ukrainian resistance in the wake of Russia's siege of that city in 2022. In another example, Ukraine's state-owned nuclear power company, Energoatom, has publicly announced that it is considering a claim against Russia relating to the Kremlin's expropriation of the Zaporizhzhia nuclear power plant, Europe's largest, among other assets.

But Will Russia Pay?

Russia historically has fought hard against treaty claims at every phase of the process. For example, Russia has consistently sought to set aside the awards rendered against it, in the court of the seat of arbitration, and in doing so, it has sought to exhaust all available appeals processes. Russia's efforts in this regard show that the Kremlin takes these claims seriously, even while its recent efforts to challenge Crimea-related awards have failed.

And there is a reason Russia does so. Unlike domestic court judgments, international arbitration awards are enforceable worldwide, under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958, commonly known as the New York Convention. The New York Convention establishes an international regime for the enforcement of arbitral awards by requiring the recognition and enforcement of awards subject only to certain narrow exceptions. There are more than 170 parties to the convention, including both the United States and Russia.

The effect of the New York Convention—i.e., the ready enforcement of international arbitral awards—leaves exposed not only Russian assets located abroad but also, potentially, the assets of its state-owned companies, such as Gazprom, Rosneft, and Rosatom. While sovereign immunity principles across jurisdictions restrict the attachment of sovereign assets, many jurisdictions except from sovereign immunity a country's property used for commercial purposes. For example, while real property used for government purposes, e.g., an embassy, would be excluded from attachment by sovereign immunity, residential or other property not used for government purposes may be attachable. Here, an example might be a state-owned hotel or other commercial business.

To provide some real-world examples, it was reported earlier this year that investors with an award against Spain had secured provisional attachment orders, in England, against a Spanish language and cultural center, the Cervantes Institute. It was also reported that the institute's bank accounts have been frozen. In the United States, the Third Circuit recently reaffirmed that PDVSA, Venezuela's state-owned oil and gas company, is the alter ego of the Venezuelan state, seemingly clearing the way for PDVSA to be held accountable for Venezuela's debts. *See OI European Grp. B.V. v. Bolivarian Rep. of Venez.*, 2023 U.S. App. LEXIS 17123, at *1 (3d Cir. July 7, 2023). PDVSA's assets in the United States include shares in a U.S. subsidiary through which it owns Citgo Petroleum Corporation. It has been reported that Venezuela has filed a cert petition with the U.S. Supreme Court.

As for enforcement efforts against Russia, the most widely publicized example has been the efforts of the majority shareholders in the former Russian oil and gas giant Yukos. In 2014, the majority shareholders won an arbitral award of about $50 billion for Russia's expropriation of the company's assets, in violation of the Energy Charter Treaty. But the shareholders' progress in enforcing their award has been slow, hindered by Russia's challenges to the award in the Netherlands, the place of the arbitration. That said, while the shareholders' enforcement efforts, including in the United States and the United Kingdom, had been stayed pending these ongoing set-aside proceedings, the stays are beginning to be lifted. In addition, in June 2022, The Hague Court of Appeal approved the shareholders' seizure of 18 state-owned vodka brands, including the Stolichnaya brand.

Conclusion

Beyond the brutal human cost of Putin's war, Russia has razed Ukrainian cities to the ground, inflicted almost immeasurable damage on Ukrainian infrastructure and businesses, and seized or otherwise damaged countless assets not only in Ukraine but also now in mainland Russia. While the international community continues to discuss strategies to compel Russia to pay reparations for the damage caused by its illegal war, Ukrainian companies with investments in Luhansk, Donetsk, Zaporizhzhia, and Kherson have a potentially powerful tool that they can use now. By annexing these regions, President Putin has increased the likelihood that Russia ultimately will be held accountable. ■

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