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NEWS

What are the implications of the Yukos set-aside?

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Volterra Fietta partner **Graham Coop**, former general counsel of the Energy Charter Secretariat, considers the Dutch court judgment that set aside the US$50 billion awards in the *Yukos* case and its implications for investors in Russia and other states that have signed the Energy Charter Treaty.

As *GAR* readers will recall, the tribunal at the Permanent Court of Arbitration in The Hague that heard the Energy Charter Treaty claim against Russia brought by three shareholders in Yukos Oil Company issued awards on jurisdiction and admissibility in November 2009 and awards on the merits in July 2014, ordering Russia to pay US$50 billion to the claimants. Russia then asked the Hague District Court to set the awards aside on five distinct grounds, arguing that:

- the tribunal had no jurisdiction to deal with the claims;
- the tribunal had overstepped its remit;
- the tribunal's assistant, Martin Valasek (the alleged "fourth arbitrator"), played an excessive substantive role in the tribunal's work and hence the tribunal's composition was irregular;
- the awards lacked substantiation in several critical respects; and
- the awards showed partiality and bias on the part of the tribunal and hence were contrary to Dutch public policy and public morality.

In its 20 April 2016 judgment, the Dutch court set aside the awards on the first ground (that the tribunal lacked jurisdiction). The court's judgment is interesting from at least three viewpoints: what it said in addressing the parties' arguments; what it did not say; and which arguments the court chose not to address.

What the court said

In the arbitration, the claimants had argued that, despite never having ratified the Energy Charter Treaty (ECT), Russia was nonetheless bound by it because, under article 45(1) of the ECT, the state had agreed to apply the treaty provisionally pending ratification "to the extent that such provisional application is not inconsistent with [Russia's] constitution, laws or regulations".

The claimants had argued that Russia could only invoke article 45(1) to justify non-application of the ECT if the concept of provisional application as a whole is inconsistent with Russia's constitution, laws or regulations (the all-or-nothing approach). Russia had argued that any individual provision of the ECT could be declared not provisionally applicable if that provision was inconsistent with Russia's constitution, laws or regulations (the piecemeal approach). In the awards on jurisdiction and admissibility, the tribunal ruled in favour of the all-or-nothing approach.

In the Dutch court's view, the assessment of the tribunal's jurisdiction was based on two distinct questions: whether any alleged inconsistency between the ECT and Russia's constitution, laws or regulations should be considered according to the all-or-nothing or the piecemeal approach; and whether, in particular, the investor-state arbitration provision of ECT article 26 was inconsistent with Russia's constitution, laws and regulations.

On the first point, the court accepted Russia's interpretation of ECT article 45(1). It thus held that Russia was only bound by those treaty provisions which were reconcilable with Russian law. The court paid particular attention to the phrase "to the extent that such provisional application is not inconsistent with its constitution, laws or regulations" and held that the term "to the extent" could not justify the all-or-nothing approach adopted by the tribunal.

In light of its interpretation of ECT article 45(1), the court proceeded to address the question of whether the provisional application of the investor-state arbitration clause of ECT article 26 was inconsistent with Russia's constitution, laws or regulations. In the claimants' submission, a provision of the ECT such as article 26 could only be held inconsistent with Russian law if that ECT provision was expressly prohibited by some provision of Russian law. The court rejected this position as being "too limited". It held that the provisional application of ECT article 26 could be considered to be contrary to Russian law in the following circumstances:

- if Russian law contained no legal basis for the same method of dispute settlement;
- if the provision in question did not harmonise with Russia's legal system; or
- if the provision was irreconcilable with the principles that had been laid down in or could be derived from relevant Russian legislation.

For the court, the main issue was whether Russian law itself offered the option of arbitration as laid down in ECT article 26. As the response to this question was negative, the court concluded that the arbitration clause of ECT article 26 did not have a legal basis in Russian law and was incompatible with the principles laid down in that law. On this basis, the court held that Russia had not consented to be bound by ECT article 26 in application of the precise wording of ECT article 45(1) and hence had not consented to investor-state arbitration under the ECT.

What the court did not say

The court did not rule on the merits of the underlying dispute.

It also did not hold that no treaty can ever be provisionally applicable or that provisional application can never have teeth. On the contrary, as the court recognised, the principle of provisional application is embodied in article 25 of the 1969 Vienna Convention on the Law of Treaties and has been implemented in other treaties (for example, the General Agreement on Tariffs and Trade).

The court did not even hold that the ECT can never be provisionally applicable. However, its decision with respect to provisional application with respect to Russia was closely linked to the specific wording of ECT article 45 and to the relationship between Russian constitutional law (as the court understood it) and the ECT provisions on which the awards were based (particularly article 26, the investor-state arbitration provision). Applying the piecemeal approach which the tribunal had rejected, the court held that ECT article 26 was inconsistent with Russia's constitution, laws and regulations and accordingly not provisionally applicable.

Arguments that the court chose not to address

The court did not analyse the other jurisdictional objections which Russia had advanced before the tribunal. Nor did it address the other four grounds for set-aside advanced by Russia. The court could have justified a decision to set aside the awards on the basis of any one of these grounds which it considered to have been established. The court in fact found the first ground to be established and on this basis did not consider the remaining four grounds.

There is no obvious reason why the court had to address the grounds in the order pleaded; it could have addressed any other ground first and, if found established, ended its analysis there. Indeed, the court could have based its decision on any one of a number of case-specific issues (for example, the Russian origin of the funds invested in Yukos) but chose instead to base its ruling on issues of more general application to Russia and, potentially, to Belarus (the only other state provisionally applying the ECT), as well as to provisional application of treaties in general.

Russia's first set-aside ground is the only ground requiring consideration of such general issues. By contrast, the other four grounds relate essentially to specific aspects of this particular investment arbitration and the underlying, highly sensitive dispute. Had the court based its judgment on one of these grounds, it would necessarily have rendered a judgment which would have been highly politically sensitive but with far fewer general legal implications. By ruling on the basis of the first ground alone, the court rendered a judgment of considerable general legal significance but avoided directly addressing some of the most politically sensitive aspects of this specific dispute. As often occurs, the court exercised a genuine discretion in seizing the opportunity to resolve the dispute in such a way as to place itself squarely at the centre of a highly sensitive legal controversy.

What next?

The court's ruling is highly relevant to energy investments in Russia and potentially Belarus, the only two states which have signed, but not ratified, the ECT and accepted full provisional application. Russia's termination of the ECT's provisional application, which came into effect in October 2009, has no legal effect on the *Yukos* dispute, and even future claims with respect to pre-October 2009 investments enjoy equal protection for a sunset period of 20 years. However, the court's ruling, if followed by other courts in the Netherlands and elsewhere, would mean that pre-October 2009 energy investments in Russia, together with all energy investments in Belarus (assuming the same constitutional compatibility analysis applies there), are no longer covered by the ECT. Investors with pre-October 2009 energy investments in Russia will no doubt be organising both their corporate structures and their relationship with the Russian state accordingly. With respect to Belarus, the court's ruling (if generally followed) has real and immediate consequences in relation to decisions currently being made by investors.

This issue could also become relevant for Australia and Norway, which have both signed (but not ratified) the ECT, while declaring that they cannot accept provisional application. If either of these states withdraws that declaration, thereby accepting provisional application, it will be in the same situation with respect to the ECT as Belarus is now (and as Russia was until October 2009).

There is no doubt that the Dutch court's judgment will not be the end of the debate. Even if confirmed on appeal, other arbitral tribunals, supervisory courts of other jurisdictions and indeed ICSID annulment committees will not be bound by the judgment. For now, the judgment is only directly relevant to investment arbitrations seated in the Netherlands. Energy investors in Russia and Belarus may nonetheless wish not only to reconsider the Netherlands as an arbitration venue but also to consider restructuring their investments in order to take advantage of other investment protection treaties than the ECT.

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