
Tribunal in \$100 Billion Yukos Arbitration Rules Russia Bound by Energy Charter Treaty

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In a decision that has potentially far-reaching implications for investors in Russia's energy sector, as well as energy investments in other countries that have signed or ratified the Energy Charter Treaty ("ECT"), on November 30, 2009 an arbitral tribunal at the Permanent Court of Arbitration in The Hague ruled that it had jurisdiction over a claim that Russia violated the ECT. The Tribunal will now hear the merits of the claim, made by former majority shareholders of oil company Yukos, that Russia undertook discriminatory measures against it and expropriated its investment, causing damages of upwards of \$100 billion.

The Yukos Arbitration

Yukos was once Russia's largest oil company. From 2003 to 2004, Russia accused Yukos and its largest shareholder, Mikhail Khodorkovsky, of tax evasion and ordered them to pay approximately \$28 billion in back taxes. In November 2004, Russia ordered the sale of Yukos' main production subsidiary at auction to recover some of that liability, and the subsidiary was sold one month later to an investor group that itself was then purchased by a Russian state-controlled oil company. The former shareholders of Yukos then filed for arbitration against Russia under the ECT, seeking damages.

The Energy Charter Treaty

Signed in December 1994 and entered into force in April 1998, the ECT is an international energy trade and investment agreement designed to provide transparency and uniform rules in order to foster investment in the energy sector. It has approximately 50 signatories, with a significant portion from Europe. (Neither the U.S. nor China is a signatory.) The ECT contains provisions on "promotion, protection and treatment of investments" in the energy sector. These include guarantees of fair and equitable treatment and of constant protection and security, as well as a prohibition against discrimination based on nationality and protection against expropriation.

Similar to investment protection agreements known as bilateral investment treaties or “BITs,” the ECT provides for settlement of investment disputes via investor-state arbitration, by which private parties can bring a claim directly against a foreign government for violation of treaty obligations. The Yukos arbitration is being administered under the rules of the United Nations Commission on International Trade Law (UNCITRAL).

The Meaning of Provisional Application

At the heart of the Yukos jurisdictional dispute was the extent to which the ECT applied to Russia. Russia signed the ECT in 1994, but its Parliament (the *Duma*) never ratified it. Under Article 45 (1) of the ECT, a party that has signed but not yet ratified the ECT is bound to the Treaty provisionally, i.e., “to the extent such provisional application is not inconsistent with its constitution, laws or regulations.” Although the Tribunal’s decision has not been made public, it is known that the Tribunal ruled that, as a signatory, Russia was bound by the terms of the ECT, including the investor treatment provisions and the investor-state dispute settlement mechanism, notwithstanding that the *Duma* never ratified the treaty.

The Tribunal’s reasoning may have been guided by a 2007 arbitral decision applying the ECT to Georgia (*Kardassopoulos v. Georgia*, ICSID Case No. ARB 05/18). This case held that, unless domestic law expressly provides that provisional application of treaties is inconsistent with domestic law, a signatory was bound to the ECT upon signing it.

Russia formally terminated its provisional application of the ECT effective October 19, 2009. However, under Article 45 (3) of the ECT, for energy investments made prior to that date, Russia remains bound to the Treaty for 20 more years, allowing investors to arbitrate disputes with Russia concerning those investments.

The Impact on Energy Investments

Rulings in arbitrations of this nature are not binding on other arbitration tribunals, but nonetheless frequently are considered influential. The Yukos ruling will have the following impacts:

- The Tribunal’s validation of the application of the ECT to Russia confirms for investors who believe Russia already has violated their rights under the ECT that they have an avenue to seek recourse.
- For energy investments in Russia made prior to October 19, 2009, the ruling may have the effect of providing a check against future discriminatory and other adverse investment measures now that it is known Russia can potentially be made liable for such conduct.
- Investors with energy investments in other ECT signatory countries may now have actionable claims for measures undertaken by host States after they signed the ECT but before they ratified it.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work or the attorneys below.

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